City of Fitchburg

# Financial Analysis

Division of Local Services/Technical Assistance Section

June 2013

June 25, 2013

The Honorable Lisa A. Wong
Municipal Offices
166 Boulder Drive
Fitchburg, MA 01420

Dear Mayor Wong:

It is with pleasure that I transmit to you the enclosed Financial Analysis completed by the Division of Local Services for the City of Fitchburg. It this analysis, we discuss the implementation status of recommendations contained in our 2008 Financial Management Review and review the upcoming fiscal challenges that you and your financial team have identified as concerns. It is our hope that the information presented in this report will assist the city in addressing these challenges and continuing the forward progress that has occurred in the city over the last five years.

As a routine practice, we will forward a copy of the report to the city's state senator and representatives.

If you have any questions or comments regarding our findings and recommendations, please feel free to contact Rick Kingsley, Bureau Chief of the DLS Municipal Data Management and Technical Assistance Bureau at 617-626-2376 or at kingsleyf@dor.state.ma.us.

Sincerely,

Robert G. Nunes

Robert G. Nunes
Deputy Commissioner &
Director of Municipal Affairs

Cc: Senator Jennifer Flanagan
Representative Stephen DiNatale

## Introduction

At the request of Mayor Lisa A. Wong, the Division of Local Services' Technical Assistance Section has prepared this limited scope analysis for the City of Fitchburg. In her request letter, the mayor noted that the city had implemented the vast majority of the recommendations contained in our original financial management review published in May of 2008. Nonetheless, the mayor and her finance team are concerned that the city continues to face daunting financial challenges, many of which have arisen since the preparation of the original report.

In the period since our last review, the mayor and city council have been forced to make a number of hard budgetary decisions to cope with the effects of an extended economic recession. For example, staffing levels in many city departments, including the police and fire departments, were decreased deeply between FY2008 and FY2011. Since then, some positions have been restored, but the total number of city employees remains lower than FY2008 levels by about 28 positions. Going forward, it is likely that these lower staffing levels represent a new baseline, so the city's focus must continue to be on providing services as efficiently as possible within these constraints.

In other areas, the city has addressed deficits in its enterprise funds by increasing water and sewer rates. Water rates have increased by about 23 percent since FY2008. Sewer rates have increased more dramatically, rising from $2.60 per hundred cubic feet in early FY2008 to the current rate of $7.30 in FY2013, an increase of about 180 percent. Over time, the decline in industrial usage has shifted much of the burden for these services to the city's residential ratepayers. Sewer rates are projected to be sufficient to fund the mandated $60 million or more in capital expenditures necessary to address the city's combined sewer overflow (CSO) as ordered by a federal Consent Decree issued by the Environmental Protection Agency (EPA).

At the same time, the mayor and her finance team have carefully managed city finances and the budget using tools such as long-term forecasting to anticipate trends and guide fiscal policy. The city has successfully negotiated changes to health insurance options, eliminating expensive plans and increasing employee copayments and deductibles to contain costs. Despite these efforts, health insurance expenses have grown by more than 17 percent, or close to $2 million, between FY2008 and the FY2014 mayor's budget amount. Contributory pension costs have risen even more steeply as the system's substantial unfunded liabilities require aggressive funding increases. Pension assessments have increased from $6.5 million in FY2008 to $8.7 million in FY2014, an increase of $2.2 million or 34.4 percent

In the analysis that follows, we review the implementation status of the recommendations contained in the 2008 report and, where appropriate, offer additional thoughts on those subject areas. To accomplish this, we interviewed the mayor and the city's key finance officers and reviewed various documents submitted by the city to the Division or otherwise supplied by city officials. The majority of the report however is devoted to analysis of the issues raised by the mayor and her team that confront the city going forward. Foremost among these concerns are the detrimental impacts of the extended recession on the city's property values and the unfunded and growing liability around Other Post-Employment Benefits (OPEB) related largely to retired employee health insurance costs. We also discuss the economic climate over the last five years and its impact on city finances; we review the city's reserve levels and bond ratings; and discuss a payment in lieu of taxes program for tax exempt entities.

## Status of May 2008 Recommendations

**1. Codify Role of Financial Team –** Over the last five years, the city has benefited from a stable, experienced team of finance officers that meet regularly. The group has worked cooperatively to solve problems and city financial information is shared routinely with all interested officials. The mayor attends meetings of the city council's finance subcommittee twice per month to present financial updates and addresses the council as a whole periodically. While these are positive steps, we are concerned that turnover in the administration or in any of the key fiscal officers' positions may cause these practices to wane. Therefore, we recommend that these advances be made a permanent part of city government by adopting a city ordinance that codifies the role of the finance team and requires regular dissemination of information on the city's fiscal position.

**2. Develop Financial Plan –** The mayor and her finance team have implemented multi-year revenue and expenditure forecasting successfully, with projections extending to periods well beyond the typical five year horizon. As a consequence, the mayor and her team are acutely aware of the challenges facing the city long-term. These projections provided the impetus to develop strategies to control employee health insurance costs, build reserve levels, improve the city's bond rating and prioritize city services. The projections have also been useful in identifying future challenges as we will discuss later in the analysis.

