



RUTHANNE FULLER
MAYOR

City of Newton, Massachusetts Office of the Mayor

Telephone
(617) 796-1100
Telefax
(617) 796-1113
TDD
(617) 796-1089
E-mail
rfuller@newtonma.gov

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Dear Councilors, School Committee Members, and Newton Retirement Board Members,

As Mayor I have continuously worked with our team to ensure the long-term financial sustainability of Newton while simultaneously addressing our current operational needs. I am pleased to announce that two recent financial developments are enabling me to propose a significant initiative to bolster both goals. This initiative will provide additional financial support for the operations of the Newton Public Schools for the next eight years while helping the City fully fund the City's pension system on our agreed upon schedule of Fiscal Year 2032.

Overlay Surplus and Appellate Tax Board Interest & Penalties

The City of Newton Board of Assessors on an ongoing basis sets aside funds in an Overlay account to pay for possible abatements (and any interest or penalties payable on abatements) and exemptions of real estate property taxes and/or personal property taxes. The Overlay account also sets aside funds in the event that property taxes are deemed uncollectible.

The current balance of the Overlay account is \$31.5 million.

In April 2022, the City received full payment of the principal and interest for Fiscal Years 2012 through FY2022 from Eversource, totaling approximately \$12.7M, for taxes that they had been challenging. While Eversource paid the taxes (which are currently in the Overlay account), they continued their legal appeal. We were required to hold these funds in reserve in Overlay until the appeal process was resolved.

On June 27, 2023, the City of Newton was notified that Eversource had withdrawn their Appellate Tax Board Filings for Fiscal Years 2012 through FY2020; however, Eversource declined to withdraw their appeals for FY2021 and FY2022.

Newton's Board of Assessors has not yet declared any Overlay surplus. However, as a result of the Eversource withdrawal of nine of their eleven appeals, the resolution of several other cases, and the passage of the Appellate Tax Board (ATB) filing deadline of August 1, Newton's Board of Assessors is poised to declare a significant amount of Overlay Surplus – \$20.5 million.

Notably, the Board of Assessors will be keeping \$11 million in the Overlay account for ongoing abatement, exemption, interest/penalties payable and uncollectible situations.

In addition to the funds held in the Overlay Account, there is \$5.5 million held in the Appellate Tax Board (ATB) Interest & Penalties Account. The State allows municipalities to have a single overlay reserve (rather than requiring a separate overlay balance for each particular year) to

cover the costs of potential abatements. The Board of Assessors has determined that \$11 million is the appropriate level to keep in the Overlay account for both abatements and any interest and penalties. Therefore, we no longer need an ATB Interest & Penalties Account and an additional \$5.5 million is now available.

In total, we expect the City will soon have available *one-time* funds of \$20.5 million in Overlay Surplus and \$5.5 million from the Appellate Tax Board (ATB) Interest and Penalties Account, for a total of \$26 million.

I want to thank our leaders in Newton's Assessing Department for their wisdom and tenacity over more than a decade. Elizabeth Dromey and Jim Shaughnessy, working with a small handful of other Assessing Departments, reinvented how Eversource pays taxes. Their new approach is now the standard operating procedure across the Commonwealth. We have them to thank for this significant additional collection of taxes which we can use for our community.

Free Cash

Free cash in layperson's terms is the remaining, unrestricted funds from operations from the previous fiscal year. Free Cash comes from unanticipated actual revenues in excess of revenue estimates, unexpected unspent funds in operating budget line items, and/or unanticipated unexpended free cash from the previous year.

The Newton's Comptroller's Office determines the amount of Free Cash in August or early September as they progress through the year-end close process. They are still doing that analysis.

In the last week or so, it has become clear that the Comptrollers' will be submitting to the Massachusetts' Department of Revenue a request to certify a Free Cash amount that is significantly higher than the amount typically declared for the City of Newton. We expect Free Cash to be certified in late September or early October in the range of \$21 - \$23 million. These are also *one-time* funds.

There are two specific reasons for this larger than normal Free Cash designation. First, we held \$5.4 million from last year's Free Cash for potential liabilities and settlements that we may be facing which rolled over into this year's Free Cash. Second, interest rates have risen dramatically in the past eighteen months. Consequently, our actual interest earned from investments in FY2023 was \$8.4 million more than we had budgeted; this entire amount dropped into this year's Free Cash.

