CITY OF NEWBURYPORT

CAPITAL PLANNING | A COMMUNITY COMPACT INITIATIVE

FEBRUARY 2016

DIVISION OF LOCAL SERVICES
MA DEPARTMENT OF REVENUE

PREPARED BY:

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DIVISION OF LOCAL SERVICES
MA DEPARTMENT OF REVENUE

Mark E. Nunnelly
Commissioner of Revenue

Sean R. Cronin
Senior Deputy Commissioner

February 1, 2016

The Honorable Donna D. Holladay
Mayor's Office
60 Pleasant Street
Newburyport, MA 01950

Dear Mayor Holladay,

I am pleased to present the enclosed capital planning guide that was developed for the City of Newburyport as part of the Baker-Polito Administration's Community Compact initiative. Community Compacts create clear mutual standards, expectations, and accountability for both the state and municipalities. It is my hope that our report provides important guidance and consistency to Newburyport's capital investment strategy, as together we seek to build better government for our citizens.

If you have any questions regarding the report, please feel free to contact Zack Blake, Director of the Division's Technical Assistance Bureau, at 617-626-2376 or at blakez@dor.state.ma.us.

Sincerely,

Sean R. Cronin
Senior Deputy Commissioner

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INTRODUCTION

In August 2015 the City of Newburyport entered into a Community Compact agreement for capital planning. A team from the Division of Local Services, Technical Assistance Bureau visited the city, conducted interviews with the mayor and financial staff, and spoke with school officials via conference call. One goal identified by city officials is to develop a predictable, comprehensive financing strategy for capital planning and to enhance the city's existing process where possible. This document is meant to provide a broader fiscal context for capital planning and to suggest best practices that will enable the city to achieve its stated goal.

First, we describe the current state of the city's capital plan and supporting ordinances and policies. Next, we provide an analysis of relevant financial trends to describe the city's fiscal context. Finally, we make specific recommendations on:

- Budgeting for and projecting capital financing capacity as a percentage of revenue;
- Policies to monitor capital spending and debt load as a percentage of revenue;
- Policies to monitor and manage free cash, the stabilization fund and retained earnings;
- Policies to effectively allocate one-time revenue sources;
- Procedures to make the capital planning process more effective, including working with the Community Preservation Committee to integrate Community Preservation Act funding with the process.

The key underlying concept is that capital planning should not take place in a vacuum. Rather, the city's capital budget must be grounded firmly within the context of its overall fiscal condition. While a detailed, well-structured process is necessary for determining capital needs and organizing projects, it must be supported by careful budgeting practices and practical debt management, reserve, and revenue policies. In order to build a useful, sustainable, and predictable capital financing strategy, the city must find the right balance in implementing these practices.

Background

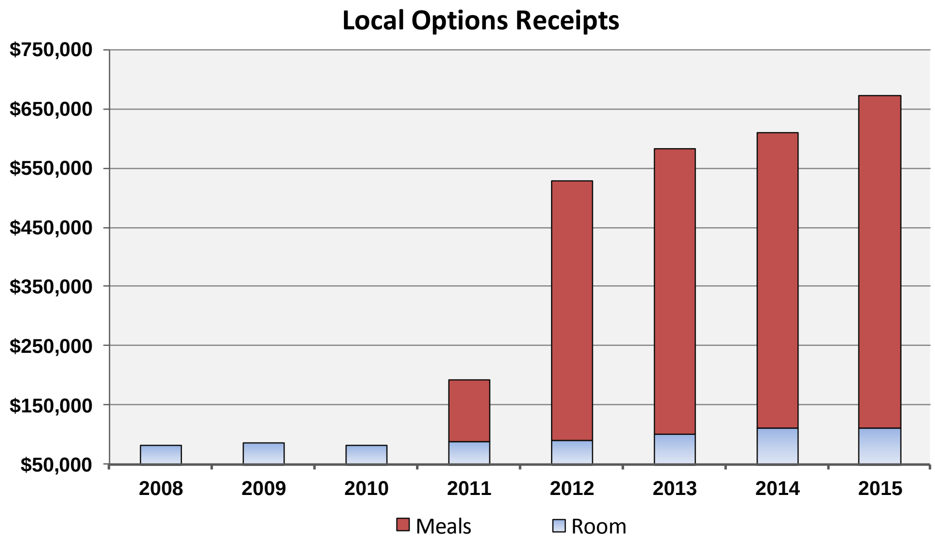
Newburyport is a North Shore city with a population of about 18,000 residents. Fulfilling the executive role of government is a popularly-elected mayor serving a four year term, while an eleven-member city council serving two year terms makes up the legislative body. All department heads, including the city's financial offices—finance/auditor, treasurer/collector, and assessing—are appointed by the mayor, except for the city clerk, who is appointed by the city council.

Newburyport's maritime tradition is a strong part of the local character, and the city's history and waterfront attractions help to support a healthy tourism economy.

Newburyport's FY2016 general fund budget is about $59 million, with an additional $12 million for the city's water, sewer, and harbormaster enterprises. The city's main revenue source is the property tax, at about $50 million in FY2016, followed by $4.7 million of local receipts and $4 million in state aid. Newburyport also maintains two primary reserves (free cash and a stabilization fund) and a smaller capital stabilization fund. City policy is to maintain a combined reserve balance of five to ten percent of the city's general fund operating expenditures. During the past few years, the mayor has deliberately avoided using free cash to balance the budget. This effort is in line with local policy requiring the city to reserve a balance of $500,000 of certified free cash (or one percent of the tax levy, whichever is greater) for use in the next year's certification. While this policy is partly designed to maintain a favorable level of reserves, its other purpose is to develop free cash as a reliable financing source for smaller, one-time capital projects. Over the years, the city has also appropriated from its capital stabilization fund for various small-ticket capital items, but does not have an associated policy or strategy in terms of building and maintaining the fund.

The city's other main source of capital financing is long-term debt. Newburyport's existing debt policy establishes a $50,000 minimum expenditure for the use of debt as a financing source, identifies an annual debt service limit of eight to ten percent of general fund expenditures, and emphasizes using non-debt financing whenever possible. As part of the city's annual joint budget planning sessions with the school committee, the finance department tracks debt service as a percent of annual general fund expenditures.

To capitalize on its economic success from tourism, the city has a policy whereby 50 percent of the prior year's actual meals tax revenue is dedicated to street and sidewalk capital projects. Newburyport adopted the local option to collect meals tax beginning in mid-FY2011. Since then, meals tax revenue has grown steadily.



Another positive effect of the healthy tourist economy is a steady revenue stream from downtown paid parking receipts, dedicated to maintaining downtown streets and parking-related capital projects. One such project was a recent buildout of an Intermodal Transit and Parking Facility in the downtown area**,** with parking receipts funding the associated debt service. Officials are also considering raising parking fees in the future to further develop this revenue stream as a capital financing source.

The increase in local receipts resulting from the meals tax and paid parking has been a boon to the city. However, meals tax and paid parking revenue is closely tied to the economy's overall wellbeing. During an economic downturn, it is possible that these revenue sources could be negatively impacted, which would force the city to defer capital spending or reduce operating expenditures to pay for debt service on projects already underway. Due to this potential revenue volatility, it is important that Newburyport develop a multi-faceted plan to finance its capital priorities.

