

## NEWTON BLUE RIBBON COMMISSION

### Report of the Forecasting Subcommittee

#### *Mission of Subcommittee*

Our subcommittee was asked to “look at the assumptions about revenues and expenditures to determine if the [city’s] forecast for the next five years is within the range of reasonable projections.”

With one notable exception (maintenance of the city’s physical infrastructure and plant), we interpreted this request as an exercise in vetting the assumptions of the city’s current forecast rather than modeling various policy options or changes in current financial and management practices. This distinction between inspecting current assumptions and proposing new policies is an important, but sometimes blurred one. To clarify this distinction, consider the following: The subcommittee did not, for example, build a new forecast around what its members might subjectively determine to be a more appropriate property tax rate. We did, however, examine the assumed rate of growth in property tax revenues at the current tax rate. This examination took into account such matters as new property construction and the balance between the size of the city’s residential and commercial tax base. In sum, with the single exception of capital maintenance, we looked at expected cash inflows and outflows under the current policy framework. We reserved for the accompanying narrative any potential changes in policy and practices that seem to merit further consideration.

#### *Methodology*

The subcommittee adopted as its base case the five-year forecast prepared by the Mayor’s Office, in collaboration with the Board of Aldermen, the School Committee, and the Comptroller’s Office during the spring of 2006 (“the City’s Forecast”). We then identified in this forecast those items that had the greatest impact on the future surplus or deficit of the city’s operating budget. For each of these critical items we examined the underlying assumptions of the City’s Forecast and assessed their realism in light of Newton’s past experience, expert testimony from key city officials, and our best judgments of “what was inevitable.” In several instances our assessments led to revised assumptions about what is driving an increase or decrease in revenues and expenditures. We then integrated these revised assumptions into a new forecast called “the Commission’s Forecast.”

The principal output of this analytical work includes (1) a summary of the assumptions embedded in each forecast, (2) the five-year forecasts themselves, and (3) an accompanying narrative that either further explains the subcommittee’s revisions or highlights issues for the full commission and the public-at-large to consider.

We should stress that the forecasts presented here are, by their nature, estimates of future events, which cannot be known with certainty (there are no facts about the future). While we believe the forecast and the accompanying narrative presented here are reasonable and directionally correct, it is likely that future revenues and expenditures will differ from the figures presented here.

We also want to acknowledge at the outset the professionalism of the above-mentioned parties who prepared the initial City’s Forecast. This preliminary forecast, which represents the first effort of city government to move from an annual budget process to a process that looks several years into the future, was presumed to be a starting point of a more detailed five-year operating budget forecast. The Blue Ribbon Commission considers this initial effort at multi-year budgeting to be both a bold and skilled exercise. Finding the right balance between projections, predictions, and pure speculation is never an easy exercise—even after all the relevant (and correct) quantitative data has been assembled. Although the forecast of the Blue Ribbon Commission differs in some important respects from that of the city, we want to acknowledge the fact that the city’s base case forecast provided us with a truly excellent point of departure for further consideration and revision.

Finally, the subcommittee was ably assisted in preparing its revised forecast by the testimonies and expertise of the following city officials who were interviewed in the course of our work:

