

Newton Finance and Management Working Group

**Report on Revenue Expansion
and Cost Savings Opportunities
for the City of Newton**

May 2005

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Foreword

In recent months as the severity of Newton's financial crisis became clear, it occurred to me that addressing our City's budgetary problems would take a new approach. For us to succeed in maintaining the quality of services in Newton, we would need to be bold and innovative, reexamining our assumptions about how City government needs to operate. We would need to take a fresh look at Newton's financial balance sheet, asking tough questions about where we could generate more revenue and what costs could be trimmed without jeopardizing the quality of our services. We would need to ask some tough questions about the way we manage the City's finances.

Fortunately, Newton has a resource that makes asking these kind of tough questions a little easier – our residents. I set out to assemble a group of Newton residents with sufficient expertise in finance and management to formulate some of these budget-related questions and to begin the process of identifying opportunities to expand Newton's revenue and to control our operating costs. My hope was that I would be able to find a few people to serve on an informal working group that would begin the process of identifying these issues and opportunities.

The group of people who answered this call is impressive. Leaders of business and industry, together with academics and state officials, gave generously of their time and expertise to delve into a number of ideas to address the City's financial problems. This document represents the product of that labor and I hope will be a useful starting point for City leaders in attempting to get Newton's financial crisis under control. While I do not expect every one of the recommendations in this report to be adopted, I do hope that this effort may help to open the door to further discussion and investigation of ways to improve the financial operation of the government of the City of Newton.

My heartfelt thanks go out to everyone who took part in this effort or who helped us to assemble the information needed to put together this report. It was truly a team effort and would not have been possible without the commitment and hard work of many people.

Ultimately, this report offers a road map for identifying and realizing improvement to the bottom line of the City of Newton government, but our timeline was short and there were many areas that we did not have the chance to investigate. The potential revenue opportunities and savings in this report represent just the tip of the iceberg of what we may be able to achieve if we continue to tap into the vast resource that is the energy and expertise of the people of Newton.

Ken Parker

May 9, 2005

I. Executive Summary

A. Background and Scope of Work

The Newton Finance and Management Working Group met in March and April of 2005 with a simple goal – finding ways to improve the City of Newton’s financial health. The Working Group operated with a tight timeframe, so our work is far from comprehensive, but we hope it will be a useful starting point for City policymakers in their attempts to improve the fiscal operation of City government.

The Working Group adopted two constraints on our study: No new fees or fee increases for existing services would be recommended, nor would any reduction of service be discussed in our report. We decided not to recommend new fees or service cuts, not because they might not be appropriate, but because we set as our goal to find innovative ways to improve the City’s bottom line without resorting to such measures, which are better left to Newton’s elected officials to sort out.

In examining Newton’s finances, we put aside policy interests, acting as though we were an outside management team being brought in to review a company’s profitability. This report reflects our best attempts to find ways to improve the City of Newton’s bottom-line operations. We attempted to steer clear of substituting our judgment about the priority to which various services should be given.

Throughout this process, our Working Group interacted with City staff on understanding both challenges and potential solutions. We found the enthusiasm with which our inquiries were met to be encouraging and we were pleased that so many City staff were enthusiastic about listening to outside input into the effort to find solutions to the City’s budget problems. We believe that these recommendations are by no means an “end product,” but rather the beginning of a constructive, city-wide conversation.

Our recommendations fall essentially into three categories: Opportunities for new and expanded revenue, cost savings, and management steps that will improve the fiscal operation of the City.

Some of our recommendations are more fully developed than others. In many cases, we identify an area of potential revenue or savings and indicate a need for further study, while in others we make more specific recommendations that can be implemented immediately.

B. Summary of Findings

The Finance and Management Working Group identified five areas in which the City of Newton could expand revenues, four areas of potential cost savings, and a number of management steps that we believe would be helpful to maintaining the long-term fiscal health of the City. In some cases, a recommendation includes both revenue and cost-savings components, but for purposes of simplicity, we present each recommendation in only one section.

The four revenue ideas presented in this report are:

- 1) Improving cash management and investment practices,
- 2) Establishing a Payment In-Lieu of Taxes (PILOT) program for the City,
- 3) Building a citywide wireless Internet access network, and
- 4) Establishing a Municipal Power Company.

The first two of these ideas have the potential to generate significant revenue for the City in Fiscal Year 2006, while the wireless Internet access network would begin to benefit the City's bottom line only over the course of the next year, and the municipal power company could take years to establish.

Our five cost savings recommendations are

- 1) Increasing the energy efficiency of municipal facilities,
- 2) Reducing health insurance costs,
- 3) Expanding the City's recycling program,
- 4) Managing municipal pension liabilities, and
- 5) Conducting an asset-management audit.

These cost-control measures also vary with respect to the speed with which they can be implemented. We believe that significant savings can be realized in the energy and waste disposal areas during Fiscal Year 2006, but that addressing the rapid increase in health insurance costs is a more complex project. The steps we recommend with respect to managing the City's pension liabilities and conducting an asset-management audit may or may not have an impact on the operating budget in the next fiscal year but should have significant long-term financial benefits to the City.

The management steps we discuss have the potential to help the City implement our revenue-generation and cost-savings recommendations, as well as to further future efforts to find more ways to improve the City's bottom line. Specifically, we recommend:

- 1) Implementing benchmarking procedures,
- 2) Establishing a chief financial officer position,
- 3) Reviewing financial functions and practices,
- 4) Conducting ongoing budget forecasting and review, and
- 5) Establishing a citizen budget advisory committee for the City.

Many of these recommendations are consistent with ongoing efforts by City officials to make our local government work better. We hope that the specifics provided in this report will be helpful in focusing efforts in areas where they will be most productive and in setting forth concrete steps that can be taken to implement these ideas.

II. New and Expanded Revenue

The vast majority of Newton’s revenue is currently generated by property taxes, which have the advantage of being a predictable revenue stream, but have not increased in recent years as rapidly as many of Newton’s expenditures. This is due in part to the fact that while tax revenues have kept pace with inflation, they have not kept pace with overall wage growth, which comprises a large part of the city’s budget. In its recommendations to expand Newton’s revenue stream, this report does not look at charging new fees for existing services or increasing existing fees, but it does make recommendations for offering new fee-based services to Newton residents and others, as well as increasing revenue from existing non-fee sources.

A. Improve Cash Management and Investment Practices

1. Summary and Scope

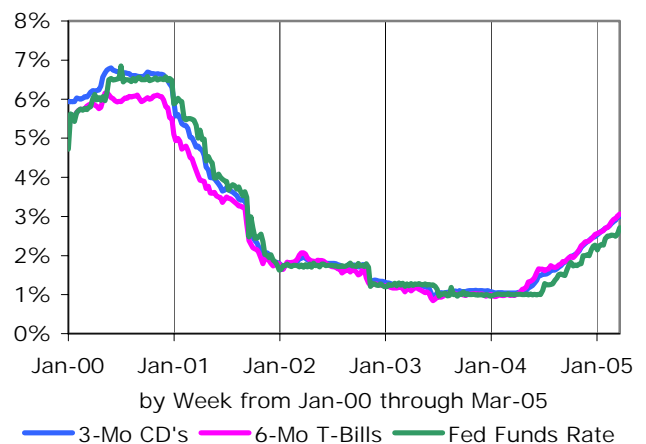
Newton’s FY2006 Revenue Budget includes earnings from short-term investments of \$1,400,000. While interest income is not a major source of income for the City, and investments are restricted by regulations to limited securities with maturities of less than one year, nevertheless, Newton has the opportunity to generate at least \$1.6 million more in short-term investment income, for a total of \$3 million in investment income in FY2006. To achieve higher investment income, the City can take advantage of rising interest rates and improve cash management practices that enable cash to be invested sooner and into the highest-rate investments.

2. Discussion

Additional short-term investment income to cover budgetary expenses of the City can easily be generated without additional staffing costs:

- a) The market for short-term investment earnings is now higher than it had been for the two years between January 2002 and June 2004 (see Figure 1);
- b) Specific management steps related to upfront processing activities could maximize the timing of investments; and
- c) Specific management of the mix of different investments could further help to maximize earnings.

Figure 1. Short-term Investments - Selected Rates



Source for data: Federal Reserve Statistical Releases, online <https://www.federalreserve.gov/releases>.

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Investment earnings in the 2006 Budget are low based on current short-term market rates, which began to rise in mid-2004 (see Figure 1). By March, 2005, the Federal Funds rate was 2.79%, and 6-month Treasury Bills and 3-month CDs were both at approximately 3%. This compares to rates of around 1% for all three a year ago. Figure 1 illustrates the current trend based on published rates available from the Federal Reserve. Economists and investment experts expect rates to continue to rise.

Figure 2 illustrates Newton's potential for additional earnings based solely on earning higher investment rates on the same invested cash balances as were invested throughout FY2004. At an average interest rate of 3% rather than 1%, the City would earn approximately \$1.3 million more *—before* any effects of managing cash and investment activity differently, discussed below.