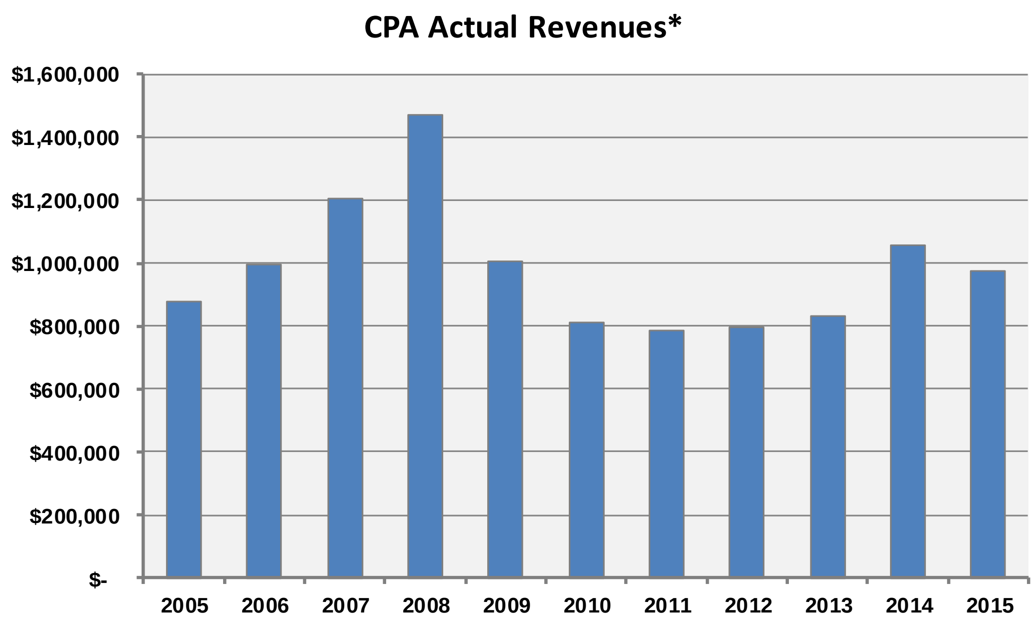
In general, Newburyport's revenue outlook is positive. Since FY2013, the city has maintained about $350,000 worth of excess levy capacity (partly offsetting the increase in the average tax bill from recent debt exclusions). This past year, for instance, Newburyport could have raised an additional $324,726 in its levy and remained within the bounds of Proposition 2½. In effect, the city's excess levy capacity functions as a kind of reserve and offers some flexibility for offsetting any future volatility in its dedicated capital

FY15 Total Valuation	**$**	**3,608,068,142**
FY15 Levy Limit	**$**	**48,489,985**

		FY15 Levy	**Excess Capacity**
Actual Rate	13.34	$ 48,131,629	$ 358,356
Maximal Rate	13.43	$ 48,456,355	$ 33,630
FY15 Unused Capacity		**$ 324,726**	

financing sources. This excess capacity also creates an opportunity for the city, which can begin building its capital projects stabilization fund and to shore up its general stabilization fund as necessary.

An additional source of capital financing is revenue from the Community Preservation Act surcharge and matching state trust fund distribution. Newburyport adopted the Community Preservation Act in 2002 with a two percent property tax surcharge, passing an ordinance to create a nine-person Capital Preservation Committee in 2003. The fund has steadily generated approximately one million dollars in annual revenue over the past ten years.



*Includes surcharge plus state trust fund distribution.

Historically, capital planning in Newburyport had not been a centralized, comprehensive process. Prior to the current administration, departments looked after their own capital needs without much coordination or long-term planning. To move the city away from this compartmentalized approach, the mayor introduced a city-wide capital planning process in FY2013, resulting in the city's first comprehensive capital plan. The plan is well-presented and includes descriptions of each departmental request, along with a basic five-year estimate of the project's annual costs and proposed funding sources.

To continue this process into the future, the city codified the capital planning process in its charter. According to Section 6-5, the mayor must submit a Capital Improvement Program to the city council by April 1st for consideration in the budget. The CIP must include cost estimates, timelines, and the prospective operating budget impact for each project. Leading up to this point, the mayor, finance director, and chief administrative officer meet with department heads to discuss their capital submissions, sometimes making revisions until very close to the due date. The charter also requires a public hearing be held 14 days after April 1st, with adoption by the city council by June 1st. The operating budget however, is not due to the city council until May 15th, after which the Budget and Finance committee holds workshops to review budget submissions.

Newburyport has made significant progress in formalizing its capital planning since FY2013. However, the additions described below could further strengthen it. By formalizing its capital planning process and carefully managing its reserves and available funds, the city will be better positioned to finance its capital needs.

Analysis of Financial Trends

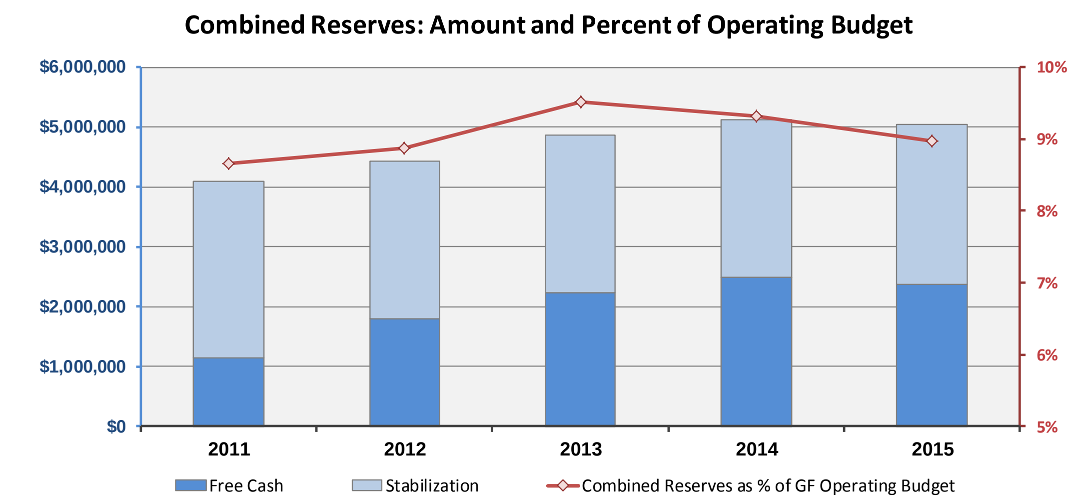
Reserves

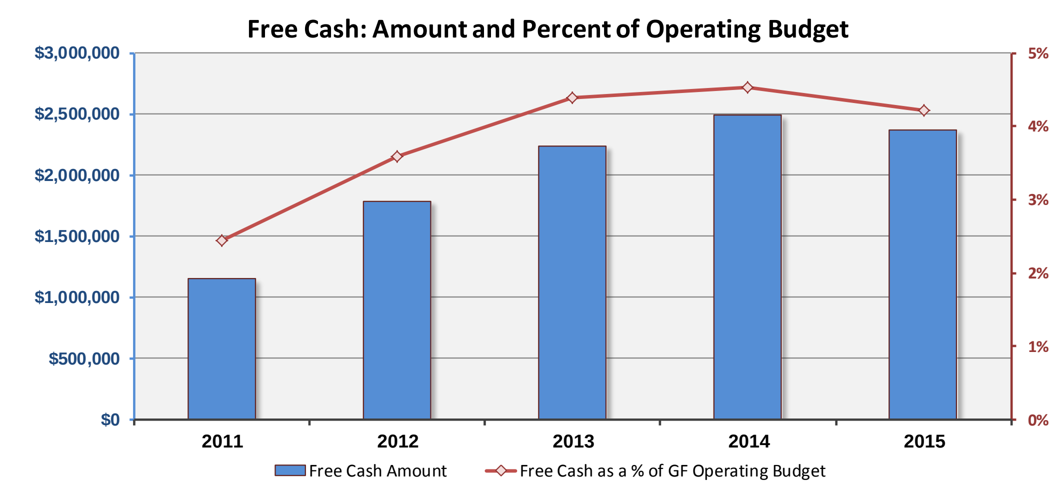
Over the past five fiscal years, combined free cash and stabilization fund amounts have been very favorable relative to local policy guidelines, remaining at approximately nine percent of the operating budget.