**3. Establish City-wide Goals and Objectives –** In an effort to link departmental budgets with city goals and objectives, each department submits a list of objectives or initiatives that will be accomplished within the fiscal year spending plan. To hold employees accountable for meeting these goals, the city also actively conducts performance evaluations of most employees with the exception of police and fire employees. The annual evaluation process starts in the spring when the human resources director sends forms to the departments. Evaluations are completed before the end of the fiscal year in June.

**4. Reinstate Capital Improvement Commission –** The city has re-established its capital improvement commission as prescribed by the original 1972 ordinance. The commission is comprised of four citizens appointed by the mayor, two members of the city council and the city auditor serving as an ex officio member. The civilian members have backgrounds in engineering and other professional disciplines that allow them to make meaningful contributions when deciding on projects. The commission meets regularly with department heads to prioritize departmental requests for capital improvements and generally works within available funding or financing options as determined by the mayor and city auditor. The commission recommends projects for funding in the mayor's annual budget and has made good use of grant funding for major purchases such as a new fire truck and energy efficiency improvements in the schools financed largely by the Massachusetts School Building Authority. The city has accomplished several significant capital projects over the last few years, improving roads, upgrading boilers and installing new windows and roofs in school buildings and is working to address the combined sewer overflows (CSOs) as required by the Environmental Protection Agency.

**5. Submit Budget to City Council Earlier –** The mayor now submits a draft budget to the city council in mid-April and finalizes her budget submission to council in mid-May. With regular updates from the mayor and earlier submission of the budget materials, the city council is in a better position to play a meaningful role in the city's fiscal management.

**6. Develop Formal Reserve and Debt Policies –** The city has made steady progress in building its stabilization fund from $31,273 as of 6/30/2007 to a FY2013 current balance of $4,581,928. Although the city is planning to use $580,000 from stabilization to balance the FY2014 budget, the city's goal is to bring this fund up to 5 percent of the general fund budget or about $5.184 million based on the mayor's FY2014 budget proposal. The city's free cash balance has improved from $211,840 in FY2008 to a high of $4,169,693 in FY2013. Moody's Investor Services recently affirmed the city's A1 bond rating and cited improving reserve levels as a fiscal strength. The rating agency cautioned however that erosion of these reserves may prompt a downgrade of the rating. With the accumulation of moderate cash reserves, the city no longer needs to borrow in anticipation of revenue.

**7. Conduct Quarterly Budget Projections –** The city auditor regularly produces financial reports that compare actual spending with the appropriation. These reports depict the percent of the budget that has been expended to date and are widely distributed to department heads and other city officials. The city uses these reports to identify any possible accounts that may be in danger of being overspent.

**8. Annually Review Management Letter Findings –** Annual audits are distributed to both the city council and the school committee. On the school side, audit findings are reviewed by the business manager, superintendent and school committee. City audit findings are reviewed with the finance team, mayor and the city council. Management responses are provided by the finance team or school business manager. Most key elected officials in the city now review the annual audits and call the appropriate officials before them when there are questions or issues.

**9. Institute a Sustainable Enterprise Rate Structure and Avoid Deficits –** The city has increased water rates modestly and sewer rates dramatically since 2008 to return these funds to fiscal health. The city has moved to radio read water meters that have allowed the city to more efficiently read meters and issue water and sewer bills on a monthly basis. This has improved the cash flow in the enterprise funds, reduced receivable balances and resulted in positive operating results and retained earnings for both the water and sewer enterprise funds (see chart below). Retained earnings represent the enterprise fund equivalent of free cash. Rates are projected to be sufficient to cover the additional debt service around the combined sewer overflow project.

**Enterprise Fund Retained Earnings**

| | FY10 | FY11 | FY12 | FY13 |
|---|---|---|---|---|
| Water | $281,728 | $537,255 | $598,055 | $1,405,421 |
| Sewer | ($96,671) | $25,523 | ($762) | $2,383,964 |

**10. Annually Evaluate Insurance Options –** The city has been aggressive in negotiating changes to its employee health insurance offerings. In 2009, the city negotiated to eliminate its most expensive indemnity plan and instituted an emergency room copayment to contain escalating health care costs. In 2012, the city negotiated with city unions to implement copayments and deductibles that were close to those charged by the Group Insurance Commission (GIC). In the next round of negotiations, city officials anticipate that deductibles and copayments will be increased to GIC levels. City officials are reluctant to turn to the GIC for health insurance, however, as many of their plans are more expensive than those offered by the city. The concern is that employees will migrate to more expensive options if available.

**11. Make Greater Use of Purchasing Function –** Purchasing in the school department is coordinated centrally by the school maintenance department. This group administers purchases of supplies and oversees the hiring of contractors. City purchases of fuel and heating oil are overseen by the purchasing department and the city has a printing office that purchases all paper. The city also contracts for engineering assistance using a three-year contract so that the city has this expertise available without the need to go through the purchase order process every time these services are necessary.