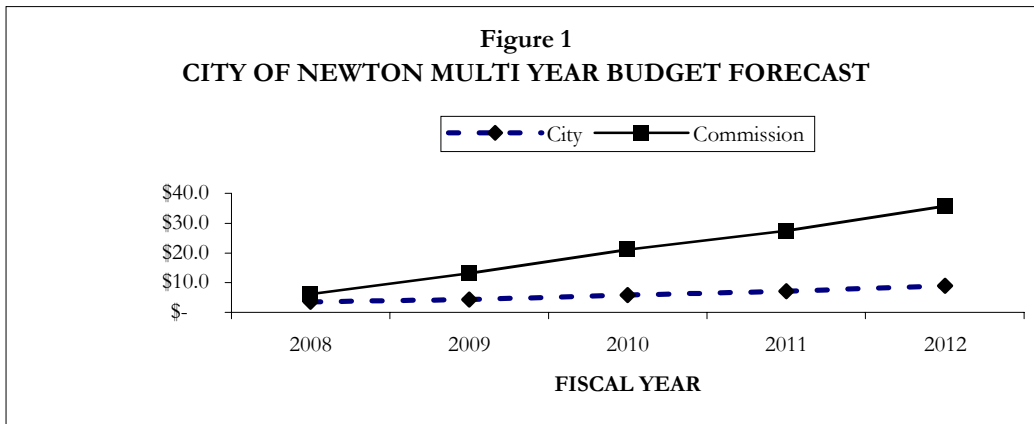
- Susan Burstein, Chief Budget Officer
- Elizabeth Dromey, Chair of the Board of Assessors
- Sandy Guryan, Assistant Superintendent for Business and Finance, Newton School Dept.
- Michael Kruse, Director of Planning and Development
- Sandy Pooler, Chief Administrative Officer
- Robert Rooney, Commissioner of Public Works
- Edward Spellman, Treasurer
- David Wilkinson, Comptroller

**Summary of Findings**

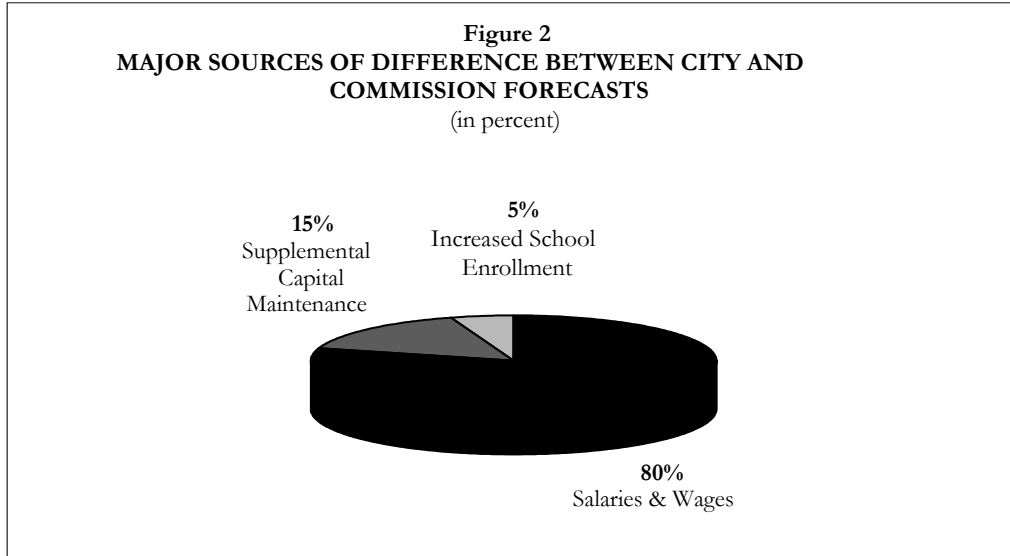
Our subcommittee’s analysis predicts that Newton’s revenues (or sources of funds) will be larger than the City’s Forecast for each of the next five years. Unfortunately, our sub-committee’s analysis also shows expenditures (or uses of funds) growing much faster than the City’s Forecast, dwarfing the revenue growth. Thus, the subcommittee shows a significantly larger deficit in each of the fiscal years for 2008-2012 compared with that in the City’s Forecast. By FY2012, we see Newton facing a \$35.7 million budget deficit, or roughly 10% of revenues. In other words, the city is facing a structural deficit, not a one-year deficit. This deficit will expand over the next five years at a rate that is likely to exceed that already assumed in the City’s Forecast.

Assuming an increase in state aid of \$1.4 million each year, the City’s Forecast shows Newton’s deficit increasing from \$3.6 million in 2008 to approximately \$9.0 million in 2012. The Commission’s Forecast shows this deficit rising from \$6.1 million to \$35.7 million over the same period.

Figure 1 below shows the increasing gap between forecasted revenues and expenditures from 2008 to 2012. As Exhibit 3 (attached) shows, a big chunk of this increasing “gap” reflects the inclusion of a much-needed supplemental capital maintenance budget. Without this supplemental item the subcommittee still sees the city deficit growing to \$20.4 million in 2012.