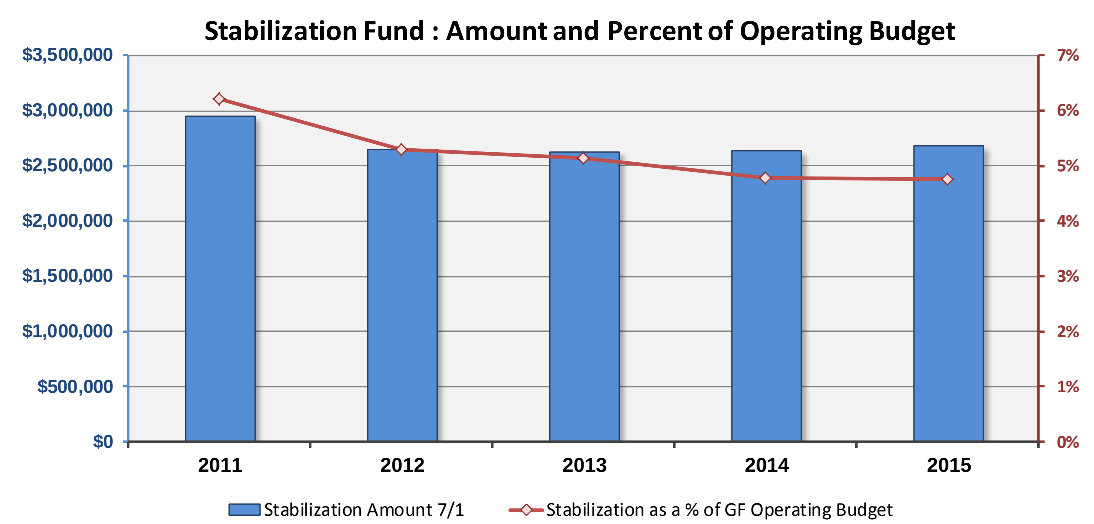
However, it is often helpful to examine the stabilization fund and free cash separately as well. The stabilization fund is essentially an emergency rainy day fund for the city, while free cash results from prior year spending and revenue collection activity. This distinction means that the stabilization fund is financed through direct appropriations, whereas free cash requires more strategic planning and is less predictable. Examining each reserve separately can help the city determine if either or both are trending unfavorably, and to determine the proper corrective action.

The city's strategy to maintain a favorable free cash balance has been effective, having remained relatively stable as a percent of the overall annual operating budget. Despite a small dip in FY2014, free cash increased by 19 percent over last year to a total balance of $2,818,436, not including appropriations.

The city's stabilization fund balance, however, decreased in amount and as a percentage of the operating budget before leveling off in FY2015. Monitoring free cash and the stabilization fund separately is important because if the stabilization fund falls below a certain percentage of the annual operating budget, it is likely that free cash will be used to replenish it. Any free cash used to replenish the stabilization fund will then be unavailable for other purposes, including for capital expenditures. This could result in either increased borrowing or deferring capital projects.

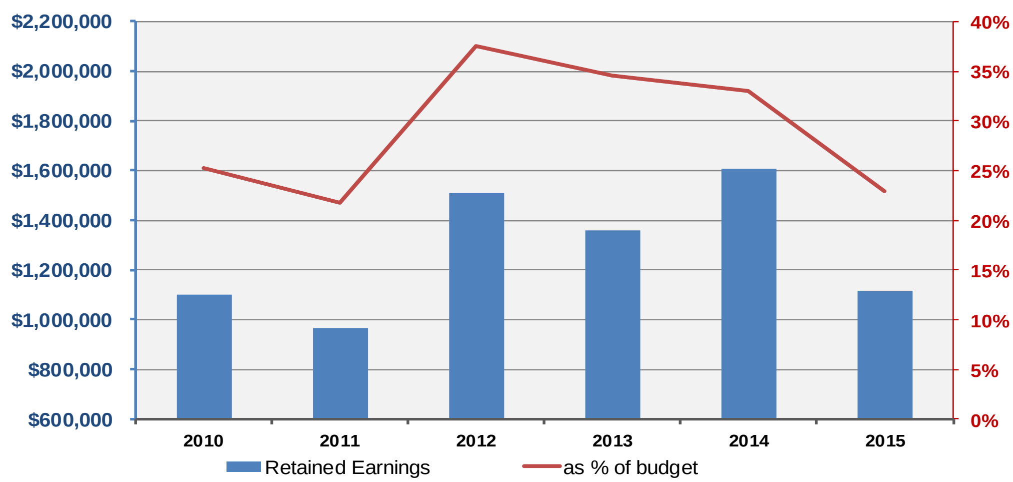

Combined Reserves: Amount and Percent of Operating Budget
$6,000,000
$5,000,000
$4,000,000
$3,000,000
$2,000,000
$1,000,000
$0
10%
9%
8%
7%
6%
5%
2011
2012
2013
2014
2015
Free Cash
Stabilization
Combined Reserves as % of GF Operating Budget


Free Cash: Amount and Percent of Operating Budget
$3,000,000
$2,500,000
$2,000,000
$1,500,000
$1,000,000
$500,000
$0
5%
4%
3%
2%
1%
0%
2011
2012
2013
2014
2015
Free Cash Amount
Free Cash as a % of GF Operating Budget

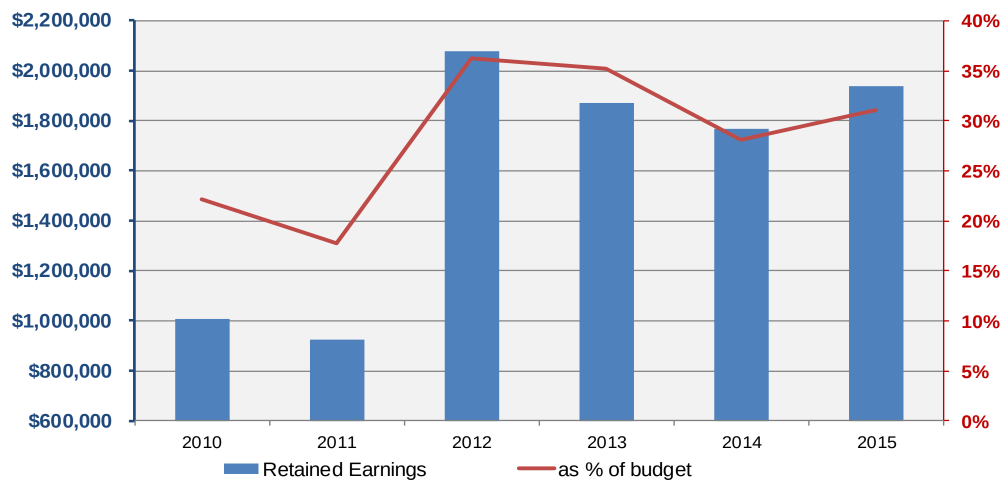

Stabilization Fund : Amount and Percent of Operating Budget
$3,500,000
$3,000,000
$2,500,000
$2,000,000
$1,500,000
$1,000,000
$500,000
$0
7%
6%
5%
4%
3%
2%
1%
0%
2011
2012
2013
2014
2015
Stabilization Amount 7/1
Stabilization as a % of GF Operating Budget