**12. Use Electronic Purchase Order System, Encumber Funds for Large Purchases** - The city's school department uses the MUNIS purchase order system for virtually every purchase that is made by the school department. On the city side, all expenditures over $1,000 must be approved by the mayor and those that exceed $5,000 require a purchase order. By requiring that city purchases over $5,000 go through the purchase order process, the city ensures that all procurement procedures have been followed. The city does not encumber funds for these purchase orders once approved, rather the purchasing department relies on the regular expenditure reports produced by the city auditor to check for adequate funding in the appropriate line-item. If the appropriation balance appears marginal, purchasing will check with the city auditor's office for the most up to date balances.

**13. Centralize Information Technology Functions –** The city has created a centralized IT department and has consolidated technology budgets formerly appropriated to each department into the budget of the IT department.

**14. Develop Technology Plan –** The city has made good progress in developing a technology plan and has developed a regular schedule for replacing hardware. With the budget centralized in the IT department, the city has effectively coordinated the process for technology purchases so that all these decisions flow through the IT department. We see this as a significant improvement over the situation where departments made their own independent technology purchasing decisions without any central coordination or oversight.

**15. Develop Plan to Enhance Utilization and Integration of Financial System –** The city has made substantial progress enhancing the utilization and integration of the financial system in the day to day processing of payroll, with about ninety percent of city departments entering their payroll data directly into MUNIS. The next phase of implementing decentralized processing will involve departments inputting their payables into MUNIS. There are still a few off-site departments that do not have MUNIS access so additional funding may be required to get these departments licensed, connected and submitting data electronically.

**16. Hire an Assistant Auditor –** The city has hired a well-qualified assistant auditor that has the experience and skills to assume the responsibilities of the city auditor if he is unavailable for any reason. This new position alleviates a substantial risk of disruption to the city's ability to produce timely and accurate financial reports. We were very pleased that the city heeded this recommendation as accurate and timely financial reports are a fundamental element to meaningful financial planning and management.

**17. Track Leave Balances Centrally –** The city has not had the staff resources necessary to complete the work of entering employee leave balances into the MUNIS system. These balances are kept at the departmental level, without an independent tracking by the city auditor. We think that this recommendation is worth pursuing if resources are available. Allowing individual departments to track employee leave balances, without proper checks and balances, compromises internal controls and is not a sound practice.

**18. Eliminate Department Telephone Charges –** The city has combined telephone budget line items formerly appropriated to each department into a city-wide telephone appropriation under the Information Technology department. This has greatly streamlined the payment of city telephone charges in the city auditor's office.

**19. Resolve Backlog in Tax Titles –** A review of the city's real estate tax receivable reports shows that outstanding balances at year end have decreased by about $500,000 between FY2008 and FY2012. Actual property tax collections in FY2012 as a percent of the net tax levy (total tax levy less overlay reserve for abatements and exemptions) approach 100 percent (99.6 percent). The low receivable balances demonstrate that the city is securing its liens on these properties by moving them into tax title status. We also saw movement from tax title to tax foreclosure status when the city takes possession of a property. The foreclosure account was almost $1 million at the end of FY2010 and had decreased to about $100,000 by FY2012. The city treasurer has held periodic auctions of tax possession properties to reduce this balance. Though the city's tax title account is significant, it now consists of a significant number of demolition liens and contains about 160 properties considered to be land of low value. According to the treasurer, there is little revenue associated with many of these properties and significant revenue producing parcels have already been moved through the foreclosure process.

**20. Fully Utilize All Means to Collect Property Taxes -** The city has an ordinance that sets out a process for denying licenses and permits to delinquent taxpayers. The ordinance defines a delinquent taxpayer as any person, corporation or business that owes taxes, fees, assessments, betterments or any other municipal charge to the city for not less than twelve months. Issues with the ordinance have arisen on occasion when someone other than the owner applies for a license or permit and the licensing or permitting authority only has a list of delinquent taxpayers to work from. The city solicitor is working on amendments to this ordinance that would enable the city to deny any license or permit that is related to a specific property owned by a delinquent taxpayer.

**21. Stagger Short-term Borrowing –** In FY2008, it was the city's practice to borrow $7 million early in the fiscal year in anticipation of revenue. The city paid off these notes at the end of the fiscal year. We suggested the city analyze its cash flow and borrow for more limited periods throughout the fiscal year only as needed. Currently, due to moderate cash reserves, the city does not have to borrow for cash flow purposes at all. With monthly local aid payments scheduled to begin in FY2014, the city's cash flow should be even better with additional opportunity for increased investment income.

**22. Improve Turnover and Deposit Procedures –** The treasurer/collector's office now completes deposits on a daily basis rather than retaining turnovers in the office safe and making deposits once per week.

**23. Develop Department Succession Plan –** The city's assessing operation continues to be well managed and on top of state requirements for valuation and triennial certification. Key personnel in the office is still in place, though one of the assessors left temporarily for a position in another community. With his return, the city has a logical successor to the current chairman when he eventually leaves city service. We suggest that the city explore using the current chairman, on a limited basis, in the capacity of valuation advisor after his retirement so that the city still has access to his appraisal expertise and vast knowledge of city properties.

