A Publication of
the Massachusetts
Department of Revenue's
Division of Local Services

City & Town

Supporting a Commonwealth of Communities

Christopher C. Harding, Commissioner • Sean R. Cronin, Senior Deputy Commissioner of Local Services

DLS
DIVISION OF LOCAL SERVICES
MA DEPARTMENT OF REVENUE

March 7th, 2019

In this issue:

Important Dates & Information

Bulletin 2019-1: FY2020 Budget Issues and Other Related Matters

The Division of Local Services has posted Bulletin 2019-1: *FY2020 Budget Issues and Other Related Matters* to its 2019 Bulletins page. This Bulletin addresses several issues that cities, towns, regional school and other districts should consider for

Area of Fiscal Stress: Pension Assessments

Theo Kalivas - Technical Assistance Bureau Project Manager
Tony Rassias - Bureau of Accounts Deputy Director

From their beginnings in the early 20th century, Massachusetts public pensions were funded on a "pay-as-you-go" basis. As employees retired, their retirement benefits were paid from current worker contributions plus the employers' contribution that was included in the annual local government's budget.

Due to increased benefits, low investment yields, the drop in asset value and other factors, annual pension costs increased. But because pension costs were pay-as-you-go, no current funding was being set aside for the retirement benefits employees were accruing yearly throughout their employment. This created a large "funding gap," or unfunded liability, leaving retirement systems at risk of shortfalls or even insolvency.

To address this gap and provide fiscal stability to retirement systems, Massachusetts passed pension system funding reform legislation in 1987 that included a mandated pension funding schedule on an actuarial basis which included an amortized payment of a system's unfunded liability by 2028 (see G.L. c. 32, §22D).

The 2028 timeframe was reportedly working as planned until the Great Recession of 2007 created a nightmare in the capital markets. After the crash, asset values plummeted causing large increases in liabilities.

From the Public Employee Retirement Administration Commission's (PERAC) 2008 Annual Report:

After a year when the typical public retirement system is likely to have suffered a loss in the range of 25-27%, perhaps the one thing we can say with confidence is that it is finally over and we very unlikely to experience another year like 2008. Bear markets have happened before and they will occur again, but investors should not lose sight of the fact that their strategies and goals are long-term in nature.

Recognizing these financial losses, Massachusetts passed pension reform legislation in 2009 that included an extended

FY2020 budgets and other related matters.

BLA to Host Informational Workshops

The Bureau of Local Assessment (BLA) will conduct three regional workshops and a webinar in March and April highlighting various topics including updates to the Certification Standards IGR, what to expect if in certification this year, improving New Growth review, interim year review, FY20 State-Owned Land review, and an update on reviewing the utility class - use code 504. Advanced registration is required for all workshops including the webinar.

Danvers - March 20, 2019
Danvers Town Hall
1 Sylvia St., Danvers
10am - Noon

Shrewsbury - April 2, 2019
Shewsbury Town Hall
100 Maple Ave, Shrewsbury
10am - Noon

Sandwich - April 10, 2019
34 Quaker Meeting House Road, Sandwich
10am - Noon

Webinar - April 17, 2019
Test link: https://zoom.us/test

Please email your site choice, name, community, email address, and phone number to bladata@dor.state.ma.us.

The Massachusetts Association of Assessing Officers (MAAO) will grant

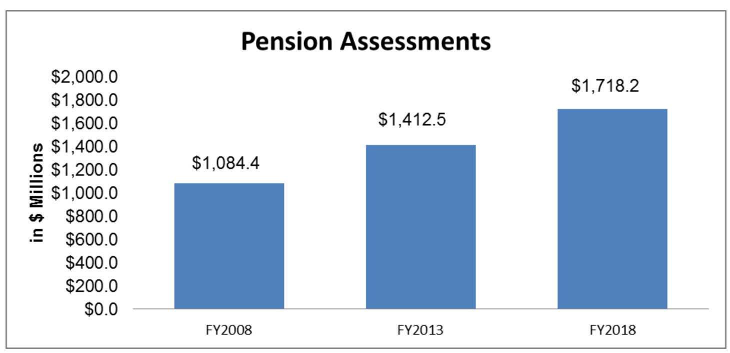
amortization deadline of the unfunded liability until 2030 and then passed municipal relief legislation in 2010 that included another extension of the deadline until 2040 (see G.L. c. 32, §22F).