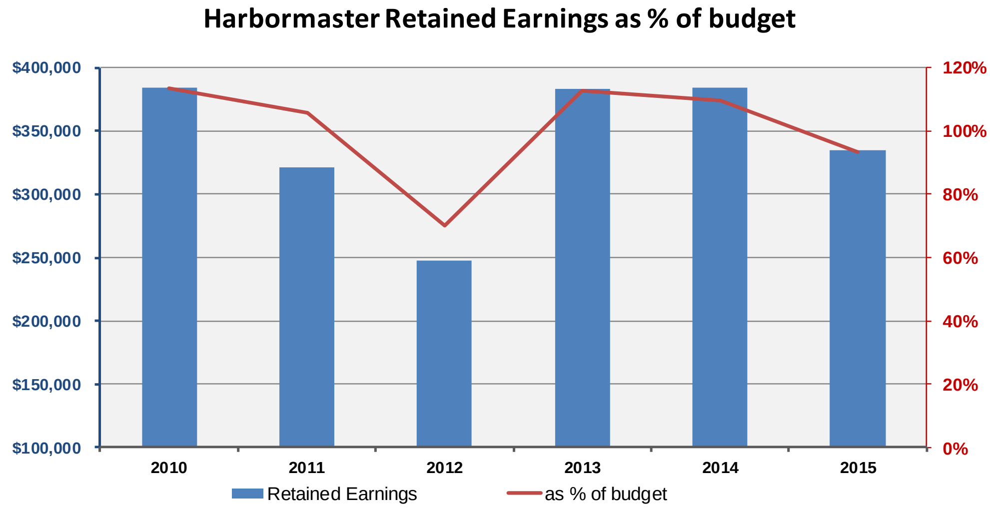
Newburyport has also maintained a healthy amount of retained earnings in its three enterprise funds. The finance department should continue to monitor retained earnings as a percent of enterprise operating budgets on a regular basis. Similar to its policy on appropriating from free cash for one-time capital purchases under $50,000, the city could set a dollar threshold for cash financing enterprise capital projects. To ensure that this reserve is maintained, officials should also establish a balance for retained earnings as a percent of the enterprise fund's budget appropriation. Since fiscal 2010, the city has maintained a considerable balance in each of its enterprise funds. This has allowed the city to appropriate a significant amount of retained earnings in a given year without exhausting the reserve. For instance, in FY2014 and FY2015, the city appropriated $540,000 and $420,000, respectively, of water enterprise retained earnings. However, in FY2015 there was a 10 percent drop in retained earnings as a percent of the water budget. Therefore, in addition to a policy governing the retained earnings balance, we recommend forming a strategy for when to appropriate retained earnings for rate relief.

Water Retained Earnings as % of budget



Sewer Retained Earnings as % of budget



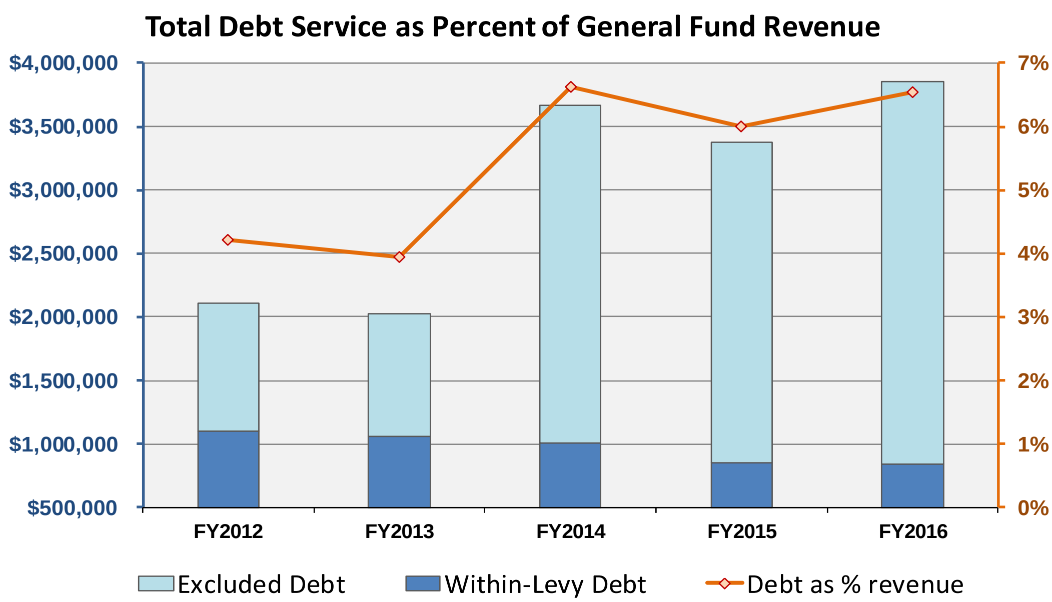


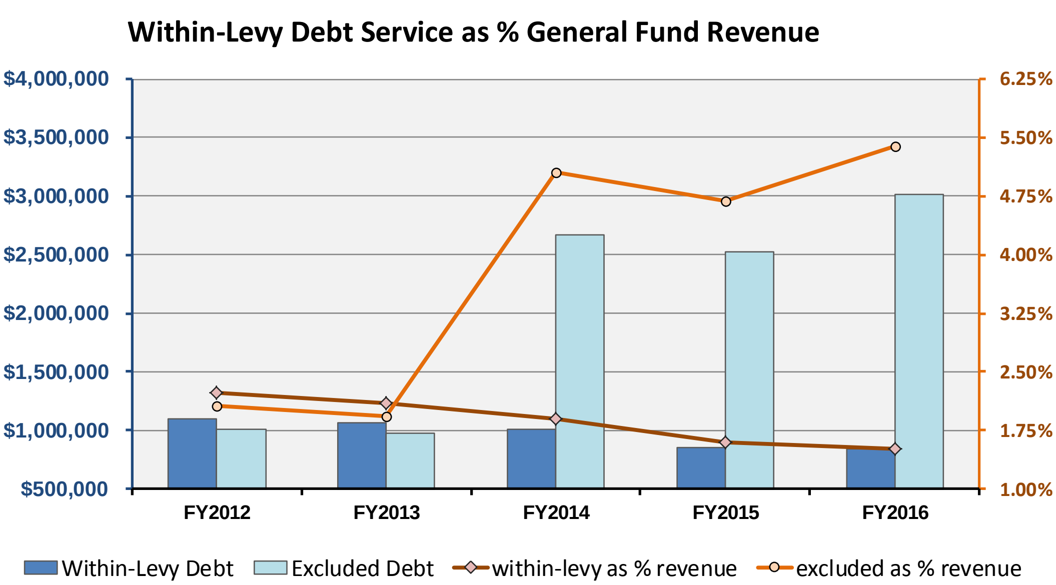
Debt Service

By the city's estimation, its total general fund debt service will peak this year at 6.8 percent, at which point it will begin to decrease incrementally to 5.5 percent by FY2019. Without regular monitoring, there is a general risk that debt service payments can crowd out essential services in the budget. Conversely, allowing budget capacity to become absorbed by the operating budget as debt service falls off creates the risk of a diminishing ability for capital investment. Finding a balance between these tendencies is essential for the city to effectively maintain its fixed assets, buildings, and heavy equipment. As a generally accepted benchmark, debt service should be maintained at less than 10 percent of operating revenues. Officials should identify a debt service target as a percent of revenue, and as debt is paid down, maintain that target level through new, within-levy capital investment. Tracking these two types of debt separately will make this target easier to monitor.

Although the city's debt service as a percentage of general fund expenditures has increased recently, this is largely due to a debt exclusion approved by the voters for the Nock/Molin and Bresnahan school construction projects, and it is expected to level off again as the debt is retired. When controlling for this debt exclusion in the budget, the amount of non-excluded ("within-levy") debt service as a percent of revenue has actually decreased steadily since FY2013, and its FY2015 amount of 1.5 percent of operating revenues is especially low.

As a general rule, new capital investments should be made in the city's infrastructure as debt is retired. The finance director should regularly monitor both categories of debt to ensure that needed investments in infrastructure are not crowded out by special projects. This analysis can also help the administration determine whether to increase cash financing to make up the difference. Regularly tracking the city's debt service as a percentage of its general fund revenues will also provide policymakers with an insight into how much (or whether) to borrow in a given fiscal year.





BUDGETING FOR THE CAPITAL PLAN

Revenue Set-Asides

By planning carefully for the use of free cash and other general fund revenues, the city will be able to more effectively identify and fund community priorities. There are two key concepts to this framework. The first is anticipating budget priorities for the upcoming year and finding a place for them in the revenue estimates. The other is to increase operating budget capacity for supplemental or unexpected budget needs while minimizing the need to appropriate from free cash.

The finance department presents revenue and expenditure projections to the city-school budget meeting in the fall. This analysis is presented in conjunction with key policy areas for the upcoming fiscal year's budget, and serves as an overall structure for budget planning. Part of this analysis is the city’s reserves, which include historical free cash (up to the most recent certification) and stabilization fund balances. However, the city does not include free cash as an available fund in its revenue projection for the upcoming year.