**Conclusion –** The city has made impressive strides in implementing virtually all of the important recommendations contained in the 2008 report. We are pleased that the city hired a qualified assistant city auditor, a much needed position that will reduce the risk of disruption in this critical office. A stable, experienced finance team assists the mayor in developing realistic annual budgets, controlling expenses and looking ahead to address emerging problems. We continue to believe however that the city would benefit from codifying this structure in city ordinance.

In other areas, the city has raised water and sewer rates aggressively and restored these enterprise funds to fiscal stability. Each fund now has positive retained earnings and, going forward, sewer rates are projected to be enough to cover the substantial expected debt service related to the EPA mandated combined sewer overflow project. The city has also made a concerted effort to build reserves as well and this policy has positively influenced the city's bond ratings. The reinstatement of the capital improvement commission, the improved credit rating and the leveraging of state grants has put the city in a better position to address numerous capital needs including new boilers, windows and roofs in the schools.

Despite this considerable success, the mayor and her finance team expressed serious concerns about the city's future. In part, this distress stems from the impact of the recession on state aid and property values. Declining property values, combined with an increasing levy limit, also points to a possible levy ceiling collision on the horizon. While we can offer no tangible recommendations to increase property values, we firmly believe that the best approach will be a concerted effort to attract new industry to the city. This will require the cooperation and assistance of city, state and even federal officials to be successful. Looming on the horizon as well are the huge liabilities related to OPEB and the possible detrimental effects these liabilities could have on city finances and bond ratings. Here, we offer recommendations on setting aside funds for OPEB and initiating discussions about how these contributions are handled in determining compliance with state school spending requirements. Finally, we offer a recommendation on establishing a payment in lieu of taxes program for tax exempt entities.

## Challenges Facing the City

**Economic Downturn –** In the few short months after the completion of our financial management review in May of 2008, the national economy took a severe downward turn. In fact, the period from the fall of 2008 to the present has spanned perhaps the worst sustained economic recession in this country since the Great Depression.

In Massachusetts, actual state revenue collections plummeted between FY2008 and FY2009, decreasing by $2.62 billion or more than 12.5 percent. State revenues slowly recovered during FY2010 and FY2011, but if not for the 1.25 percent increase in the state sales tax, FY2010 total revenues would have been lower than the FY2009 level. By FY2012, state revenues were only about $236 million above the FY2008 pre-recession level, though $951 million of the FY2012 total was the result of the increased state sales tax. So though the economy and state revenue collections have rebounded to an extent, the recovery has been slow and uneven.

Given the downturn in revenues, coupled with increasing costs at the state level, it is not surprising that significant local aid cuts where necessary during these years. For the most part, when cuts were made to general government aid the primary method to allocate the cuts was on a percentage basis. Consequently, communities that depended most heavily on state aid received cuts of the largest magnitude. As recently as FY2003, Fitchburg received slightly more than 50 percent of its budget from state aid. By FY2013, this percentage had decreased to 43.29 percent, though Fitchburg's socioeconomic indicators showed that the city was among the poorest communities in the state. For example, city property values as measured by the 2012 equalized property valuations per capita were the fifth lowest in the state. The only communities with lower property wealth per capita in the state were Lawrence, Springfield, North Adams and Holyoke. DOR income data from 2010 state tax returns shows that city income levels are only slightly better, ranking 22nd lowest in the state (See Appendix A).

In Fitchburg's case, the resulting cuts to general government local aid were particularly deep as the city lost a cumulative total of $15.2 million between the original cherry sheet estimates in FY2009 though FY2013 (See table below). The $15.2 million figure represents the difference between what Fitchburg actually received in general government aid between FY2009 and FY2013 compared to what the city would have received had the city's aid been level funded at the original FY2009 levels.

**City of Fitchburg**

**Cumulative Loss of General Government Aid Since FY2009**

| | FY2008 | FY2009 | FY2009 9C cuts | FY2009 net | FY2010 | FY2011 | FY2012 | FY2013 | |
|---|---|---|---|---|---|---|---|---|---|
| UGGA * | $10,621,113 | $10,621,113 | -$1,034,987 | $9,586,126 | $7,518,871 | $7,218,116 | $6,696,216 | $7,218,116 | |
| Other Gen. Gov. Aid | $1,166,038 | $1,179,581 | | $1,179,581 | $945,972 | $958,106 | $982,836 | $1,050,140 | |
| Library Offset | $73,823 | $78,291 | | $78,291 | $50,736 | $46,510 | $49,857 | $46,939 | |
| Total Gen. Gov. Aid | $11,860,974 | $11,878,985 | | $10,843,998 | $8,515,579 | $8,222,732 | $7,728,909 | $8,315,195 | |
| One-time aid | | | | | | | $521,900 | | |
| General Government Aid Lost since FY2009 | | | | **$1,034,987** | **$3,363,406** | **$3,656,253** | **$3,628,176** | **$3,563,790** | **$15,246,612** |

*Unrestricted General Government Aid (UGGA) included both Lottery and Additional Assistance aid in years prior to FY2010.

