Final Report and Recommendations

Town of Franklin, MA

Prepared by the Long-Range Finance Committee

June 30, 2012

Contents

Purpose of Report

- Explain whether the Town's financial outlook has changed since the Committee's earlier reports in 2009 and 2010
- Make observations with respect to additional matters covered by the Committee since its earlier report
- Provide recommendations to improve the way Franklin understands and addresses its long term financial risks

Committee History
Inaugural Committee

- Citizen advisory group tasked with helping citizens and Town officials better understand
  - Franklin's long-term financial outlook
  - Various courses of action available to secure Franklin's financial future
- Created by Town Council in June 2008 to develop a 3 to 5 year financial projection
  - Original ad hoc Committee included three Town Councilors, two School Committee members, two Finance Committee members and two citizens at large
  - Completed its charge in early 2010, finding that Town and School services are declining steadily because costs are rising faster than revenues (a "structural deficit")
  - Committee's report, which includes recommendations for addressing the growing problem, is available on the Committee's page of the Town of Franklin website, along with an executive summary version and subsequent mid-year update.

Committee History

Transition to Citizens' Advisory Committee

- In December 2010, the Committee was reconstituted as a citizen advisory group
- Structure was designed with two principal benefits in mind:
  - Its members have no other Town responsibilities, enabling them to focus exclusively on Franklin's long term financial future
  - Its members have no other role in Town decision making, enabling them to speak for the citizens of Franklin with a voice that is independent in both fact and appearance
- Committee mission:
  - Evaluating and reporting on the Town's internally developed five-year financial projection
  - Assessing the nature and potential magnitude of the Town's significant financial risks, particularly those that give rise to a structural deficit
  - Recommending steps to close the gap between future expected revenues and expenditures in an effort ultimately to achieve fiscal sustainability

Observations

- Financial Outlook Remains a Serious Concern
- Road Maintenance Costs Expected to Grow Significantly
- Unfunded Employee Benefits Present Mounting Budget Challenge
- Property Taxes Low But Override Would Only Be Partial Solution
- Long Range Financial Planning Process Has Shortcomings

Observations

Financial Outlook Remains a Serious Concern

- Committee reiterates the pertinence of findings and recommendations from its previous report
  - Franklin has been cutting costs and reducing services steadily since the mid-2000s
  - This trend is expected to continue for the foreseeable future
    - Town faces a structural deficit, whereby the cost of core services is increasing at a faster rate than revenue
  - Town officials currently estimate that over the next five years the cost of core services will increase by $10M more than revenues
    - Represents approximately 10% of the budget
- Key drivers of this increase are:
  - Revenue sources tend to grow more slowly than the rate of inflation
  - Unfunded federal and state mandates (particularly in the schools) drive up costs by adding new requirements
  - Health care and pension costs are rising faster than inflation due to commitments made in prior years and “pay-as-you go” funding

Observations

Financial Outlook Remains a Serious Concern (Cont'd)

- Problem will become more severe over the next 10 years:
  - Franklin's infrastructure (e.g., roads and sewer system) is aging and will require increased spending levels in the near future
  - Franklin's pension and other post employment benefit commitments (for past services) are significant and will require future spending that has not been set aside
  - Franklin's heavy reliance on state aid makes the Town vulnerable to reductions or smaller increases in the future
  - Franklin faces a $75M potential cost to implement a storm water runoff pilot program mandated by the Environmental Protection Agency
- Problem exists on multiple fronts as Franklin residents must also grapple with federal and state financial woes, such as the growing national debt and unfunded state OPEB obligations
- Large financial gap poses significant threat to quality of life in Franklin, including condition of roadways, sidewalks and sewers, and effectiveness of public safety, education and other core services

<u>Observations</u>

Road Maintenance Costs Expected to Grow Significantly

- Franklin faces significant looming budget problems related to roads
  - Budget constraints have delayed maintenance beyond optimal time, an approach that costs the Town more in the long run
  - Growing % of roads are in poor to very poor condition
  - Significant Town growth from 1985 to 1995 will require a spike in infrastructure spending from 2015 to 2025
- Town estimates that cost to repair roads <u>currently</u> rated in "poor" or "very poor" condition would be $20M to $30M
- Town estimates that a minimum annual road appropriation of $2.5M to $3.0M is needed; an updated study of road condition is nearing completion and will enable a more detailed cost analysis
- Committee estimates that annual cost could be $5M to $7M if the Town were to follow a "proportional maintenance" approach (220 miles of road over 30 years at $700K to $1M per mile)
- Problem is getting worse each year – both in terms of road condition in the Town and future cost of addressing the problem