The finance director should create an estimate for the year’s free cash certification (with a plan to appropriate for the upcoming fiscal year’s budget). While this analysis is a useful internal tool, whether to present it to the joint meeting is up to the city. However, it should follow a similar timeline. After finalizing account balances in late summer or early fall, the finance director would likely have enough information to construct a preliminary estimate of free cash. It is important to note that estimating free cash is never a guarantee, so this estimate should be conservative. In addition to the previous fiscal year’s closing data, the finance director should also take into account a 10 year average of the city’s annual free cash certification for a placeholder number. This analysis should be used for initial planning purposes only, but it will give the mayor and finance director a rough estimate of the city’s capacity for cash capital financing and provide context while the administration begins to review capital project submissions.

With this estimate, the administration will be able to create a range of scenarios with various budget priorities carved out and weigh them during the budget planning process. For instance, pursuant to Newburyport’s policy of financing smaller capital projects through cash rather than debt, the mayor may wish to allocate a certain amount of that year's free cash certification to a "cash capital" item in the following year's budget. Alternatively, the city administration may find that its reserve policy calls for an appropriation into the stabilization fund.

By maintaining a healthy reserve fund the city will be able to better plan for budget contingencies while avoiding the need to appropriate from free cash during the year. As part of the above analysis, the finance director should conduct an historical review of supplemental budget appropriations from free cash. Using this analysis, he could then consult with the mayor to determine an appropriate amount of free cash to plan to leave unappropriated for unforeseen issues. This amount could also be the basis for an appropriation for the annual operating reserve fund. If no emergencies arise, then the reserve fund will roll over into next year’s free cash certification when it closes out at the end of the fiscal year.

Once free cash is certified by the Bureau of Accounts, the city can adjust its internal estimates accordingly. Please note the sample analysis on the following page. This is the city’s existing revenue presentation with the addition of the capital stabilization fund and free cash as sources of available funds. Integrating available funds into this analysis ensures that they are accounted for in the budgeting process.

Note that the sample revenue projection contains line items for capital stabilization both as an available fund and as a designated set-aside. The distinction is that the item under the available funds table shows an appropriation from the fund, whereas the set-asides table shows an appropriation into the fund.

	FY2014 Actual	FY2015 Estimated	FY2016 Projected
PROPERTY TAXES			
Prior Year Levy Limit	$ 42,716,528	$ 44,298,205	$ 46,062,191
2.5% increase	$ 1,067,913	$ 1,107,455	$ 1,151,555
New Growth	$ 513,764	$ 656,531	$ 450,000
TOTAL LEVY LIMIT	$ 44,298,205	$ 46,062,191	$ 47,663,746
Debt Exclusion	$ 2,669,446	$ 2,427,790	$ 3,015,218
MAXIMUM LEVY LIMIT	**$ 46,967,651**	**$ 48,489,981**	**$ 50,678,964**
LOCAL RECEIPTS			
Motor Vechicle Excise	$ 2,508,083	$ 2,250,000	$ 2,340,000
Other Excise			
a. Meals	$ 499,232	$ 425,000	$ 485,000
b. Room	$ 112,074	$ 91,000	$ 91,000
c. Other	$ 102,966	$ 95,000	$ 95,000
Penalties and Interest	$ 372,195	$ 335,000	$ 335,000
PILOTs	$ 61,264	$ 60,000	$ 60,000
Fees	$ 415,610	$ 275,000	$ 385,000
Other Departmental Revenue	$ 57,917	$ 55,000	$ 55,000
Licenses and Permits	$ 765,738	$ 650,000	$ 650,000
Fines and Forfeits	$ 15,112	$ 15,000	$ 10,000
Investment Income	$ 42,617	$ 45,000	$ 45,000
Medicaid Reimbursement	$ 90,081	$ 85,000	$ 85,000
Miscellaneous Recurring	$ 42,017	$ 94,000	$ 128,000
Miscellaneous Non-Recurring	$ 125,371	$ -	$ -
TOTAL LOCAL RECEIPTS	**$ 5,210,277**	**$ 4,475,000**	**$ 4,764,000**
STATE AID			
Cherry Sheet Receipts	$ 7,491,543	$ 7,361,674	$ 7,457,662
Less Offsets	$ (1,096,819)	$ (935,813)	$ (778,025)
Less Charges and Assessments	$ (2,633,925)	$ (2,615,040)	$ (2,670,223)
TOTAL NET STATE AID	**$ 3,760,799**	**$ 3,810,821**	**$ 4,009,414**
AVAILABLE FUNDS			
Parking Receipts	$ -	$ -	$ -
Capital Stabilization Fund	$ -	$ -	$ -
Free Cash	$ -	$ 2,373,046	$ 2,200,000
TOTAL AVAILABLE FUNDS	**$ -**	**$ 2,373,046**	**$ 2,200,000**
RESERVE FOR ABATEMENT	**$ (448,914)**	**$ (441,002)**	**$ (350,000)**
TOTAL GROSS REVENUE	**$ 55,489,813**	**$ 58,707,846**	**$ 61,302,378**

As a part of the revenue projection, the city could add a "Revenue Set-Asides" table (below) to the existing analysis. This would identify expenditures for which city officials have dedicated specific revenue sources, isolating them from the rest of the budget. For instance, city policy dictates that 50 percent of prior year actual meals tax receipts should be set aside specifically for street and sidewalk repairs. Please note that this is a sample analysis and the exact dollar amounts would be locally determined.

In our example, the city maintains a favorable free cash balance by setting aside $500,000, with an additional $1.15 million set aside for capital projects, $100,000 for an appropriation into the capital stabilization fund, and $50,000 into an OPEB trust fund (as an example priority). Also included in the set-asides is a line item for anticipated supplemental needs for the current year, allowing for some budget flexibility. Note that the total free cash set-aside equals the total projected free cash revenue.

The final portion of this analysis takes the “Total Gross Revenue” (inclusive of available funds) from the previous table and deducts the amount set aside for designated budget priorities to fully account for the added available funds. The end result of this calculation is the “Total Net General Fund Revenue,” which represents the starting point for available revenue to fund the upcoming year’s budget, after accounting for specific community priorities.

REVENUE SET-ASIDES

	FY2014 Actual	FY2015 Estimated	FY2016 Projected
From Tax Levy and Local Receipts:			
Streets and Sidewalks[1]	$ -	$ -	$ 250,000
From Free Cash:			
Anticipated Supplemental Needs	$ -	$ 332,237	$ 400,000
Maintain FC Balance	$ -	$ -	$ 500,000
Capital Projects	$ -	$ -	$ 1,150,000
Appropriate to Capital Stabilization	$ -	$ -	$ 100,000
OPEB	$ -	$ -	$ 50,000
Total Free Cash Set-Asides	**$ -**	**$ 332,237**	**$ 2,200,000**
TOTAL REVENUE SET-ASIDES	**$ -**	**$ 332,237**	**$ 2,450,000**
Gross Revenue	**$ 55,489,813**	**$ 59,040,083**	**$ 61,302,378**
Less Revenue Set-Asides	**$ -**	**$ (332,237)**	**$ (2,450,000)**
Total Net General Fund Revenue	**$ 55,489,813**	**$ 58,707,846**	**$ 58,852,378**

[1] Amount represents half of prior year's actual meals tax revenue.

Projecting Capacity

Since the finance director has already completed a long-range financial projection of revenues and expenditures, the city is in a good position to extrapolate the effects of its policies into the future. One of the administration's primary objectives has been to establish a predictable model for determining, on an annual basis, what the city can afford to devote to capital projects, in terms of both free cash and debt service. The table below demonstrates the effect of reserving a set percentage (four percent, in the example) of net operating revenues for the CIP. This amount could be a combination of debt service and cash financing. In this analysis, revenue is shown as net of free cash and the debt exclusion. Free cash is excluded because of the relative uncertainty in projecting it forward, while the debt exclusion is only temporary and dedicated to a specific project.