The Cost of Municipal Pension Assessments

Due to increasing pension costs, government leaders nationwide face fiscal challenges providing necessary governmental services while trying to meet pension obligations. Pension costs rely on three major sources of revenue: investment earnings, employer contribution, and employee contribution. When a system has an unfunded liability and a revenue source falls short, other revenues must be increased for the system to be adequately funded or the system's unfunded liability will grow.

In Massachusetts, the municipal pension cost is an assessment by the retirement system upon the participating local governments and therefore must be provided for in the government's annual operating budget either by appropriation or by including an amount without appropriation in the next tax levy. (G.L. c. 32, §22) Retirement systems in other states that do not require such an amount to be raised may leave them short of their required contribution with a growing unfunded liability.

The following graph shows the growth in total municipal pension assessments included in municipal budgets for 99 Massachusetts retirement systems for three fiscal periods. The graph shows that these assessments have increased from FY2008 to FY2018 by about $634 million (58.4%).



Common Fiscal Metrics for Retirement Systems

Category Two of the DLS Municipal Finance Trend Dashboard focuses on four common fiscal metrics that can help assess whether a retirement system is fiscally healthy. These include the Funded Ratio, the Unfunded Liability, the Funding Schedule and the Assumed Rate of Return.

The Funded Ratio

The funded ratio is the total value of a plan's assets weighed against its accrued liabilities as of its last valuation date. It *two (2) continuing education credits to assessors attending the Local Assessment Workshops.*

OSD: Latest Issue of *Buy the Way* Now Available

Don't miss the February 2019 edition of *Buy the Way*, the monthly Newsletter of the Operational Services Division (OSD).

Click here to get news and updates from OSD delivered to your inbox.

Other DLS Links:

Local Officials Directory

Municipal Databank

Information Guideline Releases (IGRs)

Bulletins

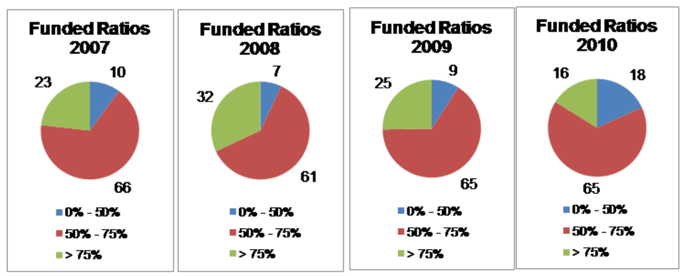
Publications & Training Center

Tools and Financial Calculators

indicates the extent to which assets cover system liabilities. A system with a greater funded ratio is considered a stronger system.

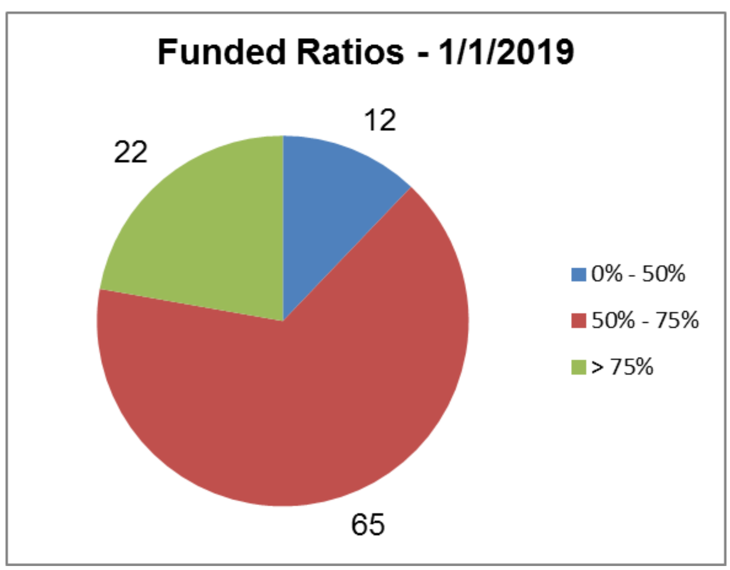
The value of assets and their investment earnings are major factors in a funded ratio. Retirement systems allocate the investment of their assets in cash, domestic and international equities and other areas as advised by their investment strategist. However, an asset portfolio dependent upon the capital markets always carries a risk of value and revenue loss which then negatively affects the system's funded ratio.