On the education side of the budget, the city fared better. For the most part, in the years when Chapter 70 appropriations were reduced, additional federal stimulus aid was allocated to replace state education aid. Federal SFSF and Education Jobs grants were used to supplement state funding in the years FY2009 to FY2011, enabling the state to provide stable, but not increasing, funding for education during these years (See table below).

**City of Fitchburg**
**Chapter 70 and Federal Stimulus Grants**

| | Chapter 70 Aid | Federal SFSF and Education Jobs Grants | Total Education Aid |
|---|---|---|---|
| FY2008 | 40,080,379 | 0 | 40,080,379 |
| FY2009 | 36,822,755 | 4,327,540 | 41,150,295 |
| FY2010 | 40,327,289 | 951,974 | 41,279,263 |
| FY2011 | 39,281,344 | 2,132,669 | 41,414,013 |
| FY2012 | 40,477,603 | 0 | 40,477,603 |
| FY2013 | 43,692,664 | 0 | 43,692,664 |

**Property Values and the Loss of Tax Base** – Since our initial review in FY2008, the national recession has had a chilling effect on property values in many areas across the state. Property values in Fitchburg have decreased from about $2.77 billion to about $2.07 billion between FY2008 and FY2013, a decrease of close to $700 million or more than 25 percent (See chart below). Statewide, only five other communities realized total valuation decreases of this magnitude over this same period (Brockton - 32.7%, Templeton - 27.3%, Everett – 26.6%, Revere – 26.1% and Athol – 25.6%). Although the vast majority of Massachusetts communities (300 of 351) also lost value during this period, total property valuations statewide dropped a more modest 8.8 percent. Taken together, Fitchburg's commercial, industrial and personal property values were stable over this period with modest decreases offset by growth in personal property values. Valuations within the residential class, however, declined by slightly more than $700 million or 30 percent.

**City of Fitchburg**

**Assessed Value by Class**

| Fiscal Year | Residential | Open Space | Commercial | Industrial | Personal Property | Total Assessed Value |
|---|---|---|---|---|---|---|
| 2008 | 2,338,208,370 | 0 | 235,620,767 | 118,632,100 | 82,100,169 | 2,774,561,406 |
| 2009 | 2,225,181,532 | 0 | 237,146,816 | 120,085,700 | 91,076,226 | 2,673,490,274 |
| 2010 | 1,993,453,635 | 0 | 235,972,456 | 117,636,400 | 96,319,517 | 2,443,382,008 |
| 2011 | 1,820,915,934 | 0 | 227,699,526 | 114,153,700 | 112,374,243 | 2,275,143,403 |
| 2012 | 1,718,112,950 | 0 | 222,182,867 | 112,062,500 | 116,447,354 | 2,168,805,671 |
| 2013 | 1,634,790,575 | 0 | 211,979,373 | 109,833,500 | 120,365,137 | 2,076,968,585 |
| % Change | -30.08% | | -10.03% | -7.42% | 46.61% | -25.14% |

As an indirect result of declining property values, city assessing officials point to a number of properties that have been purchased by non-profits and taken off the tax rolls as exacerbating the problem. Institutional investors such as Fitchburg State University, state environmental agencies and public service/non-profit agencies have purchased land and residential housing. This has removed approximately $12 million in taxable property from the city's tax rolls and, in some cases depending on the use, has increased demand for city services such as police and fire. The city has also been disproportionately impacted by property foreclosures which have de-stabilized some already poor neighborhoods in some cases. Despite aggressive efforts on the part of the administration to enforce health, safety and building codes to contain these detrimental effects, the low property values generally serve to discourage higher-end investment and development. Not all the foreclosures resulted in negative outcomes though as developers purchased certain foreclosed properties, made improvements and then rented or sold them.

**Property Values and the Levy Ceiling -** Perhaps the most damaging aspect of the diminished tax base for Fitchburg is the potential for a levy ceiling collision under Proposition 2 ½. Proposition 2 ½ places constraints on the amount of the property tax levy raised by a city or town and on how much the levy can be increased from year to year. Proposition 2 ½ established both an overall limit on the total amount of taxes as well as annual limits on how the levy can increase from year to year. First, a community cannot levy more than 2.5 percent of the total full and fair cash value of all taxable real and personal property. This overall limit is referred to as the levy ceiling. Second, a community's levy is also constrained in that it can only increase by a certain amount from year to year. Generally, this increase is limited to 2.5 percent per year, plus any new growth or construction that adds to the tax base. When the levy limit reaches or collides with the levy ceiling, a community may no longer increase its annual levy by the 2.5 percent or new growth.