While the *accumulated* deficit over the forecast period projected by the city totals approximately \$30 million, the subcommittee projects a number closer to \$100 million. As depicted in Figure 2 below, three items account for most of the \$70 million difference: salaries and wages (80% of difference), supplemental capital maintenance (15%), and increased school enrollment (5%).



Readers should bear in mind that due to the mathematics of compounding, a seemingly minor initial difference between faster expenditure growth and slower revenue growth can have a profound impact over a five-year period. This is what Figure 1 on the preceding page shows so graphically. The \$35.7 million deficit forecasted by the subcommittee for 2012 represents, for example, a difference of 2.3 percentage points in the annual growth rate of expenditures (5.5%) over revenues (3.2%)

Exhibit 1 attached to this cover memo lists the major assumptions of both the City’s Forecast and the Commission’s Forecast. Exhibit 2 presents a summary page of the City’s Forecast. Exhibit 3 presents the Commission’s Forecast.

As noted above, some of these assumptions deserve a special narrative or explanation. These appear in the following section.

***Narrative***

Both the City’s and the Commission’s Forecasts are divided into Financial Sources of Funds and Financial Uses of Funds. The Financial Sources panel in the Commission’s Forecast reflects the subcommittee’s sense of what revenues are “most likely.” The forecasts included in the Financial Uses panel reflect our understanding of what expenditures are essential to keep the city’s policies and priorities in place.

Even a casual review of the forecasts reveals that the big line items are Property Taxes (a source of funds) and Salaries, Benefits, and Pension Contributions (uses of funds). The assumptions for each of these items, along with a selection of other important line items, are elaborated below. Readers should be comfortable relying on Exhibit 1 for all other assumptions.

Before turning to this narrative, we should point out that the Commission’s Forecast integrates expenditures related to currently expected increases in student enrollment in the city’s schools that were not foreseen at the time of the City’s Forecast. To be more specific, Newton’s public schools see enrollment

increasing by about 230 students, or approximately 2%, each year over the next several years. Additional costs related to this increased school enrollment will affect salaries & wages, benefits, utilities, supplies & materials, and capital outlays.

**Property Taxes.** The commission's property tax forecast is based on the \$2.2 million of FY 2007 new growth increased at an average rate of 2% growth per year, which is the historical rate over the past five years. This forecast does not assume any significant additional, taxable development over the forecast period—such as the Chestnut Hill Square development project. Should this specific project come on line as currently defined by the developer, we estimate on the basis of expert testimony that it could generate approximately \$2 million per year in new tax revenues for the years 2011 and 2012 (and perhaps more thereafter).

The Commission's Forecast also assumes that property tax abatement allowances will fall from 1.4% of the tax levy to approximately a 1% level as current disputes over the valuation of telecommunications properties get resolved in the near term. The 1% abatement allowance tracks the City's historical experience.

**Intergovernmental Revenues.** The Commission's Forecast assumes that state aid will grow at \$1.4 million per year. This amount has been added to the relevant line item, which, we hasten to point out, includes other items that are expected to increase and decrease over the forecast period. Our assumed annual rate of growth in new state aid is equal to the city's low-end estimate shown at the bottom of Exhibit 2. There is a possibility, however, that state aid could increase by a factor of two (according to the Mayor's Office). Such an occurrence would have a moderate, positive impact on the operating budget in the early years of the forecast period.

**Salaries & Wages.** Based upon a historical review of wage and salary adjustments, the subcommittee feels that an overall 2.5% per year increase in total payroll expenditure is more likely than no increase at all—as currently assumed in the City's Forecast. While the City's Forecast acknowledges that each one percent increase in salaries would increase annual operating costs by approximately \$1.5 million, it does not include any increases for salaries and wages. Going forward, the city will need to continue assessing the competitiveness of salaries and wages in order to attract and retain qualified municipal employees.