The following charts illustrate the funded ratio status of all municipal systems for fiscal periods immediately before, during, and immediately after the Great Recession.



Note from the above charts that as new valuations were performed by the retirement systems, more systems entered the 0% to 50% category after the Great Recession (10 before, 18 after) as well as exited the > 75% category (23 before, 16 after).

PERAC data as of January 1, 2019 illustrates the current funded ratio status of systems. The detail shows a median funded ratio of 64.4% and funded ratios ranging from 27% to 94.7% when using valuation dates between 1/1/16 and 1/1/18.



Of the 12 systems currently funded at < 50%, 10 systems were in the same category in 2010. Of these 10 systems, 6 have a lesser funded ratio today than in 2010 reflecting their difficulty returning from economic losses suffered during the Great Recession. However, the number of systems where the funded ratio is > 75% has increased from 16 in 2010 to 22 today.

The Unfunded Liability

Projecting future pension costs requires an actuarial look at future demographic and economic events such as investment returns, the number of workers, retirees, life expectancy, wage and benefit growth, inflation, and the value of invested assets.

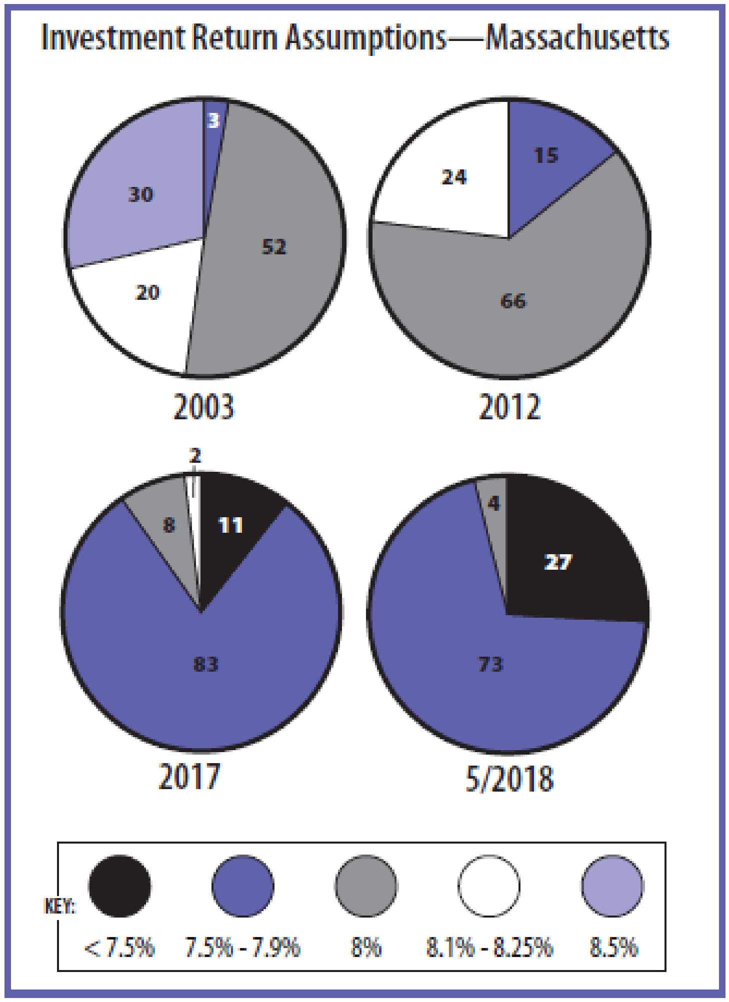
On an actuarial basis, these factors show an unfunded liability estimated at over $1 trillion nationwide. In 2017, PERAC reported the unfunded liability for 99 Massachusetts cities, towns, and regional school districts at over $15.6 billion.