Recent trends in Fitchburg point to a possible levy ceiling collision on the horizon. In fact, if we project that the city's tax levy continues to grow at the average annual rate between FY2008 to FY2013 (about 4.1 percent) and that property values were to stabilize at the FY2013 levels going forward, the city faces a potential levy ceiling collision by FY2019. If property values were to increase by one percent per year, the levy ceiling collision is pushed out to FY2020, an indication of how sensitive these calculations are around changes in total property valuation.

To put the city's situation in a statewide context, we looked at other communities where the tax levy is approaching the levy ceiling. As of FY2013, there are 16 cities and towns that are closer to their levy ceiling than Fitchburg. Of these 16 communities, six have significant debt exclusions that temporarily increase the maximum levy limit. The data shows that there are three communities that have already collided with their levy ceiling (Springfield, Everett and Monroe). Of these communities, Springfield has been impacted the most severely and was forced to decrease its actual tax levy by $2 million between FY2012 and FY2013.

While much could happen in the local and regional economies in the intervening years to avert a levy ceiling collision, the best approach to avoid this outcome is a strategy to increase the city's tax base. While an improving economy may forestall a levy ceiling collision beyond FY2020, the city would benefit most from a concerted, regional economic development strategy to breathe new life into the city's tax base. While the city has had some recent residential growth in the form of new apartment buildings, along with a significant renovation and expansion planned for a commercial hotel property, industrial development and the resultant new jobs have been harder to attract.

Although the city administration has worked hard to attract new businesses, the difficulty in drawing new industry to the area is a problem too broad for the city to solve on its own.

Solutions will require a concerted effort on the part of both state and local officials, and perhaps even federal officials. The city would benefit from additional assistance regarding how Fitchburg might complement other industrial activities in the area such as those located at nearby Devens or how the city might better utilize the city airport property where federal agencies play a role. Once areas of opportunity are identified, the city will need a properly trained workforce to attract industry to the city. This issue might be addressed with the assistance of local vocational schools and area colleges to design and offer training programs. The lack of industrial space currently available in the city is another important area where the city could use assistance.

**Reserves and Bond Rating –** The city has worked hard to improve its bond ratings through disciplined budget management, the elimination of operating deficits in the enterprise funds and careful long-term forecasting and fiscal planning. The results of these efforts have been the accumulation of moderate reserve balances in the stabilization fund and certified free cash (see chart below for bond ratings and reserve levels). Despite the success the city has had in accumulating these reserves since FY2008, there remain numerous competing needs for these funds. For example, the city has appropriated some free cash to balance its operating budget in recent years. Escalating health and pension costs, together with declining state aid, have placed added pressure on the city to use these one-time revenues as well. Capital spending needs also place demands on city reserves.

It is important to note that bond rating agencies generally view reliance on one-time reserves for the operating budget as a negative factor in their credit assessments. In anticipation of an upcoming bond issuance, Moody’s affirmed the city’s A1 bond rating and cited improving reserve levels as positive attributes for city finances. Conservative budgeting and careful management of spending were also identified as city strengths. The rating agency cautioned that the city faces challenges with regard to wealth and income levels, property values and Proposition 2 ½, the use of reserves for the operating budget and significant pension and OPEB liabilities.

Although the city has done well to initiate a number of capital improvements by leveraging state grants, limited borrowing and the judicious use of reserves, there are additional capital needs to be addressed. One important example is the city hall building that was built in 1853 and is located in the heart of the city. This structure is currently vacant and likely requires a considerable amount of work to be returned to usable status. The city is currently leasing storefront space for its municipal offices a few blocks away. While the historic city hall building may be expensive to rehabilitate, leaving it abandoned in the city center does little to project a positive image for the city or honor its important cultural and industrial heritage.

Thought the city lacks the fiscal capacity to undertake necessary capital projects like city hall at the present, debt service schedules reveal that, after FY2019, the city will experience a significant drop in debt service as a large school bond will be paid off. This represents an opportunity to re-invest in critical city infrastructure such as city hall, but the city needs to position itself with a strong bond rating to minimize the associated interest costs of any planned bond issues. Other fiscal issues such as the city's OPEB liability and the potential for a levy ceiling collision may limit the city's ability to finance this much needed investment, so it is important that the city's bond rating be as strong as possible to lower financing costs around any future debt issues.

Moody's Bond Ratings

| 2008 | 2009 | 2010 | 2011 | 2012 | 2013 |
|---|---|---|---|---|---|
| Baa1 | Baa1 | A1 | A1 | A1 | A1 |

Standard and Poor's Bond Ratings

| 2008 | 2009 | 2010 | 2011 | 2012 |
|---|---|---|---|---|
| BBB- | BBB+ | BBB+ | A- | A- |

Stabilization Fund

| 6/30/2007 | 6/30/2008 | 6/30/2009 | 6/30/2010 | 6/30/2011 | 6/30/2012 |
|---|---|---|---|---|---|
| $31,273 | $320,940 | $1,021,319 | $2,033,595 | $3,051,036 | $3,566,383 |

*the 6/30/2013 balance is expected to be slightly over $4 million.