**Benefits.** Like most cities and towns in Massachusetts, Newton faces a large, unfunded retiree health benefit liability. As of June 30, 2006, this totaled \$561 million. Were the city to change from the pay-as-you-go policy that is reflected in the forecast to an actuarial funded method, the annual expenditure on employee benefits would increase immediately by \$38 million, rising to \$44 million by the end of the forecast period (2012).

This projected increase reflects the pre-funding of a rapidly increasing liability. Municipal health care costs have increased by 63% from 2000 – 2005 across the State. During the five years ending June 30, 2006, Newton's total health care insurance expenditures increased by 54% or \$10.4 million. That equates to the 11% annual average increase assumed in the Commission's Forecast model.

Since the city actually does not have authority from the State to create a trust for the funding of these benefits, the subcommittee has chosen to stick with the pay-as-you-go method of funding for modeling purposes.

**Pensions.** Along with health insurance, pension costs are a major expenditure growth item. The numbers included in both the City's and the Commission's Forecasts are predicated upon the most recent (January 1, 2006) actuarial valuation of the pension plan. The numbers also assume an 8% annual rate of return on plan assets. To the extent that this rate of return can be improved through participation in the Massachusetts Pension Reserves Investment Trust (MassPRIT), the city would have more flexibility to address the financial implications of increasing life expectancies of retirees and their dependents, and other financial needs of the city.

**Supplemental Capital Maintenance.** The subcommittee added this line item to the forecast as a result of due diligence that revealed a persistent under-funding of renewal of the city’s physical capital.

Assuming (a) an estimated replacement value of the city’s buildings, exclusive of the high schools, totaling \$390 million (we excluded the replacement value of the two high schools because one is essentially new and the other is provided for in the mayor’s capital plan and because the forecast covers a relatively short five-year period), (b) a need to invest at a rate of 3% of replacement value per year to maintain these buildings, based upon a recognized and widely used standard, and (c) a building life of 25 – 50 years, the city needs approximately \$11.7 million each year for capital maintenance versus the currently projected spend of \$4 million per year.

The \$7.4 million gap between “required” and “current” capital maintenance can be bonded, meaning financed with bonds. Assuming a 20 year term for the bond and a 5% interest rate on the bond, it will cost the city approximately \$750,000 in incremental expenditures each year to service the required debt (i.e., supplemental capital maintenance expenses for buildings would increase by \$750,000 each year).

In addition, the subcommittee estimates an annual \$2 million shortfall in funding for the maintenance of road and street infrastructure, which translates into an increase of \$200,000 in debt service each year.

All in, the subcommittee foresees required supplemental capital maintenance expenditures of \$950,000 per year going forward.

\* \* \* \* \*

In sum, the city’s changing financial picture deserves continued study and discussion. While the subcommittee reports a developing structural deficit of some significance, we hasten to add that that a narrow debate of (a) the numbers presented here and (b) related proposals of how best to close the widening gap between revenues and expenditures would miss the point of this forecasting exercise. The “big question” facing all of us is what kind of city do we want Newton to be. The city’s management team, including the Mayor’s Office and the Board of Alderman, has provided excellent support (and significant expertise) to this forecasting review. It’s now up to us, as citizens, to make our collective aspirations explicit and figure out how best to shape our portfolio of wishes to the fiscal capabilities of the community.