The Unfunded Liability for Massachusetts Municipal Retirement Systems (in $ billions)			
	Funding Gap	$ inc (dec)	% inc (dec)
FY2007	$9,620.9		
FY2012	$14,738.1	$5,117.2	53.2
FY2017	$15,608.3	$870.2	5.9
FY2007 to FY2017		$5,987.4	62.2

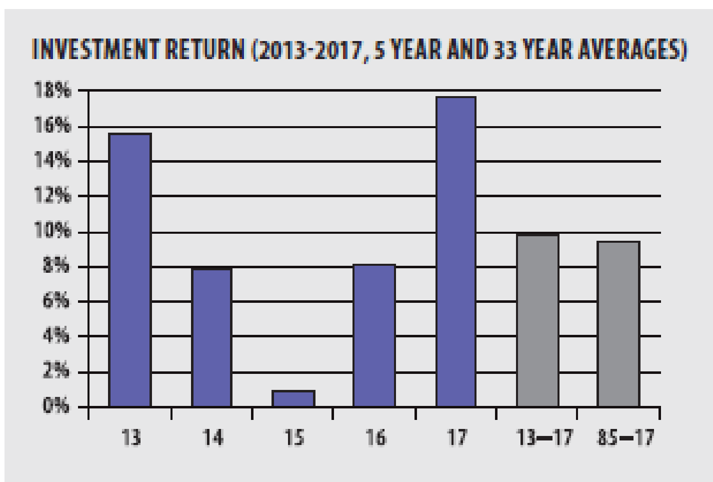
The Assumed Rate of Return (ARR)

A major component in a retirement system's projected asset growth is its ARR because of the importance of investment earnings to the system. The ARR is chosen by the retirement system and should represent the long-term rate of return based upon a retirement system's investment policy. A higher ARR results in a greater projected asset growth of the system's portfolio, a lesser plan liability, and a lesser required local contribution. Conversely, a lower ARR results in a lesser projected asset growth of the system's portfolio, a greater plan liability, and a greater required local contribution.

The following chart to shows investment return assumptions for certain years beginning in 2003. Note from these charts that 50 systems had ARRs greater than 8% in 2003, while in May 2018 there were zero. Also note that 52 systems had ARRs of 8% in 2003, while in May 2018 there were only 4.



The chart below shows the composite rate of return for all systems within PERAC's oversight. Note that the rate in 2015 (0.91%) was significantly lower than in FY2017 (17.63%).



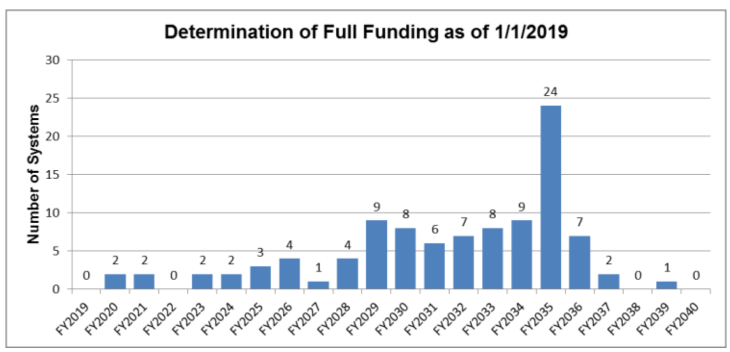
Reductions in ARRs by Massachusetts systems have followed a similar nationwide trend by other retirement systems over this time period taking into consideration capital market conditions and local option for more conservative assumptions.

The Funding Schedule

Under state law, the unfunded actuarial liability (UAL) must be $0 no later than by year 2040, but local retirement boards may adopt an earlier target date. When the UAL reaches $0, the system is said to be fully funded after which appropriations are only required to cover the Normal Cost (*Normal Costs represent that portion of the Actuarial Present Value of pension plan benefits, which is to be paid in a single fiscal year*) provided that the system's full funding status is maintained, which is not guaranteed. Actuarial and investment losses, changes in plan provisions, and/or assumption changes can increase UAL, or even return a fully funded retirement system to partial funding status.

However, once full funding is achieved, maintaining a strong investment with minimal plan changes may reduce that portion of the pension's assessment once used to fund the gap, allowing those funds to be used by the local government in other ways.

The following graph illustrates PERAC's data on when Massachusetts retirement systems will reach full funding which is based on the Retirement Board's most recent valuation date. Note that as of January 1, 2019, only four systems are expected to be fully funded prior to FY2023 and also that FY2035 is the most common date.