	FY2016 Projected	FY 2017 Projected	FY 2018 Projected	FY 2019 Projected	FY 2020 Projected	FY 2021 Projected
PROPERTY TAXES						
Prior Year Levy Limit	$ 46,062,191	$ 47,847,641	$ 49,493,832	$ 51,181,178	$ 52,910,707	$ 54,683,475
2.5% increase	$ 1,151,555	$ 1,196,191	$ 1,237,346	$ 1,279,529	$ 1,322,768	$ 1,367,087
New Growth	$ 450,000	$ 450,000	$ 450,000	$ 450,000	$ 450,000	$ 450,000
TOTAL LEVY LIMIT	$ 47,663,746	$ 49,493,832	$ 51,181,178	$ 52,910,707	$ 54,683,475	$ 56,500,562
Debt Exclusion	$ 3,015,218	$ 3,148,138	$ 3,135,702	$ 3,149,006	$ 3,136,524	$ 3,143,355
MAXIMUM LEVY LIMIT	**$ 50,678,964**	**$ 52,641,970**	**$ 54,316,880**	**$ 56,059,713**	**$ 57,819,999**	**$ 59,643,917**
LOCAL RECEIPTS						
Motor Vechicle Excise	$ 2,340,000	$ 2,386,800	$ 2,434,536	$ 2,483,227	$ 2,532,891	$ 2,583,549
Other Excise						
a. Meals	$ 485,000	$ 490,000	$ 494,900	$ 499,849	$ 504,847	$ 509,896
b. Room	$ 91,000	$ 100,000	$ 102,000	$ 104,040	$ 106,121	$ 108,243
c. Other	$ 95,000	$ 100,000	$ 100,000	$ 100,000	$ 100,000	$ 100,000
Penalties and Interest	$ 335,000	$ 340,000	$ 340,000	$ 340,000	$ 340,000	$ 340,000
PILOTs	$ 60,000	$ 60,000	$ 60,000	$ 60,000	$ 60,000	$ 60,000
Fees	$ 385,000	$ 400,000	$ 408,000	$ 416,160	$ 424,483	$ 432,973
Other Departmental Revenue	$ 55,000	$ 55,000	$ 55,000	$ 55,000	$ 55,000	$ 55,000
Licenses and Permits	$ 650,000	$ 675,000	$ 688,500	$ 702,270	$ 716,315	$ 730,642
Fines and Forfeits	$ 10,000	$ 10,000	$ 10,000	$ 10,000	$ 10,000	$ 10,000
Investment Income	$ 45,000	$ 45,000	$ 45,000	$ 45,000	$ 45,000	$ 45,000
Medicaid Reimbursement	$ 85,000	$ 85,000	$ 85,000	$ 85,000	$ 85,000	$ 85,000
Miscellaneous Recurring	$ 128,000	$ 128,000	$ 128,000	$ 128,000	$ 128,000	$ 128,000
Miscellaneous Non-Recurring	$ -	$ -	$ -	$ -	$ -	$ -
TOTAL LOCAL RECEIPTS	**$ 4,764,000**	**$ 4,874,800**	**$ 4,950,936**	**$ 5,028,546**	**$ 5,107,658**	**$ 5,188,303**
STATE AID						
Cherry Sheet Receipts	$ 7,457,662	$ 7,606,815	$ 7,758,952	$ 7,914,131	$ 8,072,413	$ 8,233,861
Less Offsets	$ (778,025)	$ (762,465)	$ (747,215)	$ (732,271)	$ (717,625)	$ (703,273)
Less Charges and Assessments	$ (2,670,223)	$ (2,723,627)	$ (2,778,100)	$ (2,833,662)	$ (2,890,335)	$ (2,948,142)
TOTAL NET STATE AID	**$ 4,009,414**	**$ 4,120,723**	**$ 4,233,636**	**$ 4,348,198**	**$ 4,464,452**	**$ 4,582,447**
AVAILABLE FUNDS						
Parking Receipts	$ -	$ -	$ -	$ -	$ -	$ -
Capital Stabilization Fund	$ -	$ -	$ -	$ -	$ -	$ -
Free Cash	$ 2,200,000	$ 1,500,000	$ 1,500,000	$ 1,500,000	$ 1,500,000	$ 1,500,000
TOTAL AVAILABLE FUNDS	**$ 2,200,000**	**$ 1,500,000**	**$ 1,500,000**	**$ 1,500,000**	**$ 1,500,000**	**$ 1,500,000**
RESERVE FOR ABATEMENT	**$ (350,000)**	**$ (400,000)**	**$ (400,000)**	**$ (400,000)**	**$ (400,000)**	**$ (400,000)**
TOTAL GROSS REVENUE	**$ 61,302,378**	**$ 62,737,493**	**$ 64,601,452**	**$ 66,536,457**	**$ 68,492,109**	**$ 70,514,666**
Less Debt Exclusion	$ (3,015,218)	$ (3,148,138)	$ (3,135,702)	$ (3,149,006)	$ (3,136,524)	$ (3,143,355)
Less Free Cash	$ (2,200,000)	$ (1,500,000)	$ (1,500,000)	$ (1,500,000)	$ (1,500,000)	$ (1,500,000)
Total Net Revenue	**$ 56,087,160**	**$ 58,089,355**	**$ 59,965,750**	**$ 61,887,451**	**$ 63,855,585**	**$ 65,871,311**
4% of Net Revenue for CIP	**$ 2,243,486**	**$ 2,323,574**	**$ 2,398,630**	**$ 2,475,498**	**$ 2,554,223**	**$ 2,634,852**

Setting a goal for reserving a set percentage of net revenue by policy ensures that the city maintains its commitment to public infrastructure. The exact percentage should be determined by consulting with the community and relevant stakeholders. If the finance director were to conduct this analysis on an annual basis, it would quantify the growth in Newburyport's capital financing capacity so that policy makers could plan accordingly. Ultimately, this would depend on how the city decides to implement our recommendation for a policy range on annual combined debt service and cash capital financing. It would also depend on how the city chooses to manage its excluded debt, which is the majority of its debt service.

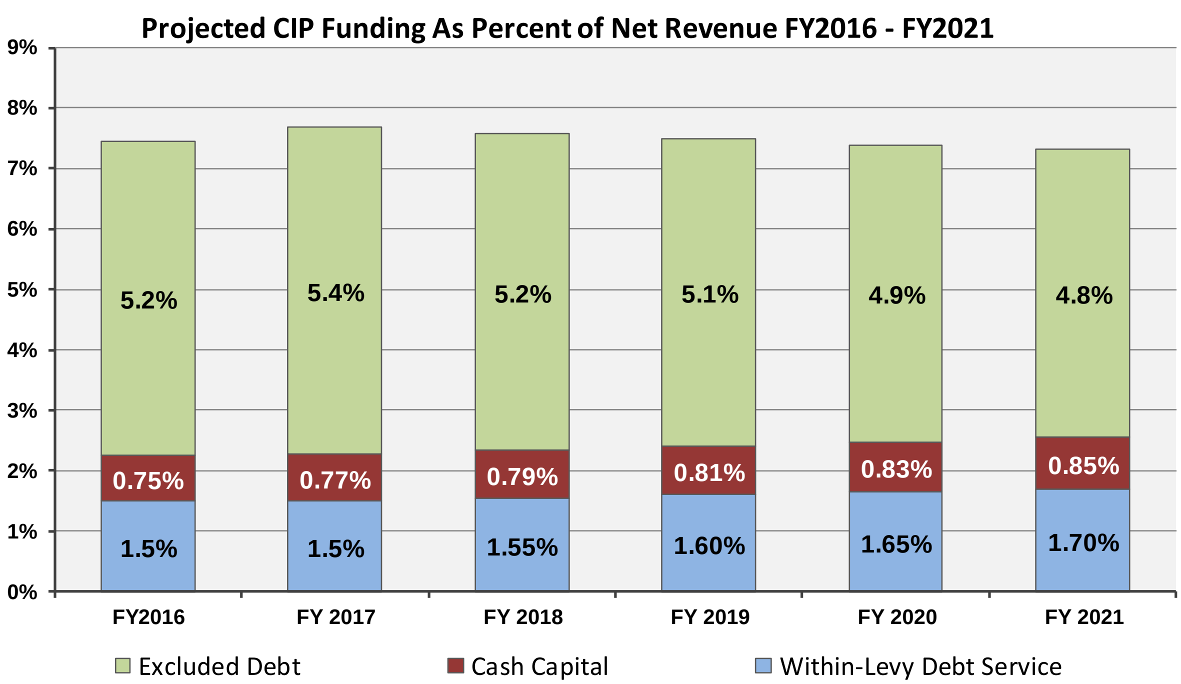
The analysis below shows a projection of both debt service and cash capital as a percent of net revenue. In this case, "cash capital" may include the levy, free cash, one-time revenues, or other available funds. Notice that they are both well below the four percent figure shown previously. This is because when the excluded debt is added, it significantly increases both the total debt and total CIP spending as a percentage of net revenue. To maintain an overall range of six to eight percent[1], for example, the combination of cash capital and new debt service must be limited to the percentages used in the analysis.

