



March 31, 2017

Memorandum

To: Judith Flanagan Kennedy, Mayor

From: Seth Williams, Vileen Leung, Julia Belsky;
Public Financial Management Group Consulting, LLC

Re: The City of Lynn Multi-Year Planning:
Baseline Forecast, Financial Operations Review, and Capital Planning

INTRODUCTION

In January 2017, PFM Group Consulting LLC (PFM) was engaged by the City of Lynn – with funding secured as part of the City’s participation in the Commonwealth’s Community Compact grant program – to provide the following scope of services:

- 1) **Create a dynamic five-year analytical and budget forecasting model** to support and inform the City’s path toward greater fiscal sustainability. The Excel-based model illustrates City finances over that period if no changes were made to current spending and revenue trends. The goal of the baseline forecast is to provide an accurate projection of the *status quo* so that the City’s leadership, stakeholders, and residents can assess the size of any annual or recurring shortfalls before determining the need for, and impact of, a suite of corrective measures. This process and the resultant model will allow the City to dynamically plan for current and future horizons and provide an ability to react to changing conditions – or changing assumptions – in real-time to review and assess various policy choices and financial shifts as desired.
- 2) **Succinctly review the City’s financial operations** to ensure it is organized in a prudent and efficient manner that maximizes efficiency, and productivity including a review of the Department’s organizational structure, activities, and progress toward meeting desired outcomes, and fiscal effectiveness and efficiency.
- 3) **Provide a framework for a successful capital budgeting process** that can be sustainably included in the City’s annual budget activities once its immediate fiscal challenges have been addressed. Beyond addressing deferred maintenance, Lynn needs to create a process for proactive investment based on asset useful lives and budgetary affordability. By creating a capital process that is realistic, achievable, and sustainable, the City can begin to strengthen its capital infrastructure to provide the foundation for stronger neighborhoods, improved quality of life of residents, increased economic attractiveness, and competitiveness for employers.

This memorandum summarizes findings and recommendations of the three phases of the engagement – multi-year budget forecast, review of the City’s financial organization/operations, and high-level capital planning processes – and provides findings and recommendations for consideration.



GENERAL FUND BASELINE PROJECTION

Budget Projection Model

To better understand the City's financial trajectory, PFM developed a five-year projection that forecasts the City's revenues and expenditures from FY2017 to FY2022 absent significant changes and prior to corrective action. PFM used data provided by the City of Lynn to construct a multi-year financial projection model of the City's finances. This model uses a baseline of the City's Fiscal Year 2017 (FY2017) projected results, historical actual data from FY2014 (audited) to FY2016 (unaudited) and a series of assumptions to generate a baseline forecast of the City's financial results through FY2022.¹ The dynamic and interactive model has the capacity to demonstrate the impact of a variety of different assumptions in every fiscal year through FY2022, providing the City with a tool to test different financial conditions and strategies. The model also allows for real-time evaluation of a wide variety of steps to fill the forecast gap in the baseline.

It is important to recognize that the development of a multi-year financial projection is not a static process. Projections are not one-time forecasts or calculations. Instead, the intent of a multi-year financial projection process is for the City to regularly update and adjust the forecasts as assumptions, goals, and strategies change. Thus, multi-year financial forecasts require regular review and updates. As a result, this forecast – like all such projections – is a work in progress.

Methods and Assumptions

The City provided PFM with detailed budget history from FY2014 to FY2016, budgeted and year-to-date FY2017 data, and projected results for FY2017. PFM used these budget data to project future results by multiplying the value from the base year by a growth rate for each individual line of the budget. The growth rates reflect a variety of methods used to project City financial results for future years. Among others, these methods include maintaining the same compound annual growth rates from past years; including known specific numbers where debt service and other projections are available; using inflationary growth rates based on national and other economic data; applying future figures from policy-based estimates from City staff; and including fixed amounts based on recent trends in state grants and subsidies.

The baseline forecast is a projection of what Lynn's financial results would be if no policy changes are made – it reflects inflation, known or assumed growth in revenues and expenditures, and other known events. The baseline provides an estimate for the City to use in evaluating the need for, and elements of, policy changes that would adjust future financial results.

The baseline projection is not a budget itself, but rather a projection of future financial results based on recent actuals and current-year projected figures. It is assumed that the City will actually prepare and submit budgets that will be quite different from the baseline projection.

The baseline forecast makes a series of key assumptions that have major impacts on the projections. Changing these assumptions will alter the forecast outcome. Key assumptions in the current baseline include:

¹ It is important to note that the baseline FY2017 projected results discussed in this memorandum may – and likely will – change as a result of various City actions and other occurrences through June 30, 2017. Similarly, the proposed baseline FY2018 budget may potentially vary from the ultimate budget adopted by the City Council and Mayor. Additionally, some figures may vary from City budget data due to rounding and projection methodology.



- Revenue growth consistent with expected changes in the tax base over time, including a 2.5 percent increase in its annual tax levy;
- No across-the-board wage increases after expiration of current bargaining agreements;
- No change in the number of employees; and
- Expenditure growth based on the factors described earlier in this memorandum.

In recent years, the City of Lynn struggled to balance its annual General Fund budget and lags some similarly-situated cities in the Commonwealth and across New England in terms of financial strength. The City has relied on free cash in the past few years, making its fiscal condition vulnerable to reductions in revenue streams, significant non-budgeted expenditures, or other unanticipated costs. While short-term solutions have been used in the past to cope with the financial gaps, the City must create a structurally sustainable budget in order to make resources available for long-term policy priorities.