Certified Free Cash

| 7/1/2007 | 7/1/2008 | 7/1/2009 | 07/01/2010 | 7/1/2011 | 7/1/2012 |
|---|---|---|---|---|---|
| $211,840 | $1,292,994 | $2,384,789 | $3,060,013 | $1,908,904 | $4,169,693 |

**OPEB Liability and School Spending Requirements –** After falling more than $1 million short of the state legal requirement for school spending (MGL c.70, §6) in FY2008, the city has been generally meeting its school spending obligations (see chart below). The school spending target is referred to as the "net school spending requirement." The margins however are tight, with spending in some years above the requirement and in others slightly below it. When spending is less than the requirement, the shortfall carries forward into the next fiscal year. When spending is more than 5 percent below the requirement (including any shortfall carried forward from the prior year), penalties in the form of reduced Chapter 70 aid are triggered.

**City of Fitchburg**
**Compliance with Net School Spending Requirements**

| | Required Net School Spending (NSS) | Actual Net School Spending | | Dollars Over/Under Requirement | Percent Over/ Under |
|---|---|---|---|---|---|
| FY2008 | 54,437,023 | 53,324,651 | | -1,112,372 | -2.0 |
| FY2009 | 52,408,365 | 53,334,231 | | 925,866 | 1.8 |
| FY2010 | 54,367,166 | 54,292,108 | | -75,058 | -0.1 |
| FY2011 | 53,663,826 | 54,506,032 | | 842,206 | 1.6 |
| FY2012 | 55,048,365 | 54,527,450 | | -520,915 | -0.9 |
| FY2013 | 59,149,678 | 59,155,329 | * | 5,651 | 0.0 |

* budgeted spending

City officials are concerned that if they set aside funds in future budgets for Other Post-Employment Benefits (OPEB) that there will not be adequate revenue available to meet the city's annual net school spending requirements. OPEB obligations reflect the future cost of employee benefits, primarily employee health insurance benefits that are earned or accrue as the result of the employee working during that year. In other words, when the city provides its share of health insurance costs in the annual budget it is just for the current year's coverage. This approach fails to recognize the cost of an active employee that may be one year closer to being vested in the retirement system and qualifying for health insurance coverage upon retirement.

Due largely to the projected growth in health care costs combined with the longer projected life span of current employees, these costs represent an astronomical future obligation in most municipalities. For Fitchburg, the total Unfunded Actuarially Accrued Liability (UAAL) as of January 1 of 2011 is $183.1 million. When municipalities continue with the pay as you go approach and fail to set aside funds for these future obligations, they risk a situation where health care costs eventually overwhelm the rest of the budget.

Although health insurance expenditures related to active school employees and retirees are allowable costs for determining compliance with state school spending requirements, contributions to an OPEB reserve are not currently reported to the Department of Elementary and Secondary Education (DESE) on the end-of-year financial report and are not allowable to meet net school spending. We think a reasonable argument could be made that when municipalities commit funds to an irrevocable OPEB trust to cover the accrued future health insurance liabilities related to school employees, that this funding should count toward net school spending.

We think it is important, however, that the funds are set aside in an irrevocable trust that meets the Governmental Accounting Standards Board (GASB) guidelines. GASB parameters for the requirements of such funds include: contributions to the fund must be irrevocable, under the control of a trust, protected from creditors and used solely to pay benefits of retirees. Although there are outstanding questions regarding whether an OPEB reserve established under MGL c.32B, §20 qualifies as irrevocable and under the control of a trust, it is our understanding that legislation amending this section will be filed to bring this reserve into compliance with GASB requirements.

Some communities have established special purpose stabilization funds to set money aside for their OPEB obligations. There are a couple of issues with this vehicle however. The purpose of the fund may be changed, so it cannot be considered an irrevocable trust. If the fund does not meet GASB requirements, any accumulated reserve cannot be used in the financial statements to reduce the OPEB liability and the city must use a lesser discount rate in determining the actuarially accrued liability. The lower discount rate increases the accrued liability significantly and results in higher annual required contributions (ARC) to reach full funding.

We recommend that the city establish an irrevocable trust for its OPEB obligations under the authority of MGL c.32B, §20. While funding the trust at the full annual required contribution level may not be possible for the city, we recommend that the city establish a schedule to provide annual funding that is material, manageable and increases over time. By committing to meaningful contributions to this fund, the city may be able to use the discount rate that corresponds more closely to pension investment assumptions (8 percent or so) rather than a general fund investment assumption that may be less than half of projected pension returns.

The city should also raise the net school spending issue with the Massachusetts Municipal Association (MMA) and the Department of Elementary and Secondary Education to seek regulatory amendments to include contributions to the OPEB trust on behalf of school employees as eligible costs for net school spending. Even though the funds have not technically been expended when appropriated to the trust, they should be treated as such since with an irrevocable trust the funds may only be used to pay for future retiree health insurance. Providing for these accrued liabilities, and investing the resulting funds prudently and in advance of when these obligations must be met, will minimize the proportion of future school spending that must be devoted to school department employees' health insurance in the future.