Suggestions to Achieve Full Funding

If actuarial costing, Level Cost Allocation Models, the Actuarial Standards of Practice 44 concept and the layered fixed period amortization practice aren't exactly your areas of expertise, we contacted several local officials from retirement systems ready to reach full funding and asked, "How'd you do it?" Here are their suggestions.

- Work closely with your retirement board
- Get a commitment from the executive authority
- Get a commitment from the Finance Committee
- Determine a timeframe for full funding and stick to the plan

- Invest in the Pension Reserves Investment Trust Fund
- Hire and listen to a competent investment consultant
- Listen to PERAC's advice
- Consider the cost of adding new or increased benefits
- If time is getting close, develop a policy for what to do after reaching full funding
- Be realistic when determining a discount rate
- Consider privatizing certain services
- Appropriate into the system additional reserves not needed for operations or capital
- Find ways to reduce future risks
- Shorten the horizon

Additional Resources and Suggestions

Achieving and maintaining full funding is a delicate balance involving a number of factors, some controllable (assumed rates of return and employer/employee contributions), and others uncontrollable (the national or state economy and capital markets). Through their education sessions and publications, PERAC provides recommendations on assumptions, funding strategies, and funding measures retirement systems should employ to better manage their pension obligations.

In its "white paper" report on Actuarial Funding Policies and Practices for Public Pension Plans dated October 2014, the Conference of Consulting Actuaries Public Plans Community (CCA PPC) offered information on the principal elements of an actuarial funding policy.

Conclusion

It is, of course, unknown at this time whether any retirement system will meet its full funding schedule or not. But closely analyzing and monitoring investment positions, listening to professional advice and considering the example of systems well on their way to full funding are ideas to keep in mind. To see our previous article in the fiscal stress series on diminishing reserves, click here.

(DLS would like to thank the local officials from across the Commonwealth involved in the development of this article for their insights, guidance and information.)

Ask DLS: Regulating and Insuring Short-term Rentals

This month's *Ask DLS* features part two of frequently asked questions about “An Act Regulating and Insuring Short-term Rentals”, c. 337 of the Acts of 2018, signed by Governor Baker on December 28, 2018. The Act adds short-term rentals to the room occupancy excise under G.L. c. 64G and includes other new provisions of interest to municipal officials. To review part one of the FAQ series regarding the local option room occupancy excise, please refer to the February 7, 2019 edition of *City & Town*. Please let us know if you have other areas of interest or send a question to cityandtown@dor.state.ma.us. We would like to hear from you.

Did the new law provide for other options for cities and towns in addition to the local option room occupancy excise?

Yes, if a city/town has adopted the local room occupancy excise under G.L. c. 64G, § 3A, it may adopt a local option community impact fee of up to 3% of rent regarding transfers of occupancies of two categories of short-term rentals described below. G.L. c. 64G, § 3D. (St. 2018, c. 337, § 6.) If a community has not adopted a local room occupancy excise, it cannot adopt a local option community impact fee. A separate acceptance vote is required to adopt each local option community impact fee. The acceptance procedure is the same as required for accepting the local option room occupancy excise. (See the February 7, 2019 edition of *City & Town* for procedure.)

The first local option impact fee is adopted under G.L. c. 64G, § 3D(a) and applies to each transfer of occupancy of a “professionally managed unit,” which is defined as one of two or more short-term rental units in same city/town not located within a single- or two- or three-family dwelling that includes the operator’s (owner’s) primary residence. The fee applies to transfers of occupancies on or after July 1, 2019 for which a rental contract was entered into on or after January 1, 2019. It does not apply to occupancies for which the rental contract was entered into before January 1, 2019. For example, if a summer vacation rental was booked last summer (or at any time before January 1, 2019), the local option impact fee will not apply.

If the city/town has adopted the local community option impact fee (described in the previous paragraph) under G.L. c. 64G, § 3D(a), it may also, by a separate additional vote under G.L. c. 64G, § 3D(b), impose the impact fee on short-term rental units located within a two- or three-family dwelling that includes operator’s primary residence. The impact fee will, again, apply only to transfers of occupancies on or after July 1, 2019 for which a contract was entered into on or after

January 1, 2019.