Lynn faces a series of challenges that result from both structural and cyclical issues. Lynn continues to face rising cost pressures driven by personnel cost growth (including legacy costs of pension and healthcare benefits) and school enrollment.² The combination of these increasing costs and slower revenue growth creates a cyclical, structural gap. This is compounded by longer-term pressures caused by decades of post-industrial population loss, aging public infrastructure, and the ongoing need to adequately fund its school system. In the face of these challenges, the traditional approach to budgeting that looks at problems and solutions one year at a time is inadequate to meet the goal of fiscal sustainability.³

As a result of its fiscal challenges, the City began falling short of the Commonwealth-required net school spending in FY2011. By FY2013, annual structural deficits began to surface in the City's General Fund, resulting in the use and draw down of free cash and fund balance. As of the end of FY2015, the City's unassigned fund balance was reduced to three percent of total expenditures, equivalent to approximately 10 days of operational spending – and far below the Government Finance Officers Association (GFOA) recommended best practice level of two months of expenditures, or 16.7 percent of total expenditures.⁴ The City's fiscal challenges resulted in a November 2016 bond rating downgrade by Moody's Investors Service – reducing the City's credit rating from A1 to A3 (a two-notch downgrade), including a negative outlook.

Lynn now faces a critical moment. Absent corrective action, the City's General Fund is projected to have an \$8.6 million deficit in FY2017 and deficits in each of the subsequent five-years. According to the baseline projection, the City already exhausted all of the General Fund's free cash in FY2017, and is

² Budget challenges are not unique to the City of Lynn; however, Lynn's challenge is more immediate and severe than in many other jurisdictions. An April 2015 study by the U.S. Governmental Accountability Office (GAO) projects a five percent structural deficit across the state and local government sector for the next half century, prior to corrective action. While this national projection encompasses many factors, the key element is the expectation that economically sensitive revenues will struggle to keep pace with overall growth, as healthcare and retiree benefits costs are forecast to continue to increase at a much greater rate.

³ The GFOA has recognized that multi-year financial plans are a best practice. A multi-year plan provides "a comprehensive and systematic management tool designed to help organizations assess the current environment, anticipate and respond appropriately to changes in the environment, envision the future, increase effectiveness, develop commitment to the organization's mission and achieve consensus on strategies and objectives for achieving that mission." The GFOA also suggests that "all governmental entities 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." *Recommended Budget Practice on the Establishment of Strategic Plans (2005)*. GFOA.

⁴ The GFOA advises that a city establish a formal fund balance policy that can "articulate a framework and process for how the government would increase or decrease the level of unrestricted fund balance over a specific time period" including a planned level of fund balance, taking into account factors specific to the City, such as revenue stability or environmental threats. This policy should also include a plan for how and when to use this fund balance, and how to replenish it afterwards. *Appropriate Level of Unrestricted Fund Balance in the General Fund (2015)*. GFOA.

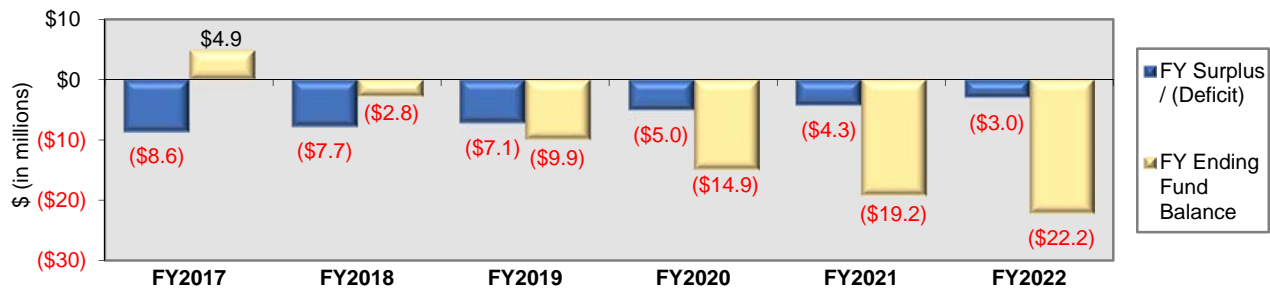


projected to deplete its fund balance reserves as soon as FY2018. In order to contract its fiscal challenges, the City’s required actions are immediate and significant. Confronting the City’s fiscal challenges will likely require the City to pursue and enact difficult, painful choices.

During the next five years, Lynn must take action in order to achieve short-term fiscal balance and sustainable long-term growth. Often, local governments seek to avoid difficult choices by deferring costs or relying on non-recurring revenues. This “kick the can down the road” approach is unsustainable for local government finance and heightens the risk of losing ground. In fact, the longer it takes for Lynn to acknowledge and confront its fiscal challenges, the harder and more painful it will become to implement viable solutions.

At the same time, population growth in recent years has provided Lynn with a growing tax base. The City also has significant economic development opportunities, especially given its proximity to Boston and the potential of improving the three-mile waterfront. This economic foundation may position Lynn to balance its budget on a sustainable basis if – *and only if* – the City immediately begins addressing its financial challenges through intentional corrective actions and a disciplined approach to financial management.