Another important consideration is maintaining the city's within-levy debt service capacity, possibly by tying it to a percentage of net revenue. At minimum, we recommend that the city maintain the current percentage. In the analysis below, we have described a scenario where the city gradually increases this number, as a well as the percentage of cash capital financing. This increase in ordinary CIP spending should be in line with a defined policy goal, and is demonstrated below in the shaded area, labeled "Total Non-Excluded CIP Financing." In the example, the amount of CIP funding as a percentage of revenue increases each year to meet the goal of four percent, as identified in the previous table. Since excluded debt is such a large percent of total debt service, this increase coincides with the gradual decrease in excluded debt. The city should monitor combined excluded and within-levy debt to maintain a steady debt load while working toward its stated goals.

By carrying out this analysis each year, the city is able to project a policy-driven estimate of its capital financing capacity and examine its annual needs in that context. Furthermore, in tracking its capital funding as a percent of revenue, and making adjustments accordingly, the city will not lose the capacity to invest in itself as debt is retired.

[1] The city's current policy is to maintain debt service at six to eight percent of the operating budget, so the same percentage basis was used for this analysis.

	FY2016		FY 2017		FY 2018		FY 2019		FY 2020		FY 2021
Within-Levy Debt	$	841,860	$	871,340	$	929,469	$	990,199	$	1,053,617	$ 1,119,812
Within-Levy Debt as % of Net Revenue		1.5%		1.5%		1.55%		1.60%		1.65%	1.70%
Cash Capital	$	420,654	$	447,288	$	473,729	$	501,288	$	530,001	$ 559,906
Cash Capital as % of Net Revenue		0.75%		0.77%		0.79%		0.81%		0.83%	0.85%
Funding From:											
Within-Levy Debt	$	841,860	$	871,340	$	929,469	$	990,199	$	1,053,617	$ 1,119,812
Cash Capital	$	420,654	$	447,288	$	473,729	$	501,288	$	530,001	$ 559,906
Total Non-Excluded CIP Financing	**$**	**1,262,514**	**$**	**1,318,628**	**$**	**1,403,199**	**$**	**1,491,488**	**$**	**1,583,619**	**$ 1,679,718**
as percent of Net Revenue		**2.25%**		**2.27%**		**2.34%**		**2.41%**		**2.48%**	**2.55%**
Excluded Debt	**$**	**2,918,868**	**$**	**3,148,138**	**$**	**3,135,702**	**$**	**3,149,006**	**$**	**3,136,524**	**$ 3,143,355**
Excluded Debt as % of Net Revenue		5.2%		5.4%		5.2%		5.1%		4.9%	4.8%
Total Debt as % of Net Revenue		6.71%		6.92%		6.78%		6.69%		6.56%	6.47%
Total CIP Funding as % of Net Revenue		7.46%		7.69%		7.57%		7.50%		7.39%	7.32%



Policy Recommendations

We recommend Newburyport incorporate the following principles into its existing financial policies. These policies will further the city's goal of a predictable financing environment for capital planning by making it easier to manage debt levels, maintain optimal reserves, and plan strategically.

Debt

- Establish a target percentage for CIP spending as a percentage of annual operating revenues. This spending could be a combination of both debt service and any cash expenditures, and could be tied to a set percentage of operating revenues. For instance, the city may wish to set aside four percent of its operating revenues for capital spending and from that amount, allocate some to new debt service and the rest to cash capital.

- Determine other variables for monitoring debt load and conduct this analysis annually. These may include annual debt service per capita, total debt as a percent of assessed valuation, and total debt per capita.

- Set guidelines for the amortization of debt. For instance, the city may wish to maintain a borrowing term of 10 years for 60 percent of its issued long term debt.

Reserves

Stabilization Fund:

- Set a target balance in the form of a percentage of the annual operating budget.

- Prohibit appropriating from the stabilization fund for normal operating budget or capital expenditures.

- Establish that appropriations from the stabilization fund should only occur under "catastrophic or emergency circumstances," or in the case of sudden and unexpected revenue loss (for instance a cut to state aid).

Reserve Fund (M.G.L c. 40, § 5A): The city should maintain a Reserve Fund as part of its annual general fund operating budget. This will further the city's goal of reducing or eliminating the need for appropriating free cash to balance the current year's budget.

- Set a percentage of the annual operating budget as the reserve fund's target balance, for example between 0.35 and 0.50 percent.

- Establish that the reserve fund is a transfer-only account and that the city may make no direct appropriations from it.

- Limit use of the reserve fund to "extraordinary and/or unforeseen" circumstances.

- Establish that transfers out of the reserve fund and into other line items must come at the recommendation of the mayor, subject to a vote of the city council, and that these recommendations may be made throughout the year.

Capital Stabilization Fund (M.G.L. c. 40 §5B): The city should develop the capital stabilization fund into a reliable financing source for capital projects.

- To adequately plan for future capital projects, the city could make regular appropriations into its capital stabilization fund according to its prospective capital needs.

- Establish that the fund's purpose is to allow for cash financing of maintenance projects, smaller capital expenditures, and for capital improvement/extraordinary repair projects, or for the purpose of offsetting debt service costs that would otherwise be funded from the tax levy.

- Officials may also want to develop "triggers" for when to appropriate into this fund. For instance, a certain percentage of new growth or of free cash above the $500,000 minimum set out by policy.

Retained Earnings: The city should develop a set of policies governing the use of enterprise fund retained earnings. Retained earnings are user charges in excess of estimates and spending below appropriations, similar to free cash in the general fund. Communities sometimes appropriate from retained earnings to reduce utility rates, but they are also a potential funding source for one-time capital projects or improvements and for major equipment purchases.

The bulk of Newburyport's enterprise debt is in its water and sewer funds. Recently, the city has been appropriating retained earnings to prevent rate increases from additional debt service. However, the administration plans to gradually phase out this appropriation as the debt is paid down. As a part of this process, the city should develop a strategy for allocating retained earnings to specific capital projects in the respective enterprise funds.

- Identify conditions when appropriating retained earnings for rate relief is appropriate. For instance, the city may wish to designate a percent increase in utility rates that would trigger such an appropriation.

- Determine a schedule to reduce the subsidy as the requisite circumstances abate. For instance, in the case of a subsidy triggered by increased debt service, a plan to decrease it as the debt service is paid off.

Revenue

One-time Revenues: While not related to capital exclusively, the use of unexpected or one-time revenue can sometimes be an ideal source for financing short term capital purchases or maintenance projects. However, in any community there are always competing demands for revenue, sometimes leading to prolonged political conflict, which a revenue policy can help mitigate. The city's existing policy on linking meals tax to streets and sidewalks spending could be rolled into a larger policy on revenues. This policy should incorporate the following criteria.

- Establish that one-time revenues must be used for one-time expenses or otherwise be allowed to flow to fund balance.

- Apply to revenues that may re-occur over a finite period and then end.

- Be developed according to input from all relevant institutional stakeholders (the mayor, city council, superintendent, and school committee) as well as the community.

Capital Process Recommendations

Adopt a Standard Capital Project Definition

Adopting a standard definition for a capital project would ensure that all departments adhere to the same criteria, make financing more predictable, and prevent the use of the capital process for operating expenditures.