Figure 2. Potential for Increased Earnings

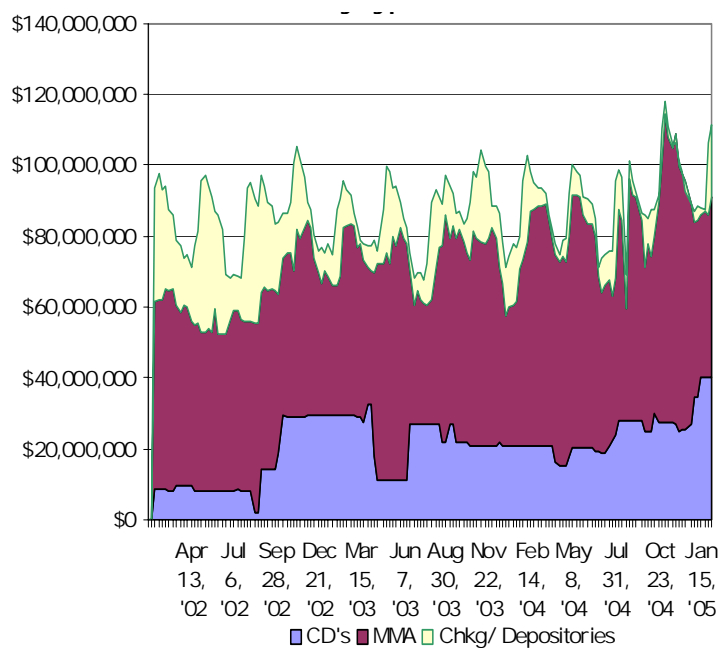
in FY2006 based on higher market rates.

Incremental Earnings	Earnings if invested at:	
\$540,000	\$1,520,000	2.0%
\$920,000	\$1,900,000	2.5%
\$1,300,000	\$2,280,000	3.0%

Steps taken to both maximize the invested vs. non-invested balances and manage the specific investment mix could provide additional investment earnings (above the \$1.3 million) in FY2006. The City's average invested balance in FY2004 was \$76 million. An increase to \$95 million at a 2.5% average rate would generate interest of an additional \$500,000 in investment income, above the \$1.3 million achievable from higher investment rates. Three ways additional earnings are achievable:

- a) Earnings in 2006 should be higher than in the current Budget draft because of better investment practices already being put in place. Newton's average cash balances by type of account over the past three years ended 2/28/05 are shown in Figure 3. The change in the total amount of cash indicates that total cash balances have been increasing during calendar 2004. It is apparent that good efforts have been made to hold more of the total amount in interest bearing accounts (money market accounts and CD's) than in checking and depository type accounts.

Figure 3. Cash by Type of Account



- b) Currently the City holds cash in checking, depository, money market accounts, and bank CDs. State and city regulations that govern what securities may be held and their duration also allow other short-term investing, such as Bank Repurchase Agreements or Securities of the U.S. government or its agencies. Managing the mix

of investments could help to maximize earnings and achieve a portion of the additional \$500,000.

- c) Finally, a review of specific daily cash processing activity could identify alternate procedures that can increase cash control and the timing of cash available for investment and thus achieve some portion of the additional \$500,000 in investment income that we believe is possible.

The Treasurer's Office handles a high volume of daily cash management activity and performs its function with good attention to regulations over investment vehicles. Personnel of this office have been cooperative participants in support of this review. The work of the department and the time available for investing activity (vs. other tasks) would benefit from the review of cash processing and reconciliation procedures discussed under the Management Steps portion of this report. The department's efforts to maximize investment earnings for the City could be enhanced by implementing review mechanisms, such as daily reporting across all accounts, review of daily reports on transactions from banks, and daily monitoring of transfers into investment accounts. Further, speedier billing and collections along with automatic investing mechanisms (such as are available through repurchase agreements with banks) might allow speedier investing.

The city of Newton Treasurer's office has about 40 cash and investment accounts to oversee or manage on a daily basis. About 31 of these are accounts are used in managing Newton's general finances, and 9 are related to specific-purpose Trust Funds that Newton administers for third parties. Figure 2 and Figure 3 include the accounts that are available or used in Newton's general operations.

Improving cash flow will increase the availability of funds to invest. Many resources are available to help cities and towns make use of the latest cash management techniques. The Government Finance Officers Association (GFOA) recently approved a new **Recommended Practice** titled: **Use of Cash Flow Forecasts in Operations (2005)** in March 2005, which may be useful to Newton's financial team.

3. Summary of Recommendations

To improve cash flow and investment income, we recommend that the City:

- a) Increase budgeted goals for investment interest rates;
- b) Manage the flow of funds from non-interest-bearing accounts and low-interest accounts to investments with better earnings;
- c) Utilize available automatic investment mechanisms to speed up investment process;
- d) Improve cash flow by accelerating collection and deposit procedures and by taking advantage of other available cash management techniques;
- e) Implement daily monitoring of balances, transactions, and investments; and
- f) Streamline Treasury functions to make more time for investment management activity.

B. Develop and Implement a PILOT Program¹

1. Summary

Under state law, many properties in Newton are exempt from paying property taxes but still consume local government services and resources. Some communities ask such property-tax exempt organizations and institutions to make voluntary “Payments In Lieu Of Taxes” (PILOTs) to the municipalities in which they are located. Currently, Newton receives only \$340,000 annually in PILOT revenue, a relatively low amount compared to the number and value of tax-exempt properties in Newton. If the City implements a structured PILOT program, sending requests for payments to owners of exempt properties in Newton, we should expect to see nearly a million dollars in additional revenue in FY2006 and an increase of at least two million over current rates in future years.

2. Background

Massachusetts state law provides property tax exemption for a variety of entities including properties owned by:

- a) Federal and state government
- b) Charitable organizations
- c) Religious organizations
- d) Health services providers
- e) Educational institutions

However, a number of communities enter into PILOT agreements with the tax-exempt property owners they host. Under these agreements, the tax-exempt property owner acknowledges its responsibility to become a full partner in the development of the quality of life of the host community. These agreements are based upon good faith and public relations, and not on any legal requirement.

3. Benchmarks

Newton today receives approximately \$340,000 in PILOT revenue. This figure would not even have ranked among the top 15 for municipalities in Massachusetts FIFTEEN YEARS AGO. Today, Harvard University and MIT each provide in excess of \$1,000,000 to Cambridge each year (see Figure 4). Boston University makes a PILOT payment to Boston of over \$3,000,000 annually. In contrast, Boston College pays Newton just \$100,000 per year and other Newton colleges, including Mount Ida and LaSalle, make no contribution whatsoever.

¹ This section relies on current data supplied by the Chair of Newton’s Board of Assessors, other area communities and on a report on negotiating PILOT payments prepared by the Massachusetts Government Finance Officers Association.

Figure 4. Estimated 2004 PILOT Payments

City	Payment	University
Cambridge	\$1,772,264	Harvard
	\$1,223,000	MIT
	\$390,000	Whitehead Institute
Boston	\$3,200,000	Boston University
	\$1,600,000	Harvard University
	\$215,000	Boston College
	\$175,000	Berklee School of Music
	\$137,000	Northeastern University
Providence	\$2,500,000	Split among 4 private universities
Newton	\$100,000	Boston College

While universities are among the largest PILOT participants, the scope of PILOT revenue in other communities also includes other types of tax-exempt institutions.² Boston has PILOT agreements with more than 40 tax-exempt institutions, which – as of September, 2003 – contribute more than \$23 million to the City on an annual basis. Other large PILOT contributions come from hospitals (Massachusetts General Hospital gives \$2.2 million each year), but many smaller institutions also participate. For example, the Boston Symphony Orchestra gives about \$60,000 and WGBH donates \$10,000.

Boston’s total PILOT revenue last year of \$23 million represents over 1% of its \$1.9 billion annual budget. The City of Cambridge received \$3.6 million in PILOT payments in Fiscal Year 2004, representing over 1% of its \$344 million budget. The Town of Brookline received approximately \$1 million in PILOT revenue last fiscal year, representing more than 0.6% of its overall budget of \$162 million. By comparison, Newton’s \$340,000 in PILOT contributions represents just over 0.1% of Newton’s \$260 million budget.

In the City of Quincy, Harvard Pilgrim gives 24% of what its tax bill would be if it were not tax exempt. In FY2005, that amounted to \$250,000. Quincy has also reached a tentative agreement with Blue Cross according to the same formula, which should bring in \$325,000 in FY2006, according to Marion Fantucchio, the Chair of the Quincy Board of Assessors.

4. Revenue Opportunity

Newton’s tax-exempt entities own properties with an assessed value exceeding \$1 billion, according to Elizabeth Dromey, the Chair of the Newton Board of Assessors. In fact, she points out that these properties have not been carefully assessed and would probably be valued considerably higher if the revenues they generate were evaluated. If they were valued at \$1 billion and taxed at residential tax rates, these properties would generate \$9,480,000 in taxes (and they would generate nearly twice that amount if taxed at commercial rates). If Newton were

² Chronicle of Philanthropy, September, 2003 issue.

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to request PILOT payments of 25% of the commercial rate³, the potential revenue would be \$4.5 million. At a 50% collection rate, that would generate \$2.25 million in PILOT revenue, nearly a \$2 million increase over current levels and in-line with PILOT collections of other nearby cities.

If only half of this increase could be achieved in FY2006, that would still represent nearly \$1 million dollars in new revenue that should be available to the City if a concerted effort is made to obtain PILOT agreements from tax-exempt property owners.