General Fund Baseline Forecast, FY2017 – FY2022⁵



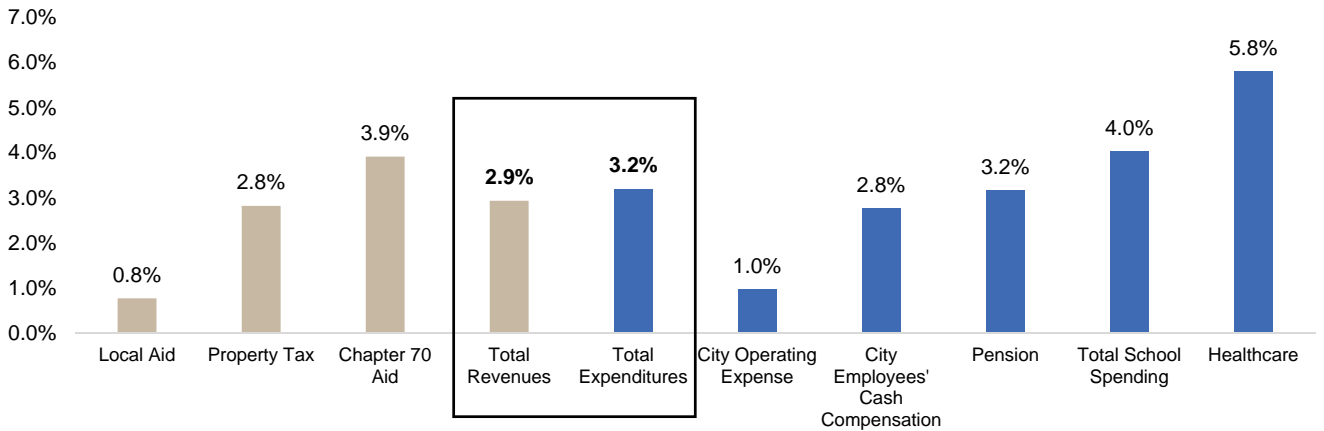
Based on the assumptions outlined in this memorandum, the baseline projection indicates an immediate fiscal challenge for the City: a projected deficit of \$8.6 million in FY2017 if no corrective action is taken.⁶ During the projected period, operating revenues are projected to grow at an average annual rate of 2.9 percent, driven largely by property tax revenue and state aid from the Commonwealth of Massachusetts. Operating expenditures are projected to grow at a higher rate of 3.2 percent, largely as a result of increasing personnel cost growth and the City’s net school spending requirement. Fundamentally, this General Fund misalignment between revenues and expenditures results in an unsustainable structural fiscal gap annually. The following chart highlights key revenue and expenditure budget drivers across the baseline projection period prior to corrective action and absent significant changes.

⁵ The net operating results are the differences between projected General Fund revenues and expenditures, and is calculated on an annual basis. The ending fund balance reflects the City’s estimated total fund balance and is cumulative of the annual net operating results.

⁶ The \$8.6 million FY2017 projected deficit is based on expenditure data as of February 2017. Since then, the City has generated additional savings through unfilled vacancies and operational spending cuts and may end the year with a lower projected deficit. Claims experience through April 2017 also suggests that the City may spend less than projected on health benefits.



General Fund Fiscal Drivers, FY2017 – FY2022⁷



The five-year projection assumes no across-the-board wage increases after the expiration of the current labor agreements. As a result, any increase in wages or other types of compensation enacted after the expiration of the current agreements (generally as of FY2019) would increase the size of the General Fund imbalance by increasing expenditures above baseline forecast projections without a commensurate revenue increase. If the City continues its current financial trajectory, its free cash may be exhausted by the end of FY2017 and its General Fund fund balance could be depleted as soon as FY2018.

Major Revenue Growth Assumptions

The City's three largest revenue sources – Chapter 70 aid, property tax, and unrestricted general government (local) aid – comprised 95.7 percent of total General Fund revenue in FY2017 and 96.2 percent in FY2022. The remaining approximately four percent includes locally-generated revenues such as licenses, permits, and fines, employee healthcare contributions, and charter school reimbursements. Significant baseline revenue assumptions are listed below:

- Chapter 70 Aid.** The single largest revenue source for the City is its Chapter 70 aid, which represents almost half of the City's 2017 budget. Chapter 70 aid is a state funding program designated specifically for school spending related to public elementary and secondary school, and has historically been approximately 75 percent of the City's net school spending requirement. This allocation is determined by the Commonwealth on an annual basis, and the baseline projection uses the most recently available allocation for FY17 and FY18. Beyond FY18, Chapter 70 revenues are projected to grow at the historical growth rate of 3.3 percent.

FY2017	FY2018	FY2019	FY2020	FY2021	FY2022
\$151.4M	\$152.8M	\$157.9M	\$163.1M	\$168.5M	\$174.0M

- Property Tax.** The City's second largest revenue source is its property tax, which represents over 40 percent of the City's 2017 budget and consists of the City's real estate tax, personal property tax, and motor vehicle excise tax. The baseline projection assumes the real estate tax to grow at 4 percent

⁷ All revenue and expenditure categories' growth as shown in the graph above represent the compounded annual growth rate (CAGR) from FY2017 to FY2022. Total revenues and revenues use the CAGR from FY2016 to FY2022 to capture the projected deficit in FY2017.



annually, inclusive of a 2.5 percent levy growth and 1.5 percent new growth. The 1.5 percent new growth assumption is based on the continuous increase in the City’s tax base, especially with the ongoing development projects the City has seen in recent years. This projection also assumes that 98 percent of the tax levy will be collected in the first year based on historical collection trends.

FY2017	FY2018	FY2019	FY2020	FY2021	FY2022
\$129.4M	\$134.5M	\$139.8M	\$145.2M	\$150.9M	\$156.8M

- **Unrestricted General Government Aid.** The Commonwealth also provides funding to local municipalities in the form of unrestricted general government aid that is distributed through revenues generated by lottery and gaming sales. The City’s funding increased by an average annual rate of 3.6 percent from FY14 to FY17, and FY18 funding is set at \$22.4 million according to the most recently available allocation. The baseline projection assumes this revenue to stay flat beginning in FY19.