The DLS Municipal Databank must be notified when the community adopts the local option impact fee by completing the notification of acceptance form found here.

Who collects the local option community impact fee?

Unlike the local room occupancy excise which is paid by the operator to DOR, the local option community impact fee is paid monthly by the operator directly to the city/town. Note that legislation is currently pending to change this so that the collection is through the Department of Revenue for distribution to the cities and towns, similar to collection of the local option room occupancy excise. H. 74, filed January 31, 2019.

Are there any restrictions on how a municipality spends these funds?

The revenue from the local room occupancy excise is general fund revenue and may be appropriated by the city/town's legislative body for any municipal purpose. The revenue from the local option community impact fee, however, is partially restricted. Thirty-five percent (35%) of the impact fee must be dedicated to affordable housing or local infrastructure projects. G.L. c. 64G, § 3D(c). As a result, thirty-five percent (35%) of the local option community impact fee revenue must be accounted for as a "receipts reserved for appropriation" account for affordable housing or local infrastructure projects. A legislative body vote will be required to appropriate these funds for either affordable housing or local infrastructure projects. The balance of the local option impact fee, the remaining 65%, will be general fund revenue of the city/town and may be appropriated for any municipal purpose. However, the city or town may, by legislative body vote, dedicate more than the required 35%, up to 100% of the impact fees to affordable housing or local infrastructure projects. In that case, the increased percentage of the revenue from the impact fee will be credited to the receipts reserved for appropriation account. Any amount not so dedicated will be general fund revenue. A city or town's legislative body vote regarding a dedication in excess of the required 35% will be effective on the July 1 following the vote and apply until a subsequent legislative body vote changes the percentage which would then become effective the next following July 1 after that vote.

"A local infrastructure project" is a capital project for which a community could borrow. For example, the legislative body could appropriate from the receipts reserved for appropriation account to fund the acquisition of a fire truck or to fund road improvements, but not to fund the payment of debt service.

May a city/town adopt a local by-law or ordinance regarding short-term rentals?

Yes, under the new G.L. c. 64G, § 14, a city/town may adopt an ordinance or by-law to regulate operators registered with DOR. Operators are defined under G.L. c. 64G, § 1 as "a person operating a bed and breakfast establishment, hotel, lodging house, short-term rental or motel in the commonwealth …." We suggest that cities and towns work with their local counsel if they wish to adopt a local by-law or ordinance.

How can a city or town obtain a list of establishments who are registered with DOR?

A list of establishments who are registered with DOR is available through the DLS Databank on request. A city or town should update this information annually so it is current. Contact: databank@dor.state.ma.us.

What is the Cape Cod and Islands Water Protection Fund?

The short-term rental legislation also includes a new Cape Cod and Islands Water Protection Fund (Fund). It is funded, in part, by a new 2.75% excise on all occupancies subject to the room occupancy excise located within a municipality that is a member of the Fund. It does not apply to occupancies where the total amount of daily rent (or its equivalent) is less than $15 per day. G.L. c. 64G, § 3C. This excise is paid by the operator to DOR with its room occupancy excise. Revenues from this new excise are to be credited to the Fund.

How do I find out if my city/town is a member of the Cape Cod and Islands Water Protection Fund?

Under G.L. c. 29C, § 19, "Each municipality within Barnstable or Nantucket counties or within the county of Dukes County shall be a member of the fund if it is subject to: (i) an area wide wastewater management plan under section 208 of the federal Clean Water Act, 33 U.S.C. 1288; or (ii) a suitable equivalent plan determined by the department of environmental protection."

According to the Mass. Dept. of Environmental Protection (DEP) and the Cape Cod Commission, all Barnstable County towns are currently subject to an area wide wastewater management plan under section 208 of the federal Clean Water Act (the "208 Plan Update") and so all are members of the Fund. (The plan can be found by clicking here.) Island towns (Nantucket and Dukes County) are not currently members of the Fund. They will need to work with the DEP to obtain its determination of a "suitable equivalent plan" to join the Fund. Those towns should contact DEP for more information on how to obtain a determination by DEP that the town's plan is a "suitable equivalent plan."

If my city/town is a member of the Fund, may it withdraw from the Fund?