Respectively submitted, January 4, 2007

Ruthanne Fuller  
Amelia Koch  
Tony Logalbo  
Malcolm Salter, Chair

**Exhibit 1**

CITY OF NEWTON, MASSACHUSETTS  
BLUE RIBBON FINANCE COMMISSION  
MAJOR ASSUMPTIONS OF FORECASTS

	<u>City's Forecast (September 22, 2006)</u>	<u>Commission's Forecast (January 3, 2007)</u>
<b>Financial sources:</b>		
Property taxes	\$2 million annual new growth less 1.4% of levy for abatements	\$2.2 million annual new growth increasing by 2% per year less 1% of levy for abatements
Motor excise taxes	2% annual increase	2% annual increase
Other taxes, interest & penalties	1% annual increase	1% annual increase
In lieu of tax payments	Level funded	Level funded
Charges for service	4% annual increase	4% annual increase
Licenses & permits	Level funded @ \$4.8 million per year	Level funded @ \$4.8 million per year
Fines & forfeitures	Level funded	Level funded
Investment income	Level funded	Level funded
Other miscellaneous revenue	Level funded	Level funded
Free Cash	\$500,000 per year annual reduction to \$0	\$500,000 per year annual reduction to \$0
Intergovernmental revenue	Level funded except for changes in School Building assistance grant payment schedule	Mayor's forecast assumptions plus \$1.4 million in new state aid per year
Reimbursements from other funds	Level funded	Level funded
<b>Financial uses</b>		
<b>Operating budget</b>		
Salaries & wages	School contract steps only - no collective bargaining adjustment	School contract steps, plus 2.5% annual wage and salary increase, plus staff increases to serve additional school enrollment
Benefits	Health insurance expenditures @ 11% growth per year - no actuarial funding	Health insurance expenditures @ 11% growth per year - no actuarial funding plus benefits for additional staff to serve additional school enrollment
Pension contribution	Actuarial funding schedule	Actuarial funding schedule
Energy/utilities	5% annual increase	5% annual increase plus funding to serve additional school enrollment
Refuse collection/disposal	3.5% annual increase	3.5% annual increase
Out of district education tuitions	8% annual increase	8% annual increase
School transportation	10% annual increase	10% annual increase
Services	2% annual increase	2% annual increase
Supplies and materials	2% annual increase	2% annual increase plus funding to serve additional school enrollment
Capital outlay	Level funded	4% annual increase in expenditures plus funding to serve additional school enrollment
Other - unclassified	Contingency @ 1% of budget - all other level funded	Contingency @ 1% of budget - all other level funded
State assessments and charges	2.5% annual increase	2.5% annual increase
<b>Capital and Capital Reserves</b>		
Debt service	Mayor's capital plan	Mayor's capital plan
Fund for Future Capital Needs	Mayor's capital plan	Mayor's capital plan
Supplemental capital maintenance	Not addressed	3% of estimated capital replacement value for buildings, plus \$200,000 per year in additional debt service for road and street infrastructure

**Exhibit 2**

CITY OF NEWTON, MASSACHUSETTS  
 GENERAL FUND MULTI-YEAR BUDGET FORECAST  
**FORECAST SUMMARY - CITY'S FORECAST UPDATED FOR ACTUAL TAX LEVY (September 22, 2006)**