FY2017	FY2018	FY2019	FY2020	FY2021	FY2022
\$21.5M	\$22.4M	\$22.4M	\$22.4M	\$22.4M	\$22.4M

Major Expenditure Growth Assumptions

The City’s \$328 million General Fund budget in FY2017 includes \$200 million in school spending, which includes funding for its K-12 schools as part of the School Department budget, and \$128 million in City spending, which includes funding core municipal services that range from public safety to waste collection. Significant baseline expenditure assumptions are listed below and comprise 99.3 percent of total General Fund expenditures from FY2017 to FY2022 (98.3 percent from FY2017 to FY2022 excluding school spending):

- **Total School Spending.** Representing 60 percent of the total City budget, the City is projected to spend \$200 million on its school department in FY2017 based on a school funding formula governed by the Commonwealth. The net school spending amount is established by the Massachusetts Department of Elementary and Secondary Education every year based on school enrollment, student demographics, and growth across various education spending categories (e.g. teacher compensation, health benefits, professional development, building maintenance etc.). The baseline projection assumes that the City would meet its required net school spending in FY17 (\$197.2 million) and FY18 (\$201.0 million), after which net school spending would grow at the historical annual growth rate of 3.3 percent, the same rate at which Chapter 70 aid is projected to grow. This category also includes additional spending to repay prior years’ spending deficits (\$8.4 million in FY15 and \$1.1 million in FY16) over a four-year period.⁸

FY2017	FY2018	FY2019	FY2020	FY2021	FY2022
\$199.7M	\$203.4M	\$210.1M	\$214.7M	\$221.5M	\$228.8M

- **City Employees’ Cash Compensation.** The second largest spending category is City employees’ cash compensation, representing 15 percent of total General Fund spending and almost 40 percent of the City’s portion of the budget. This category includes personnel costs such as salaries, longevity, overtime, tuition reimbursements, and personal and sick days’ buyback. The baseline projection

⁸ Any FY17 net school spending deficit is not reflected in this analysis.



assumes headcount at levels consistent with the 2017 budget, and routine turnover of public safety personnel based on retirements with full replacement. All salary-related items are projected to grow by a blended salary growth rate that assumes no across-the-board wage increases beyond existing bargaining agreements (FY19) and applicable step increases for public safety personnel.

FY2017	FY2018	FY2019	FY2020	FY2021	FY2022
\$49.7M	\$49.4M	\$49.8M	\$49.8M	\$49.9M	\$49.9M

- Health Benefits.** Health benefits represents 13 percent of the City's total General Fund budget, of which 55 percent is allocated for school employees and included in net school spending. Beginning in FY16, the City was authorized by majority vote to begin a four-year phase-in toward including school retirees in its actual net school spending calculation, per section 260 of the State's FY15 budget. The baseline projection accounts for the four-year phase-in schedule of school retirees' health benefit costs and assumes full funding by the FY19. The baseline projection also assumes that health benefit costs would grow at an annual rate of 5.8 percent according to historical trends.

FY2017	FY2018	FY2019	FY2020	FY2021	FY2022
\$43.1M	\$45.6M	\$48.2M	\$51.0M	\$54.0M	\$57.1M

- Pension.** The City is a member of the Lynn Contributory Retirement System and is governed by Chapter 32 of the Massachusetts General Laws. Prior to the beginning of each fiscal year, the Commonwealth Public Employee Retirement Administration Commission (PERAC) provides the Lynn Retirement Board with the required appropriation for its pension fund. The City is responsible for 88 percent of the total pension contribution, while the Housing Authority and the Water and Sewer Commission account for the remaining 12 percent. Using the funding schedule provided by PERAC as of October 2016, the following shows the City's projected pension contribution, which assumes an annual growth rate of 4 percent:

FY2017	FY2018	FY2019	FY2020	FY2021	FY2022
\$27.2M	\$27.1M	\$28.2M	\$29.6M	\$31.6M	\$33.2M

- City Operating Expense.** The City's operating expense includes spending on utilities, supplies, equipment, maintenance, liability settlements, and school transportation. Most of these expenses are projected to grow at an annual inflation rate of 2.3 percent, consistent with the national Survey of Professional Forecasters expectations issued by the Federal Reserve Bank of Philadelphia. Utilities (electricity, motor fuel, gasoline, etc.) are projected to grow at a blended rate of 3.5 percent according to national forecasts by the US Energy Information Administration.

FY2017	FY2018	FY2019	FY2020	FY2021	FY2022
\$30.0M	\$29.5M	\$32.3M	\$34.0M	\$34.7M	\$35.0M



- **Debt Service.** The City's existing debt schedule phases its debt service payments down from \$8.4 million in FY17 to \$4.5 million in FY22, net of the Massachusetts School Building Authority (MSBA) reimbursement. Because the baseline projection assumes no significant changes which, by definition, includes leveled investments in its capital infrastructure, the baseline forecast includes additional debt issuances of \$58 million in FY19, resulting in annual debt service payments averaging \$8.3 million from FY18 to FY22.

FY2017	FY2018	FY2019	FY2020	FY2021	FY2022
\$8.4M	\$6.7M	\$8.9M	\$8.7M	\$8.8M	\$8.5M

- **Capital Pay-as-you-go (Paygo).** From FY14 to FY17, Lynn's repair and maintenance spending dropped by almost 50 percent from \$2.1 million to \$1.2 million as a result of recurring annual deficits since FY13. The baseline projection therefore includes \$1.3 million in capital pay-as-you-go funding (equivalent to 1 percent of the City's portion of the General Fund budget) beginning in FY20 to reflect the necessary maintenance and repairs needed as a result of deferred maintenance over the past few years.

FY2017	FY2018	FY2019	FY2020	FY2021	FY2022
\$0.0M	\$0.0M	\$0.0M	\$1.3M	\$1.3M	\$1.4M

Key Baseline Budget Results, FY2017 – FY2022

- **Total Revenues** **2.9%**
 - Local Aid 0.8% (\$0.8M)
 - Chapter 70 Aid 2.8% (\$22.6M)
 - Property Tax 3.9% (\$27.4M)
- **Total Expenditures** **3.2%**
 - City Employees' Cash Compensation 1.0% (\$0.2M)
 - Total School Spending 2.8% (\$29.2M)
 - City Operating Expense 3.2% (\$5.0M)
 - Pension 4.0% (\$6.0M)
 - Healthcare 5.8% (\$14.0M)