Financial Strategy

With the certification of a significantly higher than usual level of Free Cash, we have the opportunity of transforming the entire amount of \$26 million from Overlay Surplus and the ATB Interest & Penalties into *ongoing* funds to support our Pension system, the Newton Public Schools, and the overall financial health of the City.

Our one-time Free Cash funds will be used primarily for our immediate one-time needs and prioritized in keeping with the City's Financial Management Guidelines. These may include road paving, legal settlements, one-time infrastructure investments, and snow & ice expenses. Each use of Free Cash will come before the City Council for approval in the course of FY2024.

The entire \$26 million from Overlay Surplus and the ATB Interest & Penalties will be transformed into *ongoing* funds to support our Pension system, the Newton Public Schools, and the City's overall financial health.

More specifically, within the next few days after the Board of Assessors declares the Overlay surplus, I will submit a docket item to the City Council that will request authorization for three interrelated actions. The combination of these three actions will create an "Operations Booster Stabilization Fund" with an initial balance of \$26 million. The Operations Booster Stabilization Fund will be used over the next eight fiscal years to pay for a portion of the City's General Fund pension appropriations. This will enable the City to not only fully fund the pension system by FY2032, but to also free up monies to "boost" the NPS budget during that same period and support the City's financial health.

The three components of my docket request will be:

1. Establish the "Operations Booster Stabilization Fund" as a reserve fund to pay for a portion of the annual general fund appropriations for the City's pension system, known as the Newton Retirement System Funding Schedule;
2. Appropriate the Overlay Surplus of \$20.5 million as declared by the City's Board of Assessors to the Operations Booster Stabilization Fund; and
3. Transfer funds of \$5.5 million from the Appellate Tax Board Interest and Penalties Fund to the Operations Booster Stabilization Fund.

What is the Financial Impact of this Initiative?

Currently, the Newton Retirement Board has approved a funding schedule that increases by 6.6% per year through Fiscal Year 2032, at which time we are projected to attain full funding of the pension system.

Rather than increasing the General Fund appropriation by 6.6% each year, we will increase funding by 5.0% from the General Fund and utilize funds from this Operations Booster Stabilization Fund for eight years to pay the remaining 1.6% annual increase.

In so doing, we will be able to repurpose the value of the 1.6% primarily to fund NPS operational needs. We intend to appropriate 70% of the "savings" generated by this fund to the Newton Public Schools each year with 30% used to reduce the City of Newton forecasted gap. To put this in context, 65% of the City's overall expenditures are directed to the Newton Public Schools so I am prioritizing our students and the strength of the Newton Public Schools, Newton's keystone.

Every year our team creates a Long-Range Financial Plan & Five-Year Financial Forecast. For at least a dozen years, this forecast has included a deficit in the out years. We always acknowledge the gap. However, we manage our annual budgets and long-term commitments to personnel costs, debt service and new initiatives so that we always have a balanced budget. This financial initiative makes the gap smaller, helping the overall financial health of the City.

This financial strategy allows me to increase the allocation to the Newton Public Schools for FY2025 through FY2032 from an increase annually of 3.5% to approximately 3.7%. The percent increase in the NPS allocation returns to 3.5% in FY2033.

In dollars, the increase as a result of this financial strategy means an addition of approximately \$462,000 for NPS in FY2025 growing to an increase of \$5.485 million in FY2032; this increase is above and beyond the 3.5% increase which, for example, is \$9.4 million in FY2025.

The Newton School Committee has the responsibility to determine how to spend these additional monies if the City Council approves my Administration's request for the Operations Booster Stabilization Fund.

Why This Strategy?

During the spring 2023 budget season, there was much discussion about establishing a "Stabilization Fund" to contribute to the Debt Service Payments of future projects; debt service bonds are typically for 30 years. As an administration, we did not support that plan as we would have committed the City to 30 years' of debt payments, but would have had a stabilization fund that was only able to fund the first 8 to 10 years of debt. Once the stabilization fund was used up, we then would have had either to find a new source of funding or to significantly reduce NPS and municipal department expenditures.

This financial strategy differs in one crucial way. The City will fully fund our pension system by FY2032. This "draw" on our General Fund pension appropriations drops dramatically on a 'date certain' – August 1, 2031 – from close to \$69 million in FY2032 to \$15 million in FY2033. In other words, after August 1, 2031, the funding for pensions drops dramatically just as the Operations Booster Stabilization Fund is depleted; that is why this plan works. We'll have sufficient funds in FY2033 to pay the "normal" pension costs, to increase our funding for retirement health care costs (known as OPEB), and to continue to support NPS and municipal operations.