A capital project is defined as a major, non-recurring expenditure that meets the following criteria:

- The city would be allowed to legally borrow for the expense under M.G.L. c. 44, §7.
- The expenditure is equal to or greater than $10,000 (the city may want to consider increasing this threshold to $25,000).
- The expenditure is for land acquisition.
- For buildings or building components, there is an expected useful life of 10 or more years.
- For vehicles and heavy equipment, there is an expected useful life of 5 or more years.
- The expenditure is for planning, engineering, or design services required for a capital project.

In addition, capital financing should follow these guidelines:

- Capital expenditures less than $50,000 should be funded with cash.
- Fully investigate all applicable uses of Community Preservation Act (CPA) funding.
- Any impact on the operating budget must be clearly stated in the project description.

Plan Strategically

Capital improvement plans (CIPs) provide a strategy for the maintenance, replacement, and construction of a community's major public assets, such as municipal buildings, roadways, parks, and water and sewer infrastructure. The city's capital planning strategy should be framed within the context of the following considerations.

Asset Inventory: A solid foundation to any CIP is a detailed inventory of all current assets, inclusive of age and condition. Some communities have building committees charged with developing a "Building Master Plan" that contains details on municipal buildings and structures and lays out a long-term strategy for their maintenance and eventual replacement.

While Newburyport does not have a master plan specific to its buildings and structures, it does have a "Master Plan Steering Committee," which is charged with creating an overall strategic framework for city planning. This committee has begun drafting chapters of the city's master plan, including one dedicated to "Municipal Facilities and Services." This chapter contains an inventory of municipal buildings and lays out the city's goal for maintaining and replacing infrastructure as appropriate. The work that went into this chapter is a good foundation upon which Newburyport should build an asset inventory.

The steering committee's building inventory includes the name of the building, its address, and a comment field. Expanding the list to include the department currently occupying the building, its date of original construction or acquisition, condition, and current and intended use(s), also makes sense. Working with departments, the committee should compile a similar list to catalogue the city's capital equipment, including relevant usage information, maintenance history, estimated replacement costs, and original and remaining useful life. Updating this inventory should become part of the city's annual capital budget process. Please see Attachment 1 for a sample building and asset inventory form based on the existing list.

Capital Review Committee: The mayor could also appoint staff members to an internal capital committee or working group. This committee would take ownership of the building and equipment inventory and be a permanent fixture in the community's capital planning process. Acting as chair, the mayor would assign the finance director and department heads with relevant expertise, as well as members of appropriate boards and/or committees (such as the Community Preservation Committee or school committee) to the committee. Once capital requests are submitted to the mayor, this committee would evaluate and prioritize them based on the city's strategic goals.

Formalizing the Capital Process

The recommendations presented here are designed to accommodate the city's current process. However, officials may want to consider aligning the capital and operating budget process more closely in the future, eventually submitting both operating budget requests and capital submissions for the subsequent fiscal year to the city council at the same time. This will encourage the city to consider its capital planning within the context of its operating budget needs, since one will always impact the other.

The following steps are separated into three categories: Needs Assessment and Project Submission, Administrative Review, and Final Approval. The first category suggests steps for determining capital needs and priorities, and for formalizing the internal planning process for project submission. The second shows how to evaluate the city's ability to meet those needs and prioritize projects accordingly. The third involves project selection, finalizing a financing strategy, and keeping stakeholders duly informed. Though we have suggested some dates, the timing should be set according to community and stakeholder priorities.

Needs Assessment and Project Submission

Assess Capital Needs: This should happen near the beginning of a new fiscal year, in early August. At this time, the city should also update its asset inventory so that the information can be used by the mayor to frame capital planning priorities for next year's capital budget. The mayor should then call upon department heads to begin assessing their capital needs for the coming year (both buildings and equipment), giving them adequate time to put together detailed capital requests.

Distribute Capital Guidelines: In August, the mayor should also distribute capital budget guidelines to department heads, formally beginning the capital budget process. A capital manual (please see Attachment 2 for a sample manual) is a useful tool to distribute at this time. The manual should contain a written overview of the community's capital planning process, a list of deadlines, and a calendar. It should also contain departmental submission forms, an explanation of how to use them, and an overview of the mayor's expectations for the quality of information in the submissions.

Compile Capital Requests: Departments should submit capital projects to the Finance Department for review by November 1st. The finance director can then compile the requests into a comprehensive capital package for the mayor's review.

Administrative Review

Establish a Vetting Process for Capital Projects: City officials should develop a practical vetting process for project submissions, which should be made clear to all department heads in the capital manual.

- Mayor and finance director meet to review the most recent revenue and budget data.
- They examine departmental capital requests in context of projections.
- Guided by policy and strategic goals as outlined in the Building Master Plan and overall master plan, they compile a prioritized list of projects to become part of the capital budget.

The mayor may also wish to establish a staff-based committee (see page 22) to review and prioritize projects, consisting of herself, the finance director, and additional staff and/or committee members.

- Finance director and mayor determine an appropriate financing plan guided by policy and revenue availability.

Conduct Departmental Capital Review Sessions: Once initial project submissions are in, the mayor and finance director should meet with each submitting department head to review their proposed capital projects. Department heads should update the mayor and finance department on anything that has changed since the initial project submission and provide additional background information when appropriate. This is also an opportunity to discuss project costs and identify any alternative sources of funding, such as grants or use of CPA funds.

Evaluate Fiscal Capacity: Sometime in mid-November, the city should conduct an analysis of its expected revenues and expenditures for the next fiscal year. Also included in this analysis should be an evaluation of the city's debt service and reserve levels to determine if they will stay within the bounds set by policy, or if not, what action may be required. This will help the city estimate its capacity for funding capital projects by identifying an amount of revenue not allocated to existing needs. The annual city-school meeting in mid-November would be a good opportunity to present the results of this analysis, which would allow major stakeholders a chance to weigh in on important policy issues and to discuss the use of any unanticipated or one-time revenues within the context of the city's major operating and capital needs.

Finalize CPA Submissions Package: Following the review period, the city should compile all proposed CPA funding capital requests into one package for review by the Community Preservation Committee (CPC). This will allow the administration to further refine its financing plan and better coordinate use of CPA funds.

Final Approval

Update Revenue and Expenditure Projections: By February, the finance director should update the initial revenue and expenditure projections (those done for the mid-November, city-school budget meeting) to reflect any new data and provide context for capital financing.

Submit the CIP to the City Council: On April 1st, the mayor will submit the CIP to the city council for review.

Hold a Second Joint Meeting: This meeting should take place in late April and mirror the previous city-school budget meeting with the following additions:

- An update on the revenue and expenditure projections with more recent data.
- An informational overview on the operating budget.
- An informational overview of the proposed capital budget, including a breakdown of the proposed financing sources, and how this relates to maintaining the metrics for debt and capital investment set by policy.
- A review of any emergent policy or budget issues and the city's plan to address them.

Budget and Finance Workshops for Capital: The city council currently holds operating budget workshops with its budget and finance committee after the operating budget is submitted on May 15th. We recommend including an overview of the proposed capital budget submissions (i.e. only the projects submitted for funding for the upcoming fiscal year) as a part of these workshops. This will allow council members to review capital projects both in the context of the operating budget and in greater detail, ask questions, and provide better feedback before final approval of the capital plan is required by June 1st.

ATTACHMENTS

The attachments included here are meant to provide the basis for working documents the city can use for its capital planning process. City officials are encouraged to use them as-is or adapt them to more closely fit their needs. Attachment 1, the Sample Facilities Inventory, uses information from Newburyport's own Master Plan Steering Committee's building inventory. Attachment 2 is a sample Capital Process Manual for distribution to department heads. It is meant to provide an overview of the process, the city's standard capital project definition, a capital calendar with due dates and milestones, submissions forms, and an overview of what is expected in a submission.

Documents identified in the attachments are available in Word and Excel format at the links below:

- Capital Manual in full, Word Document
- Sample Facilities Inventory, CIP Form, Capital Calendar, Excel Spreadsheet