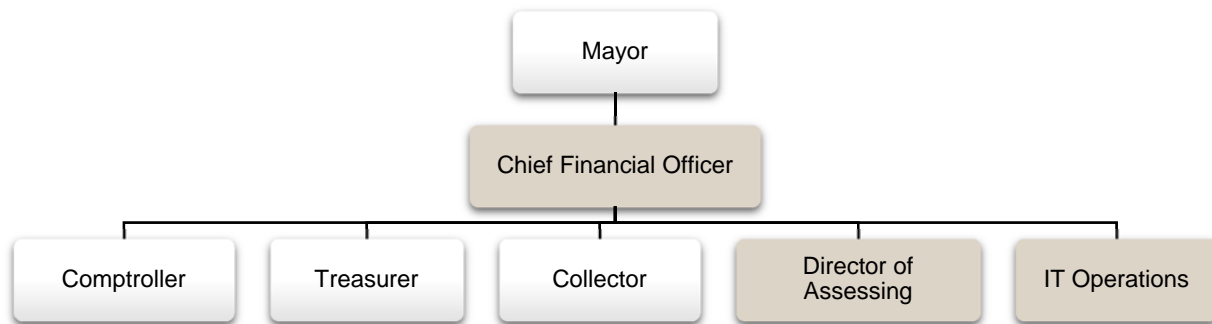
FINANCIAL OPERATIONS REVIEW

Current Operations

According to the City Charter, the City's Chief Financial Officer (CFO) is responsible for the coordination, administration, and supervision of all financial services and activities; implementation and maintenance of internal systems and procedures; and the monitoring of all the expenditures of all funds, including periodic reporting to appropriate agencies.

Under the City's current organizational structure, the only staff who manage the City's financial operations are the Assessor, Comptroller, and Treasurer. The City's Assessor currently acts as the Chief Financial Officer who, in addition to performing property assessment and financial management responsibilities, provides informational technology (IT) support and leadership to other departments in the absence of an IT Director position in the City. The below chart illustrates the City's organizational structure, and the shaded areas represent the positions that are currently held by the City's Assessor:

City of Lynn, Current Financial Management Organizational Structure



Alternative Model for Consideration

Short-Term Priority: Full-Time Chief Financial Officer

Most cities of Lynn's size – both in terms of budget and population – operate with a full-time CFO or Finance Director responsible for leading – among other items – some combination of the City's budget, audit and financial reporting requirements/statements, debt management, cash flow, revenue collection, accounts receivable/payable, and procurement.

Currently, the City's CFO serves in that role in a part-time manner in addition to being the full-time City Assessor. While this arrangement has allowed the City to save salary costs, principal CFO duties should not be held by an employee who already leads one or more other City departments. Partially as a result of the lack of a full-time CFO, the City has not been able to achieve strong internal budgetary control or adopt budgetary best practices. To be clear, this is not a reflection on the current individual or individuals serving in the finance roles for the City, but rather a critical lack of capacity that undermines the City's ability to achieve a fully-functional financial management structure.

In order to craft and implement the City's necessary fiscal recovery plan, Lynn should hire a full-time CFO. The City's current part-time CFO has helped to identify and navigate the City's fiscal challenges in addition



to other full-time duties. However, the significant fiscal challenges faced by the City require that it hire an individual to address and manage its finances on a full-time basis and allow the part-time CFO more time to fully attend to duties as the Director of Assessing – a combination which, in the immediate, would serve the City well and, preliminarily, not require any change to the City Charter.

In addition to the immediate need to meet its significant operating deficits, Lynn must build capacity for more prudent financial management processes. While confronting the City's structural deficit is necessary in the short- and long-term and deserves immediate and serious actions, the City must also take more basic actions to ensure that it adopts certain financial management best practices to help alter its fiscal trajectory.⁹ A full-time CFO should begin to establish the following best practices and management actions to eliminate operating deficit and achieve long-term sustainability:

1. Establish a revenue forecasting methodology and produce a balanced budget prior to the start of a fiscal year
2. Monthly or quarterly financial reporting and monitoring to identify variances between actuals and budget
3. Establish a fund balance policy that requires the City to maintain an unassigned General Fund balance that is tied to a percentage of annual General Fund expenditures¹⁰
4. Establish a personnel tracking system to report the number of budgeted and vacant positions at any given point in time
5. Annually update its five-year financial projections¹¹

Short-to-Medium-Term Priority: Creation of Full-Time Chief Operating Officer

Given the breadth and significant of duties conferred upon the CFO by the City Charter, the position requires an individual's undivided attention, and, given the City's urgent fiscal challenges described in this report, the need for immediate and singular focus cannot be understated. In addition to the need for a singular focus of the CFO, the effective management and operation of the City likely requires an additional senior administrator to ensure the proper and efficient delivery of critical municipal services within the parameters of a constrained municipal budget.

As Lynn confronts its projected fiscal gap and works to achieve long-term fiscal sustainability, it will likely require a strong, experienced senior executive to help implement the vision of the elected leaders of the City and be responsible to manage the day-to-day operations of the City. A Chief Operating Officer (COO) role is utilized in many cities to serve as the day-to-day manager of City operations – often including overseeing the City's budget (see potential organizational chart on following page). This role, somewhat akin to that of a City Manager, requires a seasoned individual that has fiscal and operational savvy as well as a strong orientation and sensitivity to the process and functions of government. While this action may require a change in the City's Charter, this position may be the most critical in achieving long-term fiscal and operational health and sustainability.