Because, as previously noted, the values of tax-exempt properties in Newton have been understated, the actual revenue opportunity to the City would be much greater than \$2 million per year, since part of the PILOT program would include re-assessing properties at market values in order to fully demonstrate to property owners the value of the tax exemption they receive.

5. Designing the PILOT program

a) Program Rationale

Proposition 2½ places severe financial pressure on Newton, straining its resources. This impacts tax-exempt organizations, as it becomes increasingly more challenging for Newton to provide the services that all residents and hosted tax-exempt organizations have come to expect. For example, a university may no longer have access to the same level of responsiveness from the public fire department to which its faculty and students have become accustomed.

According to former Newton Fire Chief Edward Murphy, the Newton Fire Department receives many calls from Newton colleges: approximately 200 per year from Boston College, 100 per year from Mount Ida, and 75 per year from LaSalle. While many of these calls do not involve actual fires, even the false alarms place a drain on Fire Department resources. Many of these calls are caused by actual fires—a very large number relative to the size of the colleges in Newton, according to Chief Murphy.

The Fire Department's responses are just one of the many City resources used by tax-exempt entities in Newton. They benefit from the work of our Public Works Department when they travel Newton streets, they are protected by Newton Police, and they avail themselves of Newton's library, parks, and other services. It is reasonable that we ask these tax-exempt institutions to make a contribution to help defray the costs they impose on City government, as is the practice in other communities.

Further, while many tax-exempt institutions would like to expand, their growth produces further demand for City services, including not only the direct services provided to the institution in question, but also increases demand for services to the clients, students, patients, and other visitors attracted to Newton by these tax-exempt entities.

b) Process

A PILOT program could be implemented as follows:

³ The current commercial tax rate is \$18.02 per thousand dollars of property value.

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- a) All current tax-exempt organizations will be asked for a 2005 PILOT payment. The City will cite the costs it incurs on behalf of the organization as its rationale and will base its request on the tax exempt organization's desire to be a good neighbor.
- b) Discussions regarding voluntary PILOT payments will commence with any tax-exempt organization at the time it institutes proceedings to expand or improve its property.
- c) The City will publicly thank institutions that enter into PILOT agreements.
- d) The Commonwealth of Massachusetts will be asked through legislation to compensate Newton for state-owned properties, as several other communities currently receive.
- e) Independent state authorities, such as the MBTA and Turnpike Authority, will be asked to negotiate PILOT payments in recognition of the economic costs they impose on Newton.

In order to request PILOT payments, Newton will need a standard PILOT agreement that can be provided to tax-exempt entities when negotiating PILOT payments.

c) Guidelines for Establishing PILOT Request Formula

Various methodologies can be used in deriving the appropriate PILOT payment for a tax-exempt entity to make. The two simplest are:

- a) The cost of providing municipal services to the organization (It is reasonable for a tax-exempt organization to make a contribution toward Newton's cost for providing essential services); and
- b) An appropriate fraction of the taxable revenue the property would generate for Newton if it were not tax-exempt.

Since it can be difficult to determine the portion of a given department's budget being consumed by a given institution (for example, one would need to measure vehicle trips to calculate the portion of the Public Works Department's budget needed to make repairs to roads used by a given institution), the preferred method would probably be to use a flat rate. Either 25% of the commercial rate or 50% of the residential rate would be consistent with the PILOT contributions requested by other communities.

6. Recommendations and Timeline

To implement a PILOT program in Newton, we recommend:

- a) Policymakers decide the rate to be requested, if any.
- b) Letters requesting PILOT agreements are mailed.
- c) City officials meet with leaders of larger tax-exempt institutions.
- d) City publicizes positive responses to PILOT requests.
- e) City officials meet with legislative delegation regarding state properties.
- f) City officials meet with representatives of state agencies.

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If item (a) can be accomplished by the beginning of FY2006, then it will be possible to anticipate some additional PILOT revenue in the FY2006 operating budget. Items (b)-(f) should proceed as soon as (a) is completed.

C. Build a Wireless Internet Access Network

1. Summary

A number of municipalities around the country have developed wireless Internet access networks that can be used to offer high-speed Internet access to people throughout their communities at a low cost, while generating revenue for the municipality. These networks can also be useful for improving and lowering the cost of local government services. Depending upon participation levels, a wireless Internet access network in Newton could be expected to bring at least \$2 million a year in additional net revenue to the City, not including the savings to existing City operations. With speedy implementation, the project could have a positive impact on the FY2006 operating budget.

2. Background

Many cities and towns around the country have developed wireless Internet access networks. These networks typically serve two functions:

- Enhancing internal municipal government communication and improving services, and
- Offering Internet access to the public either for free or for a charge.

Newton has a large percentage of residents who own computers and who use the Internet regularly. Many Newton residents currently have WiFi 802.11b or 802.11g access points in their homes and laptop computers with cards to access those networks. In fact, most new laptop computers now come equipped with these cards. The City currently provides public wireless Internet access at the main branch of the Newton Free Library, and several businesses and institutions in Newton have wireless networks with varying degrees of accessibility to the public.

One community that uses its WiFi Network for both purposes is Chaska, Minnesota. According to City Administrator Dave Pokorney, about half of Chaska's police cars are now equipped with wireless laptop computers that allow instantaneous background checks, report filing, and emergency communication. They also use their WiFi network for water and sewer monitoring. Having begun to set up these wireless local government services only one month ago, Chaska already has about half of its City sites networked.

In addition to using its WiFi network for municipal government purposes, Chaska also provides wireless Internet access to its residents for a charge of \$15.99 per month. After an initial period in which free access was provided, the service has now been offered exclusively on a paid basis for just over two months. In this time, more than 25% of Chaska households have signed up for the service. Chaska also has availability of cable modem and DSL service in well over 90% of the community, demonstrating that municipal WiFi can succeed in a competitive Internet-access environment.

Chaska has found that an added benefit of offering wireless Internet service is the ability to communicate with residents. Since their system is set to require that users log on once every 24 hours, they are able to put important messages about community events and other news on the log-on page. In this way, they are able to inform 25% of their residents about snow emergencies, parking bans, public hearings, street closings, community picnics, and other information of interest in an unobtrusive but effective and timely way.

Chaska is comparable to Newton in land area (about 15 square miles as compared to Newton's 18.3 square miles), but it has a much lower population density with only 22,000 residents compared to the 85,000 people living in Newton. With a population density of fewer than 1,500 people per square mile, Chaska's experience demonstrates the potential for Newton (with a population density of nearly 5,000 residents per square mile) to achieve a much higher level of usage and revenue at comparable costs.

Chaska is just one of the many cities and towns throughout the country are building their own WiFi (802.11b/g) wireless network. Other communities developing municipal wireless networks include Dublin, Ohio; St. Louis, Missouri; Granbury, Texas; Oklahoma City, Oklahoma; Buffalo, New York; Fullerton, California; and Philadelphia, Pennsylvania.

3. Discussion and Recommendations

The cost of setting up an 802.11b/g wireless network in Newton would be a wise investment that would generate significant new revenue for the City, would improve municipal services and emergency communication, would reduce City operating costs, and would provide a valuable new service to Newton residents, businesses, and institutions.

High-range, low-cost WiFi equipment is now available that can be attached to City-owned street lights.

We do not intend in this report to provide a comprehensive implementation plan for Newton's WiFi network —since there is already a City task force working on this project — but we do wish to offer our support for the task force's effort and to make some observations about the expected return of such an investment.

Revenue Generation: The potential revenue from offering wireless Internet access in Newton is considerably higher than that for Chaska at only slightly higher costs, since Newton is only 20% larger in land area and has a population of four times as many residents as Chaska and a higher concentration of computer use. If Newton were to achieve the same 25% participation as Chaska has to date while charging the same amounts for access, there would be approximately 7,500 users generating about \$1.5 million in revenue on an annual basis. However, we believe that a combination of factors (i.e. Chaska is continuing to sign up new users and could achieve a much higher level of participation; Newton's demographic differences, such as higher median household income; and higher concentration of computer use) make Newton's likely participation rate much higher. Also, a multi-tiered pricing model allowing residential use for \$14.99 per month (or less, since lower prices could result in higher participation rates), home business access (at higher connection speeds) for \$29.99 per month, and high-tier business access for \$99.99 per month could potentially generate considerably more revenue. For example, at this pricing structure we could generate \$6.9 million in annual revenue, as shown in Figure 5.