We also recommend that the city consider seeking approval from the board of trustees of the state's Health Care Benefits Trust Fund to invest city contributions in the State Retiree Benefits Trust Fund (SRBTF, MGL c.32A, §24). The SRBTF is invested in the Pension Reserves Investment Trust (PRIT) Fund's General Allocation Account (GAA), also known as the PRIT

Core Fund. This fund is the vehicle for investing state and many local pension fund assets. The fund is professionally managed and is one of the best performing state pension funds in the country. Fund rates of return have averaged almost nine percent over the last ten years and are close to ten percent on average since the fund's inception in 1983. The Health Care Security Trust Board of Trustees has set a minimum investment requirement of $250,000 and a non-binding plan for qualified governmental entities to reach $1,000,000 over three years.

**Tax Exempt Property and Payments in Lieu of Tax Agreements –** As mentioned earlier, the city has a fairly sizable amount of tax exempt property. In FY2013, city assessors valued this exempt property at more than $530 million or slightly more than 25 percent of the city's taxable property value. These tax exempt entities range from small social service organizations to large institutions such as Fitchburg State University. While the city received $41,646 from the state's payment in lieu of taxes program tied largely to land owned by Fitchburg State, these reimbursements are for the land value only and do not include building values. City officials are concerned that some tax exempt properties rely on city services, primarily public safety services, for which they do not pay.

We recommend that the city begin a process of examining the cost of providing services to the largest of these tax exempt entities. In turn, this analysis should also attempt to balance the equation by looking at services that these entities may be providing to the city. Once this baseline analysis is complete, the mayor and her finance team should meet with the largest of these entities to discuss some form of a payment in lieu of taxes to compensate the city for these costs. We would advise the city to start with modest, manageable amounts that escalate over a multi-year period. This approach may be more palatable to the tax exempt entities as it allows them to more gradually accommodate the payment in lieu of taxes into their budget planning.

# Appendix A: Selected Data for Fitchburg and Comparable Communities

## General

| Municipality | County | 2010 Population | 2013 Average Single Family Tax Bill | 2010 DOR Income Per Capita | 2012 EQV Per Capita | Land Area | Population Density | 2009 Total Road Miles |
|---|---|---|---|---|---|---|---|---|
| Chelsea | SUFFOLK | 35,177 | | 14,969 | 63,614 | 2.2 | 16,063 | 48.7 |
| Everett | MIDDLESEX | 41,667 | | 16,566 | 87,679 | 3.4 | 12,328 | 63.8 |
| Fitchburg | WORCESTER | 40,318 | 2,981 | 16,553 | 57,720 | 27.8 | 1,452 | 201.4 |
| Holyoke | HAMPDEN | 39,880 | 3,330 | 14,612 | 54,487 | 21.3 | 1,873 | 174.2 |

## FY2013 Assessed Values by Class

| Municipality | Residential | Open Space | Commercial | Industrial | Personal Property | Total Assessed Value | R/O % of Total Value | CIP % of Total Value |
|---|---|---|---|---|---|---|---|---|
| Chelsea | 1,426,058,435 | 0 | 441,564,465 | 129,895,200 | 111,145,390 | 2,108,663,490 | 67.6 | 32.4 |
| Everett | 2,260,825,559 | 0 | 407,665,811 | 616,972,410 | 262,526,300 | 3,547,990,080 | 63.7 | 36.3 |
| Fitchburg | 1,634,790,575 | 0 | 211,979,373 | 109,833,500 | 120,365,137 | 2,076,968,585 | 78.7 | 21.3 |
| Holyoke | 1,494,528,700 | 0 | 464,632,588 | 83,265,233 | 48,962,044 | 2,091,388,565 | 71.5 | 28.5 |

## FY2013 Revenues by Source

| Municipality | Tax Levy | State Aid | Local Receipts | Other Revenue | Total Budget | Tax Levy % of Budget | State Aid % of Budget |
|---|---|---|---|---|---|---|---|
| Chelsea | 41,208,288 | 65,086,138 | 29,027,299 | 6,212,881 | 141,534,606 | 29.12 | 45.99 |
| Everett | 87,262,044 | 58,519,754 | 21,624,319 | 2,388,329 | 169,794,446 | 51.39 | 34.47 |
| Fitchburg | 42,312,177 | 55,885,852 | 23,500,687 | 7,384,574 | 129,083,290 | 32.78 | 43.29 |
| Holyoke | 51,281,090 | 79,462,057 | 15,066,745 | 3,775,217 | 149,585,109 | 34.28 | 53.12 |

## FY2013 Tax Rates by Class

| Municipality | Residential | Open Space | Commercial | Industrial | Personal Property |
|---|---|---|---|---|---|
| Chelsea | 14.13 | 0.0 | 34.20 | 34.20 | 34.20 |
| Everett | 15.64 | 0.0 | 43.04 | 43.04 | 43.04 |
| Fitchburg | 19.05 | 0.0 | 25.26 | 25.26 | 25.26 |
| Holyoke | 18.35 | 0.0 | 39.97 | 39.97 | 39.97 |