The position of Chief Operating Officer is common among small- and medium-sized cities in the northeast – including Providence, Rhode Island and the City of Hartford, Connecticut. Additionally, the City of Reading, Pennsylvania, with a population size of 88,000, has a City Manager who reports to the Mayor

⁹ *12 Habits of Successful Finance Officers*, Fitch Ratings

¹⁰ *Ibid.*

¹¹ *A forecast provides a shared basis for discussion about what the fiscal future might look like and what actions can be taken. In the absence of a formal forecast, a common assumption is that the future will not be much different than the past – an assumption that could be seriously flawed.* Adapted from *Informed Decision-Making through Forecasting: A Practitioner's Guide to Government Revenue Analysis*, by Shayne Kavanaugh and Daniel Williams (GFOA: 2017)

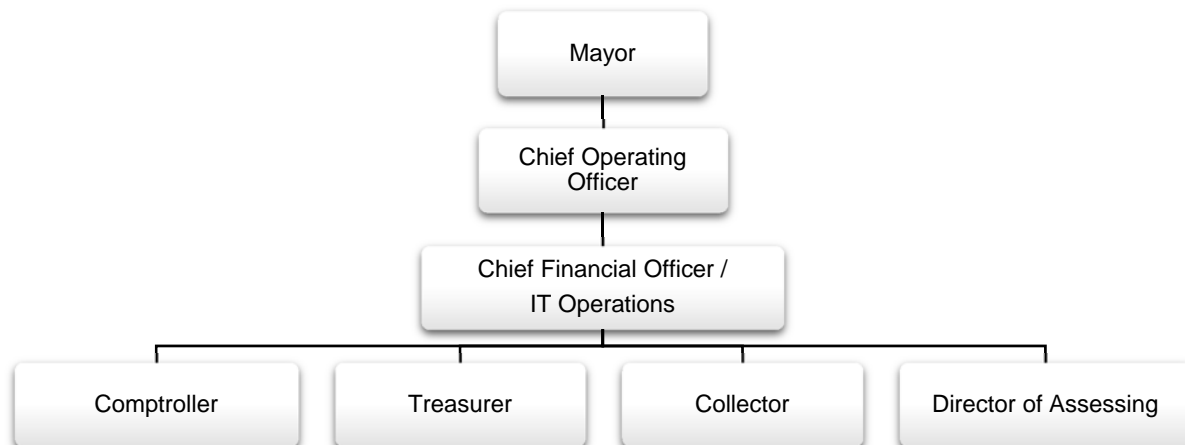


and oversees the day-to-day operations while the City's Administrative Officer and the City's Controller work together to manage the City's financial operations and auditing requirements.

A COO model would yield the following benefits:

- *Enhanced opportunities for coordination and collaboration.* Adopting a COO organizational model would allow the Mayor and COO to encourage different departments/offices to better coordinate and collaborate – addressing key City priorities as one entity rather than a myriad of separate, silos. Consolidating related services under a single direct report to the Mayor would allow for greater communication among those service providers and their managers, and would allow maximization of shared support and administration across and within City departments.
- *Focus on enterprise-wide issues and priorities at a senior executive level on a day-to-day basis.* Constituting a significant percentage of the total City budget, cross-cutting, enterprise-wide issues like education, public safety, and workforce issues are critical concerns that – in the City's current operational model – do not have the focus of one, senior-level individual on a day-to-day basis. A single, direct report to the Mayor would clearly place such priority areas high on the City agenda, and would also ensure critical issues receive warranted attention at the Executive level.
- *Creation of an appropriate organizational layer between the Mayor and office heads.* An organizational layer between the Mayor and department heads can help focus disparate issues for the Mayor's attention. The separation may allow the Mayor to gain the benefit of advice from a senior executive with a more global perspective on issues than the individual office heads may have. Notwithstanding the presence of an organizational layer between the Mayor and office heads, it is anticipated that the Mayor, on appropriate discrete occasions, would have direct contact with office heads reporting to the COO.

City of Lynn, Potential Financial Management Organizational Structure¹²



The City's CFO position may be better served to report to or through the COO so that the CFO position is both integrated into the day-to-day operations and management of the City as well as providing the time

¹²While it is not financially feasible for the City to hire a full-time IT Department head at this time given the City's current projected trajectory, it should be the long-term goal of the City to establish a position that leads the City's IT efforts.



and ability to focus intently on improving the City's fiscal health. If the City pursues the adoption of a COO position, that individual should work with the CFO to implement initiatives to reduce expenditures and enhance revenues in order to close the fiscal gap. This is especially important given the City's need to take immediate action in order to maintain fiscal solvency and avoid cash flow deficits.

The role of COO as the day-to-day leader of City government operations emphasizes the need for City government to not only think strategically about its short-term and long-term fiscal and operational realities, but also its goals and objectives. For instance, increased coordination and consolidation of certain functions under a COO should result in improvements in effectiveness and efficiency. Initially, performance metrics would need to focus on operational savings – reductions in headcount and budget – as well as improvements in the City's ability to effectively deliver core services. The COO should regularly measure key performance metrics to drive outcomes – both fiscal and operational and over the short- and long-term. Communicating this performance data – both internally to the Mayor and Council and externally to taxpayers and the public – provides accountability so that all with a stake in Lynn can become full partners in their local government.



CAPITAL PLANNING

This section of the memorandum is included to provide the City with the high-level capital planning process orientation requested pursuant to its Community Compact award; however, until such time as the City addresses its short-term and long-term structural deficits, its practical capacity to enact a meaningful and robust capital plan is severely diminished. As a result, the following pages are intended to be used as a “process guide” at such time as the City has taken sufficient steps to address its urgent structural challenges and can begin to address its capital needs in a more comprehensive and systemic manner.

Like most cities in the country, Lynn has extensive and expensive infrastructure used to deliver core services to its citizens, business, and visitors. Ranging from roads and sidewalks to fire stations, the City’s most recent annual financial statements estimated its capital assets’ value at over \$370 million, a figure that is almost certainly several times less than the replacement value of those assets due to depreciation and valuation rules.

The City has underinvested in infrastructure over the last decade (and potentially longer), utilizing piecemeal spending of operating funds as available. Given the City’s recent budgetary constraints and projected structural deficits this approach is somewhat understandable in recent years; however, prospectively, the City needs to establish a formal capital planning process in order to assure the sustainability the City’s infrastructure and reduce long-term capital spending.