A city/town may withdraw from the Fund by a two-thirds vote of its legislative body; however it may not withdraw during the term of a financial assistance award from the Fund. Furthermore, a city/town may not withdraw from the Fund until March 28, 2020, one year after the effective date of St. 2018, c. 337. We interpret this to mean that although the city/town may vote to withdraw before March 28, 2020, the effective date of the vote of withdrawal cannot be before March 28, 2020.

If a city/town withdraws from the Fund and wishes to return to the Fund, it may, by majority legislative body vote, return to the Fund after withdrawal. However, it cannot receive funding from the Fund for two years after its vote to return to the Fund.

For more information, please see the FAQs on the Dept. of Revenue's website and its Draft Technical Information Release. As previously indicated, legislation has been submitted which includes proposed changes to the short-term rentals law.

Data Highlight of the Month: Cherry Sheet Reports

Anthonia Bakare - DLS Municipal Databank

As the state budget process unfolds, the Cherry Sheets remain a topic of interest. There are several reports listed below that local officials may find helpful while navigating through the budget releases. Cherry Sheet reports include:

1.) Preliminary Municipal Cherry Sheet Estimates

2.) Preliminary Regional School Cherry Sheet Estimates

3.) Cherry Sheet Estimates by all Municipalities, School Districts and Programs, FY2010 to present

4.) Trends in Municipal Cherry Sheet Aid, FY2010 to present (State Totals & by Individual Municipalities)

5.) Trends in Regional Cherry Sheet Aid, FY2010 to present (State Totals & by Individual Regional Schools)

The Preliminary Municipal and Regional School Cherry Sheet Estimates report tracks the state budget process on an annual basis. This report displays the current year estimated receipts, charges, assessments and totals as well as the upcoming years proposed amounts as they are released.

This report defaults to upcoming fiscal year ‘All Municipalities’ but allows users to select an individual municipality and fiscal years as far back as 2009. In FY2020 this report has been redesigned using newer report technology that improves the appearance, functionality and user experience.

The Cherry Sheet Estimates by all Municipalities, School Districts and Programs report allows users to see Cherry Sheet details by program. Users can select municipalities or regional schools; receipts or assessments and Governors, House, Senate, Conference Committee and final budgets as they are released. Prior years are available as far back as 2010.

The Trends in Municipal and Regional School Cherry Sheet Aid report gives a ‘single-page’ ten year view of the receipts and charges from FY2010 to present. This report defaults to ‘All Municipalities,’ but allows users to select an individual municipality.

The purpose of these reports is to provide a comparative view of Cherry Sheet programs and its details through timely notifications. All reports are in real time and can be exported to Excel. Remember to visit the Municipal Finance Trend Dashboard which includes additional financial data related to communities.

We hope you become better acquainted with the data the Division of Local Services has to offer through the *Data Highlight of the Month*. For more information, contact us directly at databank@dor.state.ma.us or (617) 626-2384.

March Municipal Calendar

1	Municipal Databank	**Notification of Cherry Sheet Estimates for the Following Year (pending action taken by the Legislature)** The cherry sheet provides estimates of 1) receipts: local reimbursement and assistance program appropriations and 2) assessments: state and county assessments and charges to local governments. The Municipal Databank posts

		cherry sheet estimates on the DLS website and updates them at every stage of the state budget process.
1	Personal Property Owner	**Submit Form of List to Assessors** This return is due on or before March 1, but the Assessors may extend the deadline to a date no later than the date abatement applications are due.
1	Charitable Organization	**Submit 3ABC Forms** To be eligible for exemption from taxation for the next fiscal year, a charitable organization must file this form with the Assessors detailing the property held for charitable purposes. It is due on or before March 1, but the Assessors may extend the deadline to a date no later than the date that abatement applications are due.
1	Telephone and Telegraph Company	**Deadline for Telephone and Telegraph Company to File Form of List** BLA may extend the deadline to a date no later than April 1.
31	State Treasurer	**Notification of Monthly Local Aid Distributions,** see IGR 17-17 for more cherry sheet payment information, monthly breakdown by program is available here.

To view the municipal calendar in its entirety, please click here.

Contact *City & Town* with questions, comments and feedback by emailing us at cityandtown@dor.state.ma.us.