	FY 2007 Budget	FY 2008 Forecast	FY 2009 Forecast	FY 2010 Forecast	FY 2011 Forecast	FY 2012 Forecast
<b>Sources:</b>						
Property taxes	\$ 205,603,998	\$ 212,696,697	\$ 219,986,114	\$ 227,457,768	\$ 235,116,211	\$ 242,966,117
Motor excise taxes	10,964,687	11,232,219	11,481,035	11,735,363	11,995,324	12,261,044
Other taxes, interest & penalties	1,918,396	1,923,529	1,943,086	1,962,843	1,982,800	2,002,961
In lieu of tax payments	385,072	418,202	418,202	418,202	418,202	418,202
Charges for service	1,551,434	1,676,909	1,728,137	1,781,500	1,837,090	1,894,999
Licenses & permits	3,113,057	4,760,762	4,760,762	4,760,762	4,760,762	4,760,762
Fines & forfeitures	1,900,512	1,825,235	1,825,235	1,825,235	1,825,235	1,825,235
Investment income	1,400,000	3,000,000	3,000,000	3,000,000	3,000,000	3,000,000
Other miscellaneous revenue	3,056,972	868,270	868,270	868,270	868,270	868,270
Free Cash	4,620,972	1,200,000	700,000	200,000	-	-
Intergovernmental revenue	22,821,402	23,523,329	23,496,109	22,637,563	21,390,789	21,387,124
Reimbursements from other funds	2,779,245	2,815,810	2,853,472	2,892,264	2,932,219	2,973,373
<b>Total Sources:</b>	<u>260,115,747</u>	<u>265,940,961</u>	<u>273,060,421</u>	<u>279,539,769</u>	<u>286,126,903</u>	<u>294,358,087</u>
<b>Uses:</b>						
<b>Operating Budget</b>						
Salaries & wages	152,193,862	152,577,953	154,223,771	155,825,353	157,567,265	159,411,808
Benefits	38,407,820	42,371,709	46,692,753	51,488,643	56,812,237	62,722,327
Pension contribution	10,944,381	11,935,973	12,490,025	13,072,042	13,683,431	14,325,667
Energy/utilities	9,247,463	9,709,836	10,195,328	10,705,094	11,240,349	11,802,367
Refuse collection/disposal	5,859,472	6,064,554	6,276,813	6,496,501	6,723,879	6,959,215
Out of district education tuitions	5,467,561	5,904,966	6,377,363	6,887,552	7,438,556	8,033,641
School transportation	3,939,616	4,333,578	4,766,935	5,243,629	5,767,992	6,344,791
Services	8,748,398	8,921,976	9,105,975	9,286,566	9,470,768	9,658,655
Supplies and materials	5,049,315	5,150,301	5,253,307	5,358,373	5,465,541	5,574,852
Capital outlay	1,638,876	1,638,876	1,638,876	1,638,876	1,638,876	1,638,876
Other - unclassified	1,934,093	3,810,894	3,902,985	3,989,479	4,074,892	4,175,632
State assessments and charges	5,478,619	5,615,584	5,755,974	5,899,873	6,047,370	6,198,555
Planned savings	16,902	2,654,765	2,725,826	2,790,482	2,856,212	2,938,380
Operating budget subtotal	<u>248,926,378</u>	<u>260,690,966</u>	<u>269,405,933</u>	<u>278,682,464</u>	<u>288,787,369</u>	<u>299,784,765</u>
<b>Capital and Capital Reserve Creation</b>						
Debt service	9,631,318	7,279,519	7,470,440	7,666,371	7,867,440	8,073,782
Transfer to Capital Fund	1,558,051	3,018,094	3,268,094	3,209,957	2,217,041	2,467,041
Capital Maintenance Subtotal	<u>11,189,369</u>	<u>10,297,613</u>	<u>10,738,534</u>	<u>10,876,328</u>	<u>10,084,481</u>	<u>10,540,823</u>
<b>Total Uses:</b>	<u>\$ 260,115,747</u>	<u>\$ 270,988,579</u>	<u>\$ 280,144,467</u>	<u>\$ 289,558,792</u>	<u>\$ 298,871,850</u>	<u>\$ 310,325,588</u>
<b>Excess/(deficiency) Sources over Uses before collective bargaining or additional state aid</b>	<u>-</u>	<u>\$ (5,047,617)</u>	<u>\$ (7,084,046)</u>	<u>\$ (10,019,023)</u>	<u>\$ (12,744,947)</u>	<u>\$ (15,967,501)</u>
Assume \$1.4 million of new state aid each year		\$ (3,647,617)	\$ (4,284,046)	\$ (5,819,023)	\$ (7,144,947)	\$ (8,967,501)
Assume \$2.8 million of new state aid each year		\$ (2,247,617)	\$ (1,484,046)	\$ (1,619,023)	\$ (1,544,947)	\$ (1,967,501)