In summary, the Fuller Administration is fully committed to achieving full funding of our pension system by Fiscal Year 2032 – with the final payment scheduled for August 1, 2031. This plan retains the funding schedule and the full-funding date. Simultaneously, we are committed to a sustainable financial plan that supports our students, our residents and our property owners.

Why Not Put this Money Directly into the NPS/City Budgets?

We have spent the past six weeks exploring alternatives. We firmly think this financial strategy provides certainty to the City and our taxpayers as we try to achieve our dual objectives of fully funding the Pension system for the City while addressing our operational needs over the next eight years.

To be straight, we are concerned that future School Committees, future City Councilors, and even future Mayors would not be able to resist the temptation of utilizing these funds too early or solely for current operations, jeopardizing the dual needs of the City. Our unfunded liabilities for the pensions and retiree health insurance that we have promised our employees is more than \$600 million dollars. As Mayor, I am committed to providing current services and capital investments, paying employees fairly, addressing our significant pension and healthcare liabilities, all while maintaining a Aaa credit rating.

How Did We Calculate Interest Income in the Booster Fund?

The Operations Booster Stabilization Fund begins with \$26 million which will be drawn down over eight years. During this period, it will be in a completely safe, interest-bearing account, possibly the Massachusetts Municipal Depository Trust (MMDT).

We have been conservative in our calculation of the interest income that will be earned on this account. The rate in the MMDT, a money market mutual fund, historically tracks very closely to the interest rate of the Federal Funds Rate. The Federal Reserve provides projections of the median Federal Funds Rate via the St. Louis Fed. The June 2023 projection for the Median

Federal Funds rate are 5.6% for 2023, 4.6% for 2024, 3.4% for 2025, and 2.5% thereafter. (As of this month, the MMDT earnings rate is 5.55%.)

We have utilized these conservative projections for interest income as we have developed this plan.

Next Steps

This year we expect to provide the City Council, the School Committee and our residents with our Long-Term Financial Plan and Five-Year Financial Forecast a bit earlier than usual – in the third week of September. We have spent the summer analyzing our financial situation and understanding our funding sources. That work has led to this financial strategy for the use of the Overlay Surplus and ATB Interest and Penalties monies over the next eight years.

Based on economic conditions, capital cost increases, and current and projected interest rates, there will be no other additional one-time funds or significant, unusual increases in ongoing revenues for the FY2024 Budget nor for the projected Budgets for FY2025 and FY2026.

The Capital Improvement Plan will also be presented in September along with the Financial Forecast.

We look forward to working with the School Committee and City Council and continuing the dialogue with our residents as we continue to refine our financial strategy for the coming years.

While the Operations Booster Stabilization Fund will help improve school funding over the next eight years, it will not solve all of our budgetary challenges created by the constraints of Proposition 2 ½ and many different cost pressures.

City leaders must remain steadfast in their determination to balance revenue and expenditures while addressing the educational, social and emotional, and extracurricular needs of every student in our diverse community; funding infrastructure needs; providing for the functions of government; fully funding all liabilities; and maintaining an appropriate level of reserves.

We must remain committed to and disciplined in our resolve to follow the planned funding schedules for pension and retiree health insurance or OPEB liabilities, to settle collective bargaining agreements that maintain parity between revenue and expenditures, and remain vigilant in our oversight of every hard earned taxpayer dollar that has been entrusted to us in order to provide the level of municipal services that the people of Newton expect and deserve.

To each and every one of our City Councilors and School Committee members, we sincerely thank you for the good work that you do on behalf of all our residents and students.

Sincerely,

Ruthanne Fuller
Mayor

p.s. We expect that City Councilors may have questions. Maureen Lemieux, our CFO, and I are available for one on one Zoom drop-in sessions next week to answer questions and provide clarifications. If you are interested, please email both Sam Nighman (snighman@newtonma.gov)

and Hattie Kerwin Derrick (hkerwinderrick@newtonma.gov) with a couple of options from the windows below so we can fit everyone in. (Please email both Sam and Hattie as they are covering for each other with vacations.)

One on One Zoom Drop-In Sessions

Monday, Aug. 21, 8:30 a.m. – 11:00 a.m.
Wednesday, Aug. 23, 3:00 p.m. – 5:00 p.m.
Thursday, Aug. 24, 5:00 p.m. – 8:00 p.m.