Figure 5. Potential Revenue from Wireless Internet Access Network

Class of Service	Number of users	Fee per month	Annual revenue
Residential	15,000	\$14.99	\$2.7 million
Home business access	5,000	\$29.99	\$1.8 million
Unlimited business access	5,000	\$99.99	\$2.4 million
TOTAL	25,000		\$6.9 million

Costs of Setting Up and Operating Network: Only a portion of this revenue would be available the first year of operation, as users would sign up over time. Since costs would largely be up-front, it would make sense to bond to pay for the purchase and installation of the equipment. While Fullerton paid \$22,000 per square mile for its equipment and Granbury paid \$25,000 per square mile, Chaska achieved a much higher density of coverage by adding more connection points at a cost of \$43,000 per square mile. If Newton uses the same density ratio of Chaska, it would cost approximately \$800,000 for the equipment for Newton’s network. With installation costs and other contingencies, the price of building and implementing high-quality citywide WiFi in Newton would be less than \$1 million. A lower-density network with some open/low-bandwidth spots might cost as little as half this amount to set up. We recommend that the customer service operation be contracted out to a company specializing in this area. The costs of using an outside contractor to handle customer service would depend on the number of users, so this cost would start very small. The smallest portion of the operating cost is likely to be the purchase of bandwidth to connect the network to the Internet. This cost will also vary with the number of users and will start small. We estimate that the annual operating costs of the network will likely start around \$100,000 and will grow only as revenue is generated or we decide to use the network for additional functions, creating substantial savings to local government. As the use of the network grows, operating costs should still not exceed 20% of revenue. For example, in the \$6.9 million revenue scenario discussed above, Airpath Wireless (one of the possible companies with whom we could contract) would charge \$588,000 per year in service fees, less than 10% of the revenue generated.

Cost Savings and Benefits to Municipal Operations: Benefits to residential users of the municipal WiFi service would be numerous. Users would be able to access the Internet in their homes, in parks, in local businesses, elsewhere in the City, and – depending on whether we offer reciprocity with other WiFi communities – even in other cities and towns, airports, and locations on major WiFi networks around the country. But perhaps the greatest benefit would accrue to the City of Newton itself, since many municipal operations could be simplified at considerable cost savings. By using standard wireless connections in laptop computers, for example, Newton police could access information on call locations, could conduct criminal background checks, and could file reports from their vehicles or any other location in the City without the need for expensive specialized equipment. Firefighters could use similar equipment to locate call locations and file reports. With further investment, the Public Works Department could automate water-meter reading, locate faulty parking meters, and improve the management of their operations. Establishing a WiFi Network in Newton has the potential to improve the quality of services to Newton residents and to lower operating costs to the City considerably over time.

4. Implementation and Timetable

We recommend that the City of Newton establish a Citywide wireless Internet access network, as follows:

- a) The network should use the 802.11b/g standard;
- b) The network should be Citywide and used for both municipal government purposes as well as to provide access to the public for a fee;
- c) Pricing should be multi-tiered to allow wide participation for a reasonable user cost;
- d) Funds for building the network should be generated through bonding, since the network will generate more than enough revenue to repay the borrowing costs and otherwise cash-flow considerations could delay implementation;
- e) Customer service, installation, and maintenance should be contracted out to specialist companies, so as not to place an additional burden on City workers;
- f) The City of Newton should maintain ownership and control of the network to keep access fees reasonable and to use the network for governmental purposes, rather than selling the rights to a private entity to put WiFi equipment on city street lights; and
- g) The City should research options for high-bandwidth, low-cost backhaul to lower existing costs and to provide more bandwidth for the network as it grows.

D. Establish a Municipal Power Company⁴

1. Summary

Under state law, municipalities are allowed to form their own electric utilities. If Newton were to form such a utility, electricity costs to Newton residents would be reduced by approximately 20%, and electricity costs to Newton businesses would be reduced by approximately 10%. Since electricity costs currently constitute \$3.5 million of the City budget, the City would save more than \$500,000 per year if costs were lowered by 15%. This savings would grow in future years if energy prices continue to rise. Establishing a municipal power company would also:

- Reduce the number of power outages in Newton,
- Improve repair times when there is an outage,
- Allow the City to invest in alternative power generating technologies that could cut costs further, and
- Improve local ability to select environmentally-friendly electricity-generation sources to reduce pollution and improve sustainability of our energy supply.

⁴ This proposal is both a new service that generates revenue and a cost-saving measure, so it could have been placed in either of two sections of the report. Since it is not expected to have a net impact on the budget in Fiscal Year 2006, its placement in Section II has no effect on the total savings/new revenue calculations referred to in the executive summary.

2. Background and Benchmarks

Forty-one cities and towns around the state have formed their own municipal electric power utilities, providing generally better service at substantially lower cost.

Boston-area municipal electric power utilities include Concord, Belmont, Wellesley, Wakefield, Peabody, Danvers, Marblehead, Norwood, Braintree, Hingham, Hudson, Mansfield, Middleboro, North Attleboro, and Shrewsbury, which charged households a combined 24 percent less than NStar during the 10-year period of 1992 to 2003. For every \$100 charged by NStar, municipal electric power utilities charged \$76 for the same electricity, with better service, including faster response times and fewer power outages.

State law currently allows Massachusetts cities and towns to form municipal electric power utilities, but the process is cumbersome. After an arbitrated value for current electricity infrastructure in the community is determined by the Department of Telecommunications and Energy, the existing electric utility company (NStar in Newton) is not required to sell the assets at the arbitrated price. For this reason, an amendment to the state law has been filed and some communities are considering Home Rule legislation, including the Town of Lexington, which recently filed such a request.

3. Potential Benefits

After acquisition costs of energy infrastructure are amortized, the initial net effect on ratepayers would not be as great in Newton for the first few years as they have been in communities that have had decades to build their energy-delivery infrastructure. For this reason, we can conservatively estimate the following savings:

- a) Newton residential households will save approximately 20% on their electric bills or \$250 per household per year, for a total annual savings of \$8 million.
- b) Newton's more than 3,100 businesses would save approximately 10% on their electricity costs. The reason for the reduced savings rate for businesses is they are currently getting lower rates based on their higher volumes, leaving less room for further rate reductions.
- c) The City of Newton would save approximately 15% of its current \$3.5 million per year in electricity expenses for an annual savings of approximately \$525,000.
- d) Newton residents, businesses, and other institutions would benefit from fewer power outages and quicker repair times.
- e) The Newton Municipal Electric Company would be able to build arrays of solar panels and set up necessary equipment for homeowners, businesses, and institutions in the City with solar panels to sell power back to the grid at times of greater generation than use.
- f) Local control of the power utility would allow new and upgraded power lines and equipment to be placed underground, improving the visual landscape and further reducing outages.
- g) The bulk purchasing ability of the Newton Municipal Electric Company would allow it to negotiate lower rates from power suppliers and to buy larger amounts of green power from environmentally-friendly power generation facilities.

4. Implementation Steps

To implement this plan, the City would acquire NStar's distribution assets (substations, transformers, poles, wires, etc.) at fair market value and finance the purchase by a bond reimbursed by the municipal electric power utility. The municipal electric power utility would do just what NStar does: purchase power on the open market, distribute it to customers, maintain the distribution infrastructure, and provide customer service. Customers of municipal electric power utilities in other communities receive better service than they would from for-profit utilities, such as NStar.

Before proceeding with a proposal to acquire NStar's assets and forming the Newton Municipal Electric Company, the City of Newton should take the following steps:

- a) Newton officials should make a determination in favor of establishing a municipal electric power company.
- b) The City of Newton should file Home Rule legislation similar to that filed by the Town of Lexington and/or support the statewide legislation currently pending before the legislature that would simplify the asset-acquisition process.
- c) The City of Newton should inform the Massachusetts Department of Telecommunications and Energy of its intent to form a municipal power company.
- d) The City should hire an electrical engineering firm to conduct a study of Newton's existing energy infrastructure to determine the fair market value of NStar's assets in Newton and the cost of upgrading existing power generation and transmission equipment to higher standards of reliability.
- e) The City should issue bonds to pay for the acquisition of NStar's assets in Newton and necessary upgrades to that infrastructure. These bonds would be paid in full including interest by the newly formed Newton Municipal Electric Company, such that the borrowing would have no net cost to taxpayers.

Because these steps will likely take a number of months to complete, it is not reasonable to assume any savings during FY2006. With prompt action and favorable regulatory treatment, the savings to Newton government and other ratepayers should begin to be felt in the next few years.

III. Cost Savings

Providing the wide range of services that Newton residents expect from their local government can be expensive. Controlling costs is a complex challenge involving management strategies, core-service evaluation, and ongoing communication to find and take advantage of cost-savings opportunities. Poorly planned cost-control efforts can have the effect of harming employee morale and productivity and actually increasing costs in the long-run. In our Management Steps section, we offer some thoughts on controlling costs in the long-term, but this section looks only at a few areas that we believe are ripe for cost-controlling activities now.

A. Increase Energy Efficiency of City Buildings

1. Introduction

Within the city of Newton there is a tremendous opportunity to realize savings in our energy usage. In the City's FY2005 budget, energy expenses are \$6.5 million. In today's environment, this is expected to increase substantially for FY2006. Within just the School Department, \$5.1 million is budgeted for utilities.

The Newton Citizens Commission on Energy has begun work on making municipal buildings more energy-efficient and has recently completed a draft "Energy Action Plan" for the City. The group has identified approximately \$4 million in investment opportunities that would yield \$1 million in annual savings. For example, by investing \$900,000 to convert to more efficient street lighting, the City can save \$350,000 in annual energy costs. Or, by installing occupancy sensors in City and School buildings, an investment of \$100,000 can yield \$30,000 in annual savings. As energy prices continue to rise, these savings will only increase.

These are not the only opportunities, and the City or the Commission has yet to complete a full-scale energy use audit for all City and School buildings. We believe that many opportunities exist in our school buildings, for example, through investing in temperature control systems or replacing inefficient boilers (the Chief of Operations for the Schools has pointed out that some of the system's boilers run at only 60% efficiency).