**Exhibit 3**

CITY OF NEWTON, MASSACHUSETTS  
GENERAL FUND MULTI-YEAR BUDGET FORECAST  
**COMMISSION'S FORECAST (PRELIMINARY)**

	FY 2007 Budget	FY 2008 Forecast	FY 2009 Forecast	FY 2010 Forecast	FY 2011 Forecast	FY 2012 Forecast
<b>Sources:</b>						
Property taxes	\$ 205,603,998	\$ 213,812,856	\$ 221,424,169	\$ 229,271,084	\$ 237,120,640	\$ 245,699,097
Motor excise taxes	10,964,687	11,232,219	11,481,035	11,735,363	11,995,324	12,261,044
Other taxes, interest & penalties	1,918,396	1,923,529	1,943,086	1,962,843	1,982,800	2,002,961
In lieu of tax payments	385,072	418,202	418,202	418,202	418,202	418,202
Charges for service	1,551,434	1,676,909	1,728,137	1,781,500	1,837,090	1,894,999
Licenses & permits	3,113,057	4,760,762	4,760,762	4,760,762	4,760,762	4,760,762
Fines & forfeitures	1,900,512	1,825,235	1,825,235	1,825,235	1,825,235	1,825,235
Investment income	1,400,000	3,000,000	3,000,000	3,000,000	3,000,000	3,000,000
Other miscellaneous revenue	3,056,972	868,270	868,270	868,270	868,270	868,270
Free Cash	4,620,972	1,200,000	700,000	200,000	-	-
Intergovernmental revenue	22,821,402	24,923,329	26,296,109	26,837,563	26,990,789	28,387,124
Reimbursements from other funds	2,779,245	2,815,810	2,853,472	2,892,264	2,932,219	2,973,373
<b>Total Sources:</b>	<u>260,115,747</u>	<u>268,457,120</u>	<u>277,298,476</u>	<u>285,553,085</u>	<u>293,731,332</u>	<u>304,091,067</u>
<b>Uses:</b>						
<b>Operating Budget</b>						
Salaries & wages	152,193,862	157,331,588	164,344,955	171,521,347	177,443,127	185,218,331
Benefits	38,407,820	42,550,909	47,074,833	52,062,083	57,560,397	63,666,967
Pension contribution	10,944,381	11,935,973	12,490,025	13,072,042	13,683,431	14,325,667
Energy/utilities	9,247,463	9,729,561	10,215,053	10,724,819	11,260,074	11,822,092
Refuse collection/disposal	5,859,472	6,064,554	6,276,813	6,496,501	6,723,879	6,959,215
Out of district education tuitions	5,467,561	5,904,966	6,377,363	6,887,552	7,438,556	8,033,641
School transportation	3,939,616	4,333,578	4,766,935	5,243,629	5,767,992	6,344,791
Services	8,748,398	8,921,976	9,105,975	9,286,566	9,470,768	9,658,655
Supplies and materials	5,049,315	5,295,801	5,495,807	5,600,873	5,708,041	5,817,352
Capital outlay	1,638,876	1,827,011	1,976,908	2,047,813	2,121,553	2,198,243
Other - unclassified	1,934,093	3,836,055	3,945,366	4,049,612	4,150,937	4,272,962
State assessments and charges	5,478,619	5,615,584	5,755,974	5,899,873	6,047,370	6,198,555
Planned savings	16,902	-	-	-	-	-
Operating budget subtotal	<u>248,926,378</u>	<u>263,347,557</u>	<u>277,826,009</u>	<u>292,892,712</u>	<u>307,376,126</u>	<u>324,516,470</u>
<b>Capital and Capital Reserve Creation</b>						
Debt service	9,631,318	7,279,519	7,470,440	7,666,371	7,867,440	8,073,782
Fund for future capital needs	1,558,051	3,018,094	3,268,094	3,209,957	2,217,041	2,467,041
Supplemental capital maintenance	-	950,000	1,900,000	2,850,000	3,800,000	4,750,000
Capital Maintenance Subtotal	<u>11,189,369</u>	<u>11,247,613</u>	<u>12,638,534</u>	<u>13,726,328</u>	<u>13,884,481</u>	<u>15,290,823</u>
<b>Total Uses:</b>	<u>\$ 260,115,747</u>	<u>\$ 274,595,170</u>	<u>\$ 290,464,543</u>	<u>\$ 306,619,040</u>	<u>\$ 321,260,607</u>	<u>\$ 339,807,293</u>
<b>Excess/(deficiency) Sources over Uses</b>	<u>\$ -</u>	<u>\$ (6,138,050)</u>	<u>\$ (13,166,068)</u>	<u>\$ (21,065,955)</u>	<u>\$ (27,529,275)</u>	<u>\$ (35,716,226)</u>