Lynn does not have a formal capital budget or capital plan, and does not have a structured process for planning or monitoring capital investments. While the City does a good job of prioritizing capital projects based on condition assessment, this process must be institutionalized and projects must be prioritized and funded in a transparent and systematic way. By establishing a formal, annual process, the City can avoid emergencies that could be operationally or financially disruptive and be able to have more and better information with which to make strategic investment decisions. Additionally, credit rating agencies consider capital planning an important part of financial planning, and take it into account when assigning ratings.

Adopting a capital plan will help Lynn achieve a cited Government Finance Officers Association (GFOA) “Best Practice.”

Budgetary pressures often impede capital program expenditures or investments for maintenance and replacement, making it increasingly difficult to sustain the asset in a condition necessary to provide expected service levels. Ultimately, deferring essential maintenance or asset replacement could reduce the organization’s ability to provide services and could threaten public health, safety and overall quality of life. In addition, as the physical condition of the asset declines, deferring maintenance and/or replacement could increase long-term costs and liabilities. Government entities should therefore establish capital planning, budgeting and reporting practices to encourage adequate capital spending levels. A government’s financial and capital improvement plans should address the continuing investment necessary to properly maintain its capital assets. Such practices should include proactive steps to promote adequate investment in capital maintenance and replacement and necessary levels.¹³

¹³ *Capital Asset Assessment, Maintenance and Replacement Policy*, GFOA, rev. 2010



Capital Planning Principles

Financial stability	Operational stability	Transparency
<ul style="list-style-type: none"> • Capital financing strategies should be affordable and consistent with the operating budget • Reserves are needed for unanticipated projects 	<ul style="list-style-type: none"> • Proper stewardship of capital assets is necessary for the City to deliver services efficiently and effectively • Emergency capital projects should not have a claim on City finances or operational capacity 	<ul style="list-style-type: none"> • Priorities for capital spending should be explicit, aligned with other City goals and policies, and applied consistently • The status of CIP implementation should be reported regularly

A full-time CFO (and, potentially, a full-time COO), should provide additional expertise and capacity within the Finance Department to establish an annual process for a multi-year capital plan. Section 5-5 of the City Charter also requires that “the mayor shall prepare and submit to the city council a five-year capital outlay program at least three months prior to the final date for submission of the proposed operating budget.”¹⁴ It may be the case that in FY2017 and several years thereafter, the City may be unable to meaningfully fund a long-range capital program; however, during this time, the City can and should identify opportunities to invest in paygo capital as well as begin crafting a multi-year capital asset inventory and needs assessment so that, upon sufficient fiscal health – it can quickly and adeptly adopt a meaningful capital plan.

As the City begins to establish such a capital planning process, it is crucial that the process includes both transparency and accountability (e.g. at a minimum: sources of funding and projected spending allocations are published in its annual capital budget along with justification and ranking criteria and summaries). As part of the process, the City’s should also establish capital planning policies including:

- A clear definition of what constitutes a capital improvement project
- A requirement that a multi-year capital improvement plan be developed
- A minimum threshold for the City’s annual capital improvement investment
- Establishment of a cross-departmental capital improvement plan review committee
- Establishment of a structured process for prioritizing need and allocating limited resources
- Provisions for monitoring and oversight of the capital improvement plan
- A procedure for accumulating necessary capital reserves
- A debt policy governs the type of borrowing, debt structure, and maximum debt burden

Establishing a Capital Improvement Plan

A Capital Improvement Plan (CIP) has two components: the capital budget and the capital program. The capital budget provides an outline for the upcoming year’s revenues and expenditures and the capital plan provides a long-term (usually five to ten years) capital plan. This section provides a step-by-step guide to establishing a CIP.

¹⁴ *Lynn City Charter*, updated November 2004



Step 1: Identify Capital Needs

The first step in capital planning is to identify the City's needs. This requires that the City designate a lead department. In many jurisdictions, the budget or finance department begins the process; in some other cities, the planning department or the public works departments takes the lead because of their respective broader knowledge bases of the City's infrastructure and equipment.

To identify capital needs, the City needs to develop a capital asset life cycle for major capital assets to plan for acquisition, maintenance, replacement, and retirements. The City can do this by producing, and regularly updating, a comprehensive infrastructure investment plan that contains the following elements:

- Life cycle assumptions
- Documentation of the City's streets, bridges, buildings, and recreation assets
- Description of the progress made since the previous plan and the impact of such progress

Step 2: Identify and prioritize projects, their financial impacts, and funding options

The City should form a capital oversight committee to prioritize capital needs and identify funding options. The committee should include senior members from the CFO's operation (if not the CFO) and department leaders with major capital facilities, such as schools, public works, police, and fire. The committee will review capital project proposals and identify a decision-matrix that can help prioritize, evaluate, and select capital projects.

The City should also consider involving residents and stakeholders (business communities, education institutions, hospitals, etc.) to generate input.

When evaluating and prioritizing projects, the City may find it helpful to prioritize based on:

1. *Health and Safety* – priority to high risk safety issues (e.g. bridges or roads in crucial need of maintenance)
2. *Asset Preservation* – capital assets that require replacement based on capital asset life cycle (e.g. rooftop replacement based on a 20-year life cycle)
3. *Asset Expansion/Addition* – infrastructure improvements needed to support City policies and goals -- while important, likely less pressing than the prior two general categories.¹⁵

The City may find it helpful to require departments to complete project proposal forms that provide adequate information about the project so that the committee can be as informed as possible prior to making funding decision. This process would help the City meet guidelines set out in the Charter, which require the City to provide a list of capital expenditures proposed, their cost estimates, methods of financing, and time schedule in the capital budget. The City could consider the following criteria and potential questions in its capital planning process:¹⁶

- *Overall fiscal impact* – will the project bring in additional revenue or will it cost additional money to operate? Are their funding sources other than the General Fund for this project?
- *Legal obligations* – does the project improve compliance with federal law, state law, or local ordinance?