2. Discussion and Recommendations

The report of the Newton Citizens Commission on Energy will constitute an important first step in making the City's buildings and facilities more energy-efficient, but much more work remains to be done to realize the full potential of this area. The Finance and Management Working Group recommends that City officials support the work of the Commission and that the City take further action as follows:

- a) The City conduct an audit of all municipally owned facilities to identify other savings opportunities, prioritizing these opportunities based on their return on investment

(ROI) as they are identified. There are a number of approaches to conducting an audit, ranging from contracting with a private firm to working with local utilities. David Tannozzini from the Newton Public Buildings Department suggested to the Working Group that the City may be able to finance these audits through funding from NStar and Keyspan.

- b) The City should evaluate the ROI of the various energy-efficiency measures suggested by the Commission and an energy audit. One example of a project on which work — at least planning — should begin immediately is the retrofitting of City streetlights.
- c) After a list of priority energy-efficiency projects is identified, financing options should be explored. The two major options available are municipal bonding and performance contracting, in which a private entity finances design and implementation for a portion of the savings achieved. The Finance and Management Group generally finds municipal bonding to be preferable, since interest rates are lower, control is maintained locally, and more of the savings accrues to the City, but both options should be evaluated.

3. Implementation and Timeline

Conducting and ROI analysis, planning for street light replacement, examining financing options, and identifying options for conducting the energy audit can all proceed simultaneously. As gas and electricity costs are lowered, the money saved can be used to pay borrowing costs, and additional savings realized can be put back into the operating budget.

B. Reduce Health Insurance Costs

1. Summary

The City currently spends more than \$30 million per year on providing health insurance to City employees and retirees. This cost has increased substantially in recent years. Currently, the City pays 80% of health insurance premiums for both City employees and retirees. This report does not address the policy question of whether the City should continue the practice of paying for 80% of health insurance costs for City employees, since this matter is of necessity subject to negotiation between City management and employee unions. Instead, this section looks at two questions:

- a) Can health care costs be controlled with the same quality of health coverage?
- b) Should the City consider changes to the health benefits offered to retirees?

To find cost savings, we recommend the formation of a Health Care Task Force comprised of industry experts who live in Newton. As for post-retirement health care changes, we estimate that every 5% change in retiree health insurance share of premiums would save the City at least \$640,000 (increasing in future years). For example, changing from an 80/20 split for retirees to a 75/25 split (i.e., the level provided by the Commonwealth and many other cities and towns) would save at least \$640,000 per year.

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Newton is fortunate to count among its residents some of the leaders in the health care industry; we have an impressive pool of expertise to draw upon. We recommend forming a task force consisting of these industry leaders, City officials, and employees to undertake a comprehensive evaluation of health insurance options and potential enhancements.

2. Background and Discussion

The City provides health insurance for City and School System employees and retirees. With total expenditures of more than \$30 million per year, this is one of the largest line items in the City's budget. This is an enormously important and complex component of the City's fiscal operations, and one that is beyond of the resources of the Finance and Management Working Group to evaluate fully. Nevertheless, we think it is useful in this report to provide an overview of the structure of the City's health insurance program and to highlight a looming fiscal issue in the form of post-retirement health benefits and some guidance for further inquiries in this area.

The City currently self-insures most of its health benefits. On a tri-annual basis, the City bids out administrative services among the major health-care insurance providers; the current providers are Tufts and Harvard Pilgrim. These providers generally do not take on any financial risk; they simply review and process claims, which are then sent to the City for direct payment. However, the City purchases "stop-loss insurance" from another provider for any claims in excess of \$200,000.

On an annual basis, aided by a consultant (Group Benefits Strategies), the City sets the annual premium rate for different levels of service based on claims history, administrative charges, and stop-loss insurance charges. These premiums are then paid by the City (and the Schools) and their employees on a co-pay arrangement (currently 80/20). Actual claims and charges will be more or less than these premiums. The City maintains a separate health insurance trust fund where surpluses build up (in the event that actual costs are less than the premium) and are drawn down (if the reverse). The City targets maintaining net fund balances in the Trust Fund of at least two months of premiums.

Once a City employee qualifies for retirement benefits (except for disability cases, this entails a minimum of 10 years of service and a minimum age of 55), s/he qualifies for health insurance coverage on the same co-pay basis as active employees (currently 80/20). After age 65, s/he qualifies for the same coverage on Medicare Part B premiums. Given the age profile of the City's workforce and rising medical costs, these post-retirement health benefits present Newton (and all municipalities) with a very large unfunded liability (similar to the pension funding gap) that will have important fiscal implications in the years ahead. Based on an actuarial study completed in July of 2004, the size of this unfounded liability is \$520 million; however the City (consistent with current practice among other municipalities) is currently funding these costs on a pay-as-you-go basis.

Starting in FY2008, all municipalities and government entities will be required to put a portion of this liability on their balance sheets, unless they begin to make additional payments to amortize this deficit. Provided the City makes these amortization payments into a long-term investment trust, the actuarial re-investment rate would increase substantially, thereby reducing the estimated amount of the long-term liability (by approximately 50%).

This looming post-retirement health liability has some important implications. First of all, we should anticipate the possibility of a significant increase in fiscal outlays in the years ahead if the City chooses to begin making amortization payments on this unfunded liability. Secondly, we recommend exploring benefit changes to reduce the scope of post-retirement health insurance costs. While pension benefits accrue on an incremental basis as a function of years of service and compensation; there is a “cliff” vesting of post-retirement health coverage after only 10 years of service. We recommend exploring an incremental approach here where shorter terms of service require higher levels of co-pay on the part of the individual, say 50%, scaling down to 20% as years of service extend beyond the 10 year minimum.

Another option would be to lower the split for all retirees. Of the \$30.2 million in health insurance costs in the FY2004 budget, \$10.2 million or about a third was for retiree benefits. For each 5% increment that the city/retiree health coverage split is adjusted, the City would save approximately \$640,000.

3. Recommendations

We recommend that City officials take the following steps to control the cost of the growth of the cost of providing health coverage to Newton employees and retirees:

- a) The City should form a Health Care Advisory Task Force consisting of health care industry professionals who live in Newton to examine ways of providing the same or better health care services to Newton employees at lower costs;
- b) City officials should investigate options with regard to reducing Newton's post-retirement health care liability, such as scaling coverage to years of service and adjusting the splits for all retirees; and
- c) City officials should examine the merits of establishing a long-term investment trust to cover some portion of the future health care liability for retirees, thereby reducing the estimated amount of the long-term liability.

C. Expand Recycling Program

1. Summary

For decades, Newton has been a leader in the recycling area, developing its first glass collection program long before most other Massachusetts communities and accepting many types of plastic and paper before other cities and towns. However, in recent years, Newton’s recycling program has failed to grow at as rapid a rate as many programs in other communities. Due to the significant environmental and financial costs of waste disposal, efforts to expand Newton’s recycling program may prove to be cost-effective. Even a 5% increase in recycling could save the City over \$200,000 in trash collection fees and could generate \$65,000 in receipts for the sale of recyclables. If Newton were to achieve recycling rates comparable to Massachusetts cities with highly successful programs and recycle two thirds of our local waste stream, the combined net positive impact on the City’s budget could exceed \$1 million.

2. Background

In FY1995, Newton recycled 43% of our waste stream, one of the best recycling rates in the state at the time according to the Massachusetts Department of Environmental Protection. In calendar year 2001 (the last year for which statewide data are available), Newton's recycling rate had declined to 37%, while most other Massachusetts communities had increased their recycling rates. According to the Newton Public Works Department, our 2004 rate was 43.5%, putting us back to where we were a decade ago. While Newton's recycling rate has remained relatively steady over the past decade, many area communities have succeeded in expanding participation considerably. From 1995 to 2002, recycling rates increased:

- from 52% to 66% in Ashburnham
- from 41% to 50% in Ashfield
- from 22% to 61% in Ayer
- from 25% to 50% in Barre
- from 31% to 46% in Falmouth
- from 22% to 65% in Foxborough
- from 26% to 48% in Harwich
- from 27% to 53% in Lincoln
- from 29% to 57% in Marblehead
- from 37% to 50% in Needham
- from 43% to 53% in Milton
- from 47% to 69% in Sturbridge
- from 25% to 43% in Taunton
- from 41% to 65% in Wellesley
- from 21% to 62% in Westhampton

These communities all had developed recycling programs at the beginning of the time period in question. Communities that began their programs since 1995 predictably saw even greater increases. For example, Yarmouth went from 4% of waste recycled in 1995 to 60% in 2002. The growth of recycling programs comparable to Newton's in recent years shows that further growth of a developed recycling program is possible.

The City of Newton pays \$127 per ton to dispose of 32,497 tons of trash. The City pays a flat rate of \$127,000 per month to have recyclable materials collected and is paid at different rates for these materials. Under our current contract, we are paid \$45.50 per ton for paper, \$67.50 per ton for corrugated cardboard, and \$37.00 per ton for scrap metal.