Observations

Unfunded Employee Benefits Present Mounting Budget Challenge

- Other post-employment benefits (“OPEB”) include
  - Lifetime medical and prescription drug benefits for eligible employees, retirees, and their dependents (e.g., spouse)
  - Life insurance for employees and retirees
- Franklin follows a “pay as you go” approach, paying premiums each year but not setting aside funds to cover the estimated obligation
- Most towns, cities, and states have long followed a “pay as you go” approach, but in reaction to growing financial risk, many are beginning to fund at least part of the annual cost
- Franklin set aside nominal funds in FY 2012 for OPEB and plans to do so again in 2013 – a sign of progress
- OPEB costs, however, will grow exponentially as long as Franklin does not fully fund its annual required contribution
- Such growth will place further strain on future Town finances

Observations

Unfunded Employee Benefits Present Mounting Challenge (Cont'd)

- OPEB Actuarial Accrued Liability (AAL) = $84.7M at end of FY 2011
  - Represents value of OPEB benefits already earned in exchange for employees' past service
  - Funding this liability today would cost the average family in Franklin approximately $7,350 (more than 150% of their annual property tax bill)
  - Think of this as a credit card balance for each Franklin family
- Net OPEB obligation increased by $5.5M in FY 2011
  - Actuaries have estimated that it would have cost Franklin $7.2M in FY 2011 to cover (a) its current year benefit obligations and (b) a portion of the unfunded obligation (together, the "Annual Required Contribution")
  - Franklin actually paid only $1.7M (in premiums for the current year)
- Higher payments will be required in the future to make up the $5.5M gap, placing additional strain on future budgets
  - Think of the $5.5M gap as adding $490 to the credit card balance of each Franklin family

Observations

Property Taxes Low But Override Would Only Be Partial Solution

- On average Franklin residents pay less in property taxes than residents of comparable towns, based on relative factors such as property values and household income
- Franklin's annual property tax levy would be $5M to $6M higher if the tax rate were in line with comparable metrics
- Average Franklin resident's annual tax bill is $650 below comparable levels ($400 after the high school debt exclusion)
- This property tax "headroom" suggests overrides are an option
- Overrides should only be viewed as partial potential solution
  - Looming financial challenges much bigger than property tax headroom
  - Overrides might have to be used to offset future declines in state aid
  - Voters have been reluctant to pass overrides
- Overrides will not be available to expand Town services or restore cuts made in recent years

Observations

Long Range Financial Planning Process Has Shortcomings

- Town and School administrators actively monitor and plan for the Franklin's short term and mid term financial needs
  - Annual budget is accompanied by 3 year forecast, and 5 year cash based capital plan is updated annually
- Administration is experienced and has strong track record of prudent, forward thinking financial management
  - Solid bond rating and favorable analyst comments
  - Multiple stabilization funds and initial steps to fund OPEB obligation
  - Regionalization of certain services and outsourcing
  - Well maintained building infrastructure
  - Significant state funding for new high school facility
  - OPEB study conducted prior to requirement
  - Candid warnings to elected officials of growing financial challenges

Observations

Long Range Financial Planning Process Has Shortcomings (Cont'd)

- Nonetheless the long range component of the financial planning process has shortcomings
  - Projections do not include all costs of maintaining neglected roads and funding the OPEB obligation, nor do they highlight the risk associated with uncertain state aid levels and storm water mandates
  - 3 year projection does not call to light the greater challenges that exist in the 5-10 year time frame
  - Town does not have a formal plan, endorsed by elected officials, to address the structural deficit in spite of evidence that the problem getting worse
  - Information regarding long range plans and projections is not easily accessible to elected officials and residents
- Town Council and School Committee members have the ability to redefine this process and establish new expectations

Recommendations

- Establish a Formal Long Range Financial Planning Process
- Develop a Plan to Ensure Roads are Adequately Maintained
- Achieve Fiscal Sustainability for Employee Compensation

Recommendations

Establish a Formal Long Range Financial Planning Process

- Responsibility of Town Administrator
- Overseen by Joint Budget Subcommittee
- Time horizon
  - Five year financial plan – action oriented
  - Model the longer-term impact (5-10 yrs) of problems such as roads, storm water, pensions, and OPEB commitments, which are projected to consume a greater portion of future budgets if not contained
- Update biannually in conjunction with each new Town Council term
- Publish narrative report and make accessible to residents
  - Recommended model: Refer to "City of Newton: Five Year Financial Forecast (2013 to 2017)"
- Submit to Finance Committee, School Committee and Town Council
- Timing of first biannual report
  - Draft form by September 1, 2013 (pre-election)
  - Finalized by February 1, 2014 (post-election)