¹⁵ As with any such general policy, there may be exceptions and this approach is provided as general guidance that may not apply to every situation on a case-by-case basis.

¹⁶ 2016-2020 Capital Improvement Plan, City of Springfield, MA



- *Impacts on service to the public – will residents receive better service if the project is conducted? Will it address a public health, safety, accreditation or maintenance need?*
- *Urgency of maintenance needs – is the asset currently broken and in need of immediate replacement?*
- *Prior phases – if the project is a multiyear project, have prior phases been previously conducted? Department priority – what priority does the department place on the projects based on the departmental mission, goals, and objectives?*

Once all submitted capital projects are vetted by the capital committee, individual projects can be ranked in a structured, objective, and multi-dimensional way by utilizing a prioritization matrix. This tool may help the City achieve consensus by mitigating the subjectivity in the decision-making process while prioritizing complex issues. The table to the right is a decision matrix highlighted by the GFOA, and is one example of how a quantified approach to capital project prioritization helps rank various project proposals.¹⁷

Capital Projects’ Decision Matrix, Example

Priority Ranking Criteria	Weighting Factor
Public Health and Safety	1.50
Employee Health and Safety	1.25
Regulatory Mandate	1.50
Frequent Problems	1.25
Availability of Funding	1.00
Cost of Project	1.00
Generates Revenue	1.20
Generates Cost Savings	1.20
Ongoing Operation Costs	1.00
Age or Condition of Existing	1.00
Public Benefit	1.10
Public Demand	1.25
Synergy with Other Projects	1.10
Strategic Goal	1.05
Comprehensive Plan Component	1.05
Total Score	

A decision matrix requires committee members to assign a score to each of the ranking criteria, which are then multiplied by the weighting factor. The aggregate of the weighted scores results in a total score, which is then used to determine which projects are prioritized and funded (and whether each is funded using debt service or on a paygo basis). Note that the impact on the operating budget is one of the criteria considered, because it’s vitally important that the City understands how changes in capital spending impacts its annual budget and short-term and long-term affordability/viability of its project choices.

Like any government, Lynn should be thoughtful about the funding source for each of its capital projects. There are two primary methods for funding projects – pay-as-you-go and debt-financed. In the past, the City has used both methods to fund its capital projects and, going forward, may find it useful to consider GFOA’s recommendations regarding the “appropriate” funding method for certain project characteristics:

¹⁷ Adapted from *Prioritizing Capital Improvement Planning*, GFOA



Capital Funding Methods¹⁸

	Pay-as-you-go (PAYGO)	Debt financed
Ideal for Funding:	<ul style="list-style-type: none"> • Small projects • Assets with short useful lives • Projects with a local match requirement 	<ul style="list-style-type: none"> • Large projects • Assets with longer useful lives • Projects with a predictable stream of future revenue
Pros	<ul style="list-style-type: none"> • Saves interest and issuance costs • Preserves flexibility and borrowing capacity 	<ul style="list-style-type: none"> • Provides more money upfront • Easier to distribute spending over time through scheduled debt repayments
Cons	<ul style="list-style-type: none"> • Usually insufficient to fund all needs • Uneven expenditures • Lack of "intergenerational equity" 	<ul style="list-style-type: none"> • Adds interest and issuance costs • Limits financial flexibility and reduces borrowing capacity

Step 3: Adopt a capital budget and a comprehensive financial plan

Capital budgets and capital plan documents should be created in a manner that provides maximum transparency. For instance, the presentation of the capital budget should include a summary of the multi-year capital plan as well as detailed information related to the budget year on a project-by-project basis. Many local governments include detailed descriptions of individual capital projects in a separate capital document (e.g. project purpose, project type, responsible department, funding sources, and timing of each capital project) to ensure that the capital planning process and decisions are transparent.

Another capital planning best practice that the City may choose to adopt is the development of a multi-year financing plan to ensure that the capital plan is achievable within expected available resources. Capital financing strategies should align with expected project requirements while sustaining the financial health of the City’s operating budget, and should evaluate the reliability and stability of funding sources. To achieve this goal, the City must update its five-year multi-year forecast on an annual basis in order to align its capital investment strategies to its operating budget.¹⁹

After the construction of the capital budget and the capital plan (typically, the first year of the multi-year capital improvement plan becomes the current year capital budget, and the process is repeated annually to adapt to the changing capital needs of the City), the committee will prepare the capital budget and capital plan for review and consideration by the Mayor and other senior, executive branch staff. Upon confirmation from the executive branch, the capital budget and capital plan would be transmitted to the City Council for review.

Step 4: Regular monitoring and reporting

Upon the adoption of a capital budget and financial plan, it is essential that the City continues to provide transparency in the capital process by measuring and reporting performance of the capital budget. This not only allows the City to better project cash flow and funding availability, but also helps build resident and stakeholder confidence in a critical function of City government and overall quality of life in Lynn. At a minimum, the City should generate reports related to the following items:

¹⁸ Adapted from *Capital Improvement Programming: A Guide for Smaller Governments*, Patricia Tigue, GFOA

¹⁹ Adapted from *Multi-Year Capital Planning*, GFOA

- Status by project, including the following key measures:
 - Percent of project completed
 - Percent of budget expended
 - Progress on key milestones
 - Contract status
 - Revenue and expenditure activities
 - Available appropriation
 - Significant changes to project scope or costs, if any
- Project close-out, including the following key information:
 - Confirmation that the project is closed out appropriately
 - New infrastructure assets are properly recorded
- Legal and judiciary requirements of capital projects (e.g. grants with required local match) and whether the projects are meeting those requirements

Methods and Capital Budget Calendar

In order to ensure that the capital planning process aligns with the operating budget, the City should establish a capital budget calendar. The following chart summarizes the four steps as outlined in this report and illustrates how these steps could be aligned with the City’s operating budget calendar.

Capital Budget Calendar