3. Discussion and Recommendations

For every 5% increase in Newton's recycling rate, the City could save \$206,355 in collection fees (1625 tons at \$127 per ton) and generate \$65,000 in the sale of recyclables (estimated at an average of \$40 per ton). If we could increase our recycling rate by twenty percent to 63.5%, we would save the City's operating budget more than \$1 million and, of course, would have the added benefit of protecting the environment by reducing the amount of waste put in landfills and incinerated. Setting a goal of 60-65% recycling in Newton would not be unreasonable given the high level of environmental consciousness in our community.

To increase residential recycling rates in Newton, we recommend a four-step process:

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- a) Newton should identify five to ten of the most successful recycling programs in the state and find out what they are doing to encourage participation. In some cases, techniques employed by other communities may not be replicable here, but each one should be evaluated for its potential applicability to Newton. In particular, we should ask these communities what they do to publicize their programs, what they do to overcome objections to participation (inconvenience, etc.), and how they manage their programs.
- b) City officials should survey Newton residents about their recycling practices and knowledge. The survey should be designed to learn why some people participate at higher rates than others and what obstacles get in the way of higher rates of participation. For example, we should attempt to learn whether people who use their green bin to recycle plastic and glass know that they can also include metal cans without removing the paper labels. We should find out whether people who recycle green-bin materials also recycle paper and – if so – whether they are including only high-quality office paper or also newspapers and catalogs. We should research whether cutting cardboard boxes into pieces is an obstacle to participation.
- c) Once the evaluation is complete, changes to our program that respond to needs and opportunities identified should be implemented. For example, if Newton residents are not recycling paper because they lack paper bags into which they can place it or find doing so inconvenient, we could provide a separate brown bins for paper recycling. Implementation of changes to the program should reflect both the results of the Newton survey and the best practices in other communities with successful recycling programs. If we find that the most successful recycling programs include financial incentives for participation (such as pay-as-you-through trash collection programs), we should evaluate those options for their appropriateness for implementation in Newton.
- d) As part of the recycling expansion initiative, we should design a comprehensive public information campaign, that addresses obstacles to participation through a coordinated multi-media approach. Television public service announcements, web sites, tax-bill inserts, and other available mechanisms should be employed to address concerns and misconceptions about recycling participation and should promote the benefits to our community.

In addition to expanding Newton's residential recycling program, the City should also investigate the possibility of offering free paper and corrugated cardboard recycling to Newton businesses and institutions. Since many Newton businesses currently pay contractors by weight to have their waste picked up, including their recyclables, they would save money by participating in the City's program. The small incremental cost of making additional stops to pick up paper and cardboard from Newton businesses and institutions would likely pale in comparison to the revenue generated by such a program (\$45.50 per ton for paper, \$67.50 per ton for corrugated cardboard) under the City's current contract.

4. Implementation

Newton has many environmental organizations and volunteer committees that could help with the implementation of this project, defraying the staff time involved in expanding Newton's

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recycling program. The City could also draw on the expertise Newton media and marketing professionals to publicize the initiative. Specifically, we recommend:

- a) Determining which local groups (Green Decade Coalition, Mayor's Advisory Committee on Recycling, Solid Waste Commission, etc.) would be interested in helping with specific parts of this project;
- b) Contacting communities with successful recycling programs (probably defined as over 60% participation) to learn about their strategies and techniques for encouraging participation;
- c) Surveying Newton residents about their recycling practices and knowledge;
- d) Making changes to the current program designed to increase participation;
- e) Publicizing the program, including any recent changes and the value of recycling to Newton; and
- f) Working with the Chamber of Commerce to offer selected recycling services to Newton businesses and institutions.

D. Manage Pension Liabilities

1. Summary and Scope

The City of Newton is responsible for managing a fund that pays pensions to retired Newton employees. The program is a defined-benefit retirement plan with anticipated future benefit payments of \$350 million, while the fund currently has assets of only \$237 million. To make up the gap, the City operating budget must pay not only the current liabilities, but also a portion of future liabilities. In FY2005, these amounts totaled \$9.5 million in operating budget expenses. Over the next decade, annual pension fund payments by the City are expected to grow to \$15.4 million.

To control the future impact of pension liabilities on the City of Newton operating budget, we recommend that steps be taken now, which over time, could save the City approximately \$2 million per year.

2. Background

The City of Newton provides retirement, disability and death benefits to City employees via a defined-benefit plan that is supported by a pension fund with total assets of \$237 million (as of 12/31/04).⁵ Benefits are based on a combination of years of service and compensation. Based on an actuarial study completed in July of 2004, the present value of future anticipated benefit payments is \$350 million, so the pension plan is underfunded by approximately \$113 million (present value of benefit payments minus current value of pension fund). This degree of underfunding, while not desirable, is consistent with the current state of many other public and corporate pension plans in America today.

⁵ Retirement benefits for school teachers and administrators are paid by the Commonwealth and are not a City liability, but other School Department employees, including secretaries and custodians are City responsibilities.

The City's \$9.5 million FY2005 budgeted contribution to the pension system is a combination of payments for current liabilities (approximately \$2.5 million) plus an amortization payment (approximately \$7 million) on past liabilities (the \$113 million funding gap). The City's annual pension contributions are projected to grow to approximately \$15.4 million over the next decade – a 5% annual growth rate.

The amount of the amortization payment is determined by an actuarial study which, among other things, assumes an 8% long term annual net return on the pension fund's assets. The higher the earnings rate, the faster the fund is able to grow and the less the City is forced to pay out of pocket in order to amortize the funding deficit. A lower earnings rate would widen the deficit and require higher amortization payments. A rough estimate indicates that a 1% decline in the fund's long-term earnings rate would increase the City's pension costs by over \$2 million per year.

3. Discussion and Recommendations

Pension benefits for public employees are, for the most part, set by the Commonwealth (Chapter 32B). Clearly, there are some very long-term state wide initiatives that merit consideration, such as a restructuring of pension benefits or a shift to a defined contribution structure (such as a 401k plan) for new hires; however, within the scope of this task force, the primary area of focus needs to be on things that the City controls: the composition/compensation of its workforce and the management of pension assets. The recommendations herein are limited to management of the pension fund.

The pension plan is currently overseen by the Newton Contributory Retirement Board (NCRB) – a five-member board that, with the aid of a pension consulting firm, oversees the management of the \$237 million pension fund. The Fund is currently allocated among approximately a dozen asset managers, as follows:

- Domestic Equity 54%
- International Equity 11%
- Fixed Income 29%
- Real Estate 6%

As of 12/31/04, the Fund's returns were as follows:

- 1-year: 12.8%
- 3-year: 7.1%
- 5-year: 3.7%
- 10-year: 10.7%

These returns generally compare favorably to the Fund's peer group of public funds (29th percentile over the past decade). Nonetheless, given the critical importance of investment returns in determining the City's future funding liability, we believe that the City should explore transfer of the fund's assets to the \$36 billion Pension Reserves Investment Trust ("PRIT"). This Trust is run by the Pension Reserve Investment Board ("PRIM") of Massachusetts and includes pension assets belonging to the state employee and teachers plans, as well as various participating towns, cities, and agencies, including the Massachusetts Water Resources Authority, Massport, City of Brookline, Towns of Wellesley, Dedham, Hingham, and Needham. While PRIM relies entirely on external money managers, it has a deep full time staff and strong roster of pension consultants

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overseeing these managers. The fund is run very efficiently, with total fees and costs of 0.42% of assets under management. More importantly, the PRIT core account is more broadly diversified among alternative asset classes and relies more heavily on passive investing in the public equity and debt markets.

The 12/31/04 PRIT asset allocation is as follows:

- Domestic Equity 35%
- International Equity 16%
- Fixed Income 23%
- Real Estate 7%
- Emerging Markets 6%
- Alternative Investments 6%
- Timber 4%
- Absolute Return 5%

On a comparable basis, the PRIT Core Portfolio returns have been as follows:

- 1-year: 14.02%
- 3-year: 9.19%
- 5-year: 3.84%
- 10-year: 11.16%

While its long-term performance is only slightly better than the City of Newton fund, its shorter term performance is better. Given the diversification of the Trust, depth of full-time professional management and the low cost structure, we believe that there is potential for meaningful out performance in the future.

In addition to the potential for higher returns, there would be some savings in administrative costs as the City would no longer oversee a stand-alone fund nor would it require a dedicated asset allocation and fund management consultant.⁶

While it is impossible to predict future investment results with complete accuracy, we believe PRIT is well-positioned to outperform our current investment strategy. If PRIT outperforms our current strategy by 1% per year, over time that would have a positive impact of approximately \$2 million on the City's operating budget. When that effect begins to be felt will depend upon the relative performance of domestic stocks and bonds to the more diversified PRIT portfolio, so it is not possible to know whether the impact will be felt in FY2007, but it almost certainly would not be felt before then.

If the Newton Retirement Board does not choose to invest some or all of the Newton pension fund in PRIT, it should still re-examine its asset-allocation strategy to reduce risk and maximize returns by:

- a) Diversifying the investment portfolio to rely less on dollar-denominated equities, since the current heavy weighting toward domestic investments makes the overall pension fund highly vulnerable to dollar-depreciation;

⁶ Please see <http://www.mapension.com/prim/InvestmentProgram/CoreDescrip.html> for further detail on the PRIT Core Program.