Recommendations

Develop a Plan to Ensure Roads are Adequately Maintained

- Develop a plan to catch up on neglected roads, including the cost and timing of doing so (with particular focus on maintenance requirements during the 2015 to 2025 time period)
  - Version 1: Pay as you go – what is the minimum spend required on roads if costs are deferred as long as practical (least cost effective)
  - Version 2: Proportional maintenance – what spending is required to catch up and adopt a proportional maintenance approach (most cost effective)
  - Compare versions 1 and 2 to understand the financial benefits to the Town of a proportional maintenance approach
- Adopt capital guidelines that promote cost efficient proportional maintenance
- Consider this plan a business case for an eventual override vote, because an override may be the only practical means for addressing the deterioration of the Town's roads

Recommendations

Achieve Fiscal Sustainability for Employee Compensation

- Continue to work with union representatives to cultivate a shared appreciation of the Town's significant, growing financial challenges
- Enhance visibility of unfunded employee costs (annual increments and cumulative balance) during the annual budget process
- Reduce exposure caused by the unfunded other post-employment benefits ("OPEB") liability
  - Reduce benefits based on market conditions
  - Increase the portion of OPEB funded each year
  - Set deadlines by which the OPEB liability will be (a) funded for each new year of service; and (b) funded for all prior years of service
  - Set up OPEB trust
- Consider alternatives to full time employees
  - Part time (less than 20 hours)
  - Outsourced services

Future of Long Range Finance Committee

- Long Range Finance Committee has met its objectives
- Responsibility for implementing our recommendations must reside with Franklin’s elected officials and will require strong support from Town / School administration
- Joint Budget Subcommittee should expand its scope to include long range financial matters
- Town should consider appointing 1 or 2 residents to serve as advisors to the Joint Budget Subcommittee on long range financial matters
- Members of the Committee wish to express our gratitude for the opportunity to serve the Town of Franklin

Closing Thoughts

- Franklin has an excellent reputation as a place to live, work and go to school; the decisions we are making (or not making) now will determine how long this reputation endures
- Franklin's financial outlook is deteriorating
  - Quality of life in the Town will continue to erode, affecting our infrastructure, public safety, education, and other core services
  - All residents will be affected by these looming changes
- Franklin must better understand these challenges and devise a formal, comprehensive plan to address them
- Town officials must lead this effort with a sense of urgency
  - Now that the High School plan has been approved, developing a long range financial plan should be considered the next "big issue"
  - Town officials should revisit the Committee's recommendations in its October 2009 report and adopt the supplemental recommendations herein

This Report of the Long Range Finance Committee
is Respectfully Submitted by

- Doug Hardesty, Chair
- Ken Harvey
- Orrin Bean
- Greg DiMarzio
- Graydon Smith

Appendix A: What are OPEB?

- Employees of state and local governments may be compensated in a variety of forms in exchange for their services. In addition to a salary, many employees earn benefits over their years of service that will not be received until after their employment with the government ends. The most common type of these post-employment benefits is a pension.
- Post-employment benefits other than pensions generally take the form of health insurance and dental, vision, prescription, or other healthcare benefits provided to eligible retirees, including in some cases their beneficiaries. They may also include some type of life insurance. As a group, these are referred to as Other Post-employment Benefits, or OPEB.

Appendix B: OPEB in Franklin

- Other post-employment benefits include
  - Lifetime medical and prescription drug benefits for eligible employees, retirees, and their dependents (e.g., spouse)
  - Life insurance for employees and retirees
- Applies to all employees (active and retired) who meet eligibility requirements – except that certain retired teachers are covered by the Massachusetts Group Insurance Commission

Medical Insurance: Medical and prescription drug benefits are provided to all eligible retirees through a variety of plans offered by Blue Cross Blue Shield (Blue Care Elect PPO, Blue New England HMO) and MedEx. The Town of Franklin pays 68% of the premium for the HMO and MedEx plans, and 50% of the premium for the PPO plan. There are teachers covered by GIC plans as a closed group. The total premium for these plans is identical to their non-GIC counterparts.

Life Insurance: Retirees are provided with $5,000 face value life insurance, with 50% of the cost covered by the Town.

Appendix C: Franklin OPEB Overview

Amount (undiscounted) Franklin would need to pay over next thirty years to fund retiree health insurance.

	Pay as you go	Full Prefunding
2009	$ 80,000,000	$42,000,000
2011	$ 85,000,000	$43,000,000

“Funding without Trust” is similar to a pay as you go approach, whereby no funds are set aside for post retirement benefits as the employee is providing services

“Funding with Trust” is similar to the pension approach, whereby the obligation is pre-funded (i.e., funds set aside in the period services are provided)

The significant difference in total payments under the two methods is time value of money – that is by choosing not to pre-fund future obligations, we will ultimately be paying more

In FY 2011 Franklin funded $68K of its OPEB obligation, a nominal amount but meaningful in that it signals an intent to begin prefunding the obligation