- b) Diversifying the portfolio to gain greater exposure to alternative asset classes, such as private equity;
- c) Reducing reliance on active managers who charge higher fees and investing a larger portion of the pension assets in passively-managed funds, which have lower fees, since the higher fees of actively-managed funds are often not justified by sufficiently higher rates of return;
- d) Examining the pension fund management strategies of other comparable Massachusetts communities to determine whether there are ideas being implemented that may be applicable to Newton; and
- e) Investigating the possibility of developing a defined-contribution option for new employees that would work in conjunction with Social Security to provide potentially higher pensions at lower long-term cost to the City.

4. Implementation Steps

To implement improvements to Newton's pension fund strategy, we recommend:

- a) City officials ask Newton Retirement Board to examine its asset allocation policies and — in light of those policies — evaluate PRIT as an alternative or supplement to the current approach. If the Retirement Board does not find PRIT to be a sound option, it should find alternative methods of diversifying the portfolio and reducing reliance on active managers.
- b) The City should benchmark what other comparable Massachusetts communities are doing to manage their pension liability and evaluate strategies being considered in other cities and towns.
- c) Newton officials should work with their peers in other communities, as well as state officials, to examine the possibility of offering employees a defined-contribution plan integrated with Social Security as an alternative to the current defined-benefit plan.

E. Conduct Asset-Management Audit

1. Summary

The City of Newton owns and manages hundreds of millions of dollars worth of assets that are essential to providing services to Newton residents. While it is far beyond the scope of this report to provide a comprehensive analysis of all of the City's classes of assets, we are prepared to offer some input into ways of maximizing revenue and minimizing costs regarding some of the City's major classes of assets. This section offers some thoughts on the City's real estate, auto fleet, and computers.

2. Real Estate

On the revenue side, we believe that there is an opportunity to generate rental income through the systematic leasing of rooftops, water towers and other appropriate structures to cellular phone providers. The city currently leases four antennae in the cupola of City Hall for an annual rent of approximately \$45,000 each (nearly \$200,000 per year!); however, we believe that these are

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currently the only such leases in the City's real estate portfolio.⁷ There clearly is an opportunity to generate significant additional annual income from the leasing of other City-owned structures and rooftops.

On the management side, we recommend that the City undertake a systematic review of each parcel of City-owned property, so that it can create a detailed map that identifies each parcel and a database that includes all pertinent information on each parcel. With this database in hand, the City should then develop a strategic plan for excess (or potentially excess) property that would include an identified highest and best use and a time frame for executing the strategic plan relative to such parcel.

As part of this systematic review, we suggest that the City develop a maintenance plan for each parcel and conduct a financing analysis for maintaining the value of City buildings. Specifically, in cases where maintenance has been deferred due to lack of availability of capital funds in the City's operating budget, we suggest that a needs analysis be conducted and that the viability of issuing bonds to repair and upgrade the building be conducted. In many cases, there may be a long-term savings to the operating budget if maintenance problems are addressed now through borrowing, since the cost of paying back the principal and interest may be less on an actuarial basis than the cost of fixing the problems after they have compounded over time.

3. Auto Fleet

We recommend that the City undertake a top-town review of its auto fleet and its personnel policies relating to auto use. Specifically, the City should identify which positions in City government merit use of vehicle on a 24/7 basis and which positions require access to a motor pool during working hours. For motor pool vehicles, the City should undertake a demand study based on the requirements of various departments and individuals utilizing the pool. Based on this survey, the City's auto fleet should be sized and managed accordingly.

As part of this review, City officials should compare the ongoing maintenance cost of older vehicles to the amortized acquisition cost of newer vehicles. It is possible to reach a point of diminishing returns at which it is less costly to replace an older vehicle than it is to continue to repair it.

4. Computers

Prudent management of technology assets can lower acquisition, maintenance, and energy costs and can increase productivity. We recommend that the City examine:

- a) **Consolidation of servers:** The City currently maintains a large number of servers in multiple departments, including 68 in the schools. These servers require special operating environments, are expensive to maintain, and consume considerable amounts of electricity. With newer models equipped with larger hard drives, faster processors, and more memory, it may be possible to substantially reduce the number of servers needed.

⁷ The City also receives personal property tax payments on the leased equipment as an additional revenue source, over and above the rental payments

- b) **Leasing options:** Most computers used by the City, including the School Department, are purchased rather than leased. We recommend that the City conduct an analysis of computer acquisition, maintenance, and upgrade costs to determine whether leasing computers may be more cost-effective in some cases.
- c) **Switching to browser-based applications where possible:** Uniform cross-platform compatible browser-based applications can reduce software maintenance costs, installation problems, and down-time and may have the effect of allowing greater flexibility in types of computers used. Licensing of browser-based software can dramatically reduce the number of seats (copies of the software) required, since not every installed copy on a client computer is necessarily needed or used simultaneously. We recommend that available browser- or Web-based applications be explored.

5. Summary of Recommendations

In order to better manage existing assets, we recommend that the City:

- a) Develop a comprehensive inventory of locations on City buildings at which wireless telecommunications antennas can be installed by private companies for an ongoing rental fee to the City;
- b) Conduct a systematic review of city-owned property, including maintenance needs and best use for meeting core City needs and objectives;
- c) Determine which City positions require 24-hour use of City vehicles and which can make use of a shared fleet and develop a vehicle fleet management plan accordingly; and
- d) Examine available computer management options, including consolidation of servers, leasing computers, and switching to browser-based applications.

IV. Management Steps

A. Institute Benchmarking Procedures

1. Summary and Scope

The scope of a benchmarking project would be to compare the overall Newton budget and school budget to those of between 5 and 10 comparable cities and townships in the area (i.e., similar demographics, quality of school systems, etc.) to highlight significant areas of difference. These variations would be investigated in depth with an aim toward identifying best practices that could be adopted by the City to provide savings.

2. Background

It is common practice in the private sector to conduct benchmarking exercises to ensure revenue and spending practices are optimized and efficient. The insights derived from benchmarking are invaluable in financial planning and cost control. Without them, an organization tends to get trapped into inbred thinking and incremental progress rather than taking advantage of the best thinking and best practices available in the marketplace. There will invariably be differences in the way organizations choose to invest their resources, but any particularly high or low levels of investment should be made consciously within the context of vision and strategic objectives, not blindly out of ignorance.

3. Possible Steps

To begin a benchmarking review, we recommend that City officials:

- a) Identify 5 to 10 cities and townships as comparables (benchmarking group);
- b) Ideally, enlist a representative from each of the comparables in the benchmarking group to facilitate information sharing (The reward for active participation is to be provided with the results of the benchmarking exercise.);
- c) Obtain budgets and data from all comparables including both financial and non-financial metrics (such as population, percent of residents who have school-age children, ratios of teachers to administration, etc.);
- d) Prepare analyses on comparables (“apples to apples”) a best as possible (Often it is difficult to do this because different organizations categorize and classify differently.) – seek clarification and make adjustments where necessary;
- e) Based on results of comparisons, highlight key areas of difference; and
- f) Meet with representatives from comparables to research whether variances stem from accounting mismatches, endemic causes, or fundamental differences in approaches (which could be the discovery of best practices).

Results should be reported with focus in three areas:

- a) Differences driven by demographics or other identifiable causes (e.g., higher proportion of older residents in one city vs. another);
- b) Differences driven by choices Newton has made (consciously or otherwise) vs. others to provide a higher or lower level of services (e.g., no difference in demographics or in efficiency); and
- c) Differences in efficiency based on practices followed or other causes (i.e., preventive maintenance, etc.).

In some cases it will be difficult to categorize among the above areas (for example, average teacher pay) but in any case, the results would be of interest.

4. Implementation and Timing

How fast a benchmarking exercise could be done would be based on the extent to which we could enlist support from interested people. One person could probably do the whole thing individually over the course of three to four months, but it would move the process along more quickly to have a larger group working on it.

We recommend:

- a) The formation of a Newton Benchmarking Task Force consisting of Newton residents to conduct a full benchmarking process for the current fiscal year;
- b) The integration of ongoing benchmarking practices into the operation of city departments; and
- c) That a benchmarking section comparing Newton costs and revenues to those of other communities be added to the City operating budget starting with FY2007.

B. Establish Chief Financial Officer Position

1. Introduction

For intermediate to longer-term financial benefit, as well as best management practices, the City might review its financial organization and management structure and consider hiring a chief financial officer. There are currently a number of competent and capable individuals heading financial functions. We have come to learn that these individuals work together as needed and seem to have good working relations, and we applaud these very important grassroots practices. However, with no formal mechanism to pull together people and activity from various financial functions, and no formal position to oversee financial issues as they arise, the City is missing a key management function that otherwise could provide flexibility, help achieve cost control across the City and optimize decision making regarding ongoing capital/ financing.

2. Discussion and Recommendations

The appropriate candidate in this position should be able to find funds to cover the cost of the position within the existing operating budget, either by effecting cost savings or increasing

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revenues. As an example, if changes are implemented in the Comptroller's and Treasurer's departments that allow cash to be invested sooner, investment earnings will increase accordingly: An increase of \$5 million in average invested cash throughout the year, earning 3% interest, generates an additional \$150,000. On the cost side, cost savings could be identified within the operating budget, at least equivalent to the cost of this position: Any business with the size and scope of Newton's operating budget has opportunity, with review of expenses and contracts across operating departments, to address some amount of cost savings.

All the reasons why a CFO-type role (or Director of Finance, however titled) is useful has already been reviewed and written, both in private sector and more recently in government financial resources. With a total budget of over \$250 million, many pending or ongoing capital decisions, and no one person with oversight for all financial activities, the City of Newton is at risk for all of these:

- a) Potential lack of cost control across city departments: A CFO provides a mechanism for coordination of certain activity with financial ramifications, as well as for regular review of financial aspects of operations that affect the whole organization;
- b) Inefficiencies from operations resulting from use of both centralized and decentralized processing that may not be optimally configured;
- c) Internal control deficiencies that no one notices until too late because no one has sufficient full scope and top-side orientation to financial activities;
- d) Inefficiencies across financial departments or functions within operating departments: Lack of coordination among financial personnel, for example, can affect cost control over salaries of financial personnel across the City. Some form of common management over financial staff can allow for cross-department promotions that control costs of positions that should be lower paying, allow for cross training, and for interdepartmental resorting.
- e) Missed revenue enhancements from activity falling through the cracks or not even identified: Our ongoing programs to address PILOT might be considered an example of revenue potential. Programs for coordination with other local governments and revenue enhancements such as 'pay-as-you throw' are other examples where a CFO might pull together resources across departments to develop a new program.
- f) Missed opportunities to analyze operating or capital projects as they arise and assess the most beneficial funding source: Alternately, such projects are analyzed by individuals who are either diverted from the job/task the City needs them to manage, or by individuals without the contacts or resources to optimally address the project and time is wasted.

The complexity of Newton's operations demands a high-level leader, just as in the general business world. The position could be structured with sufficient internal control mechanisms. There are several models for how this might work, and a small task force commissioned jointly by the Mayor's Office and Aldermen could be useful to fully lay out the optimal approach for Newton.

It is worth noting that along with changes in professional management and accounting standards, there may come a time when the City might also require a compliance officer, or internal control function, as well. Public entities are increasingly being challenged to maintain an appropriate

internal control environment. There is currently a myriad of resources and current industry information pertaining to fiscal management of local government entities, and this recommendation is made in view of this developing industry guidance.

C. Review Financial Functions and Practices

1. Introduction

Financial functions throughout the City, including both staff positions and the technology that supports accounting activity, should be reviewed to identify opportunities for streamlining or upgrading. Doing so would provide intermediate to longer-term cost savings as well as greater flexibility to address unexpected or ad hoc matters. Newton has several central financial departments that are not jointly supervised, as well as decentralized financial personnel reporting into several operating departments. With no formal oversight and long-time hires in decentralized roles, there may even be opportunities to obtain staffing efficiencies with such a review.

2. Discussion and Recommendations

Specific areas for review of financial related operations that might produce either cost savings or time for addressing new revenue sources could include:

- a) The city has a number of remotely maintained cash accounts as well as the centralized cash management activity. Either internal control or standard accounting practices can be compromised or inefficient without sufficient guidance by trained financial professionals on an ongoing basis. Both the timeliness of making some deposits and their reporting (into central staff) has caused some problems with reconciliations, indicating a review of processes is due.
- b) Procedures for online payments are being implemented in Newton. There may also be opportunity to maximize cash flow even for payments not made online. By coordinating with commercial banks that handle bill payments for the public, Newton could receive faster payment by wires rather than manual check payments.
- c) Procedures for recording cash in the general ledger and subsidiary cash registers could be reviewed with a few objectives in mind:
 - i) Reconciliation processes have apparently been problematic for some years, from time to time either too time consuming or not timely reconciled; recording transactions in one master general ledger “cash” account in combination with the myriad of posting sources is probably inherently prone to reconciliation problems that could be overcome by a few changes to processes (computer and people related).
 - ii) In addition to redundancy, there are currently gaps in recording such that some transactions are recorded in either the general ledger or the subsidiary cash ledger (in QuickBooks) but not both, thus causing reconciliation problems. Gaps in posting to one or the other also suggest the possibility that cash is not recording in either until the time-consuming reconciliations are done.

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- iii) Non-centralized processes (either computerized or people related) might be revised, even in small ways, to achieve a more efficient operation and allow cash to be posted into the general ledger or subsidiary records on a timely basis. As an example, currently, the Treasurer's Office does not always receive complete information about a receipt and thus is not able to reflect it in the records immediately. All cash receipt sources should be reviewed for systemic problems with daily depositing and communications; these problems can usually be altered easily enough: It might mean moving some processing to decentralized locations or revising transmittal forms, to give some examples.

A related issue is the reporting structure for financial functions. At a minimum, decentralized financial personnel should have dotted-line reporting relationship to the centralized financial organization. Coordinated financial oversight for the City, such as inherent with the CFO position, would provide a natural structure for coordination of financial functions. Without that structure, the City could still implement some formal authority over the site-based financial activity which might benefit internal control and facilitate better management.

Currently, remote processing of some departments' invoices and payroll uses some decentralized staff for efficient operations. These are standard business practices, with data entered at a remote location and transmitted back to central location for payment. However, some departments such as the Library and Parks & Recreation have both a "bookkeeper" position and a payroll position – paid salaries of \$45,000 to \$50,000. Depending on what the individuals do, these may be high for accounting assistant functions. Savings might be possible if the remote functions were handled as service positions for the operating department but were also integrated with functions of the overall financial operation.

3. Implementation

The recommendations here are not based on a full study of central and remote financial operations. However, discussions with various City/School staff indicate we might obtain efficiencies from reviewing financial operations. Specific task forces could be implemented to assist with such a project.

D. Implement Strategic Planning and Comprehensive Budget Practices

1. Introduction

Strategic planning provides a longer term focus for general decision making and a framework for ongoing capital financing and budgetary matters. It has been widely used as a key management tool in the private sector for many years, and well-run not-for-profits are also developing strategic plans to guide their operations. Newton currently does not budget most capital expenditures, relying instead on an underfunded, antiquated "Capital Improvement Plan" that does not have a funding mechanism. Also, Newton does not put together multi-year financial forecasts. In addition, the City does not include all line items of expense in its budget, preferring instead to fund some expenses from what is referred to as "Free and Clear Cash." "Free Cash" is not a reliable source of funding, however, for necessary expenditures.

2. Discussion and Recommendations

The City should review its practices for budgeting of expenditures and revenues so that annual budget and forecasting reports encompass all items of income and expense within their appropriate line items, and that capital budgeting is fully implemented. Government budgeting standards are similar to standards for profit and other not-for-profit operations with respect to best practices for budgeting and forecasting. The complete use of standard budgeting practices will allow City finances to be fully understood, will provide the foundation for full management controls over expenditures, and can facilitate additional action necessary to address capital projects.

We recommend the City implement a strategic planning process. This March, the Government Finance Officers Association (GFOA) approved a **Recommended Practice on the Establishment of Strategic Plans (2005) (BUDGET)**. It calls for “governmental entities [to] use some form of strategic planning to provide a long-term perspective for service delivery and budgeting, thus establishing logical links between authorized spending and broad organizational goals.”⁸

Accomplishing a strategic plan can allow the City leaders to optimize decisions on competing projects or unexpected issues. A longer-term plan provides guidance for capital decision-making, including tolerance for debt financing, which is a growing concern. The City is underutilizing its bonding capacity and can leverage its excellent credit to invest in infrastructure and other capital needs. A complete review of Newton's borrowing plan should be conducted in conjunction with capital planning. Developing an effective Strategic Plan may demand the services of a consultant to guide the process and coordinate input from the Mayor's Office, the Aldermen, department leads, and perhaps the community.

Along with the critical, up-front tasks for goal setting, implementation of an adequate strategic plan will require preparing and maintaining forecasts to project financial results for longer time periods, with more flexibility than that available in a full annual budget process. Five-year forecasts would typically be prepared in conjunction with implementing a strategic plan. Performing adequate longer-term financial modeling requires identifying “key drivers” and developing a methodology for modeling to use key drivers to project financial results without preparation of a detailed budget. Forecasting financial results is critical to management's ability to look ahead and consider alternate outcomes – inherent components of strategic planning. With an annual operating budget of \$250 million, a myriad of possible upcoming capital projects, and a community comprised of competent professional business managers, managing this City demands appropriate planning and forecasting tools.

Specifically, we recommend that City officials include a funding plan for capital expenditures as part of the City's operating budget rather than relying on free cash for the majority of the City's capital needs. We also recommend that the City immediately begin a strategic-planning process that includes five-year financial forecasts so that future budget problems can be anticipated and avoided.

⁸ For the full text see <http://www.gfoa.org/services/rp/documents/StrategicPlanningRPOrlando.pdf> .

E. Establish a Citizen Budget Advisory/Audit Committee

As the City moves to implement the priority recommendations in this report, as well as other finance and management-related initiatives, we believe that citizen input and involvement should be institutionalized through the creation of a Citizen Financial Advisory Committee (CFAC). The CFAC would consist of Newton residents with expertise in relevant disciplines, such as management, consulting, accounting, and investment management. The CAC would work with City officials and staff to facilitate benchmarking, strategic planning, implementation of identified initiatives, and identification of new opportunities to improve the efficiency and effectiveness of City operations.

V. Acknowledgements

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