



Memorandum

To: Board of Selectmen

From: Martha White, Town Administrator
Michael Walters Young, Deputy Town Administrator

Date: Thursday, March 17, 2011

Re: Reserve Philosophy for the Town of Natick and 2011 SATM Articles 2-5

Over the last several years, the Town of Natick has made significant and important strides to create fiscal health through a practical professional and usable financial management framework in which to plan and operate annual operating & capital budgets. Among these have included:

- Streamlining and standardizing the Town's Operating & Capital Budget Processes, from materials for department heads to presentation materials to the Town's elected and appointed officials
- Development and adoption of Financial Management Principles
- Pursuant to those Financial Management Principles
- Utilization of the financial planning committee to create consensus over budget approaches between the municipal and school budgets
- Creation of the Capital Stabilization Fund and its subsequent funding via dedication of local option sales taxes for capital and debt related projects

These strategies have enabled the Town of Natick to weather recent economic challenges far better than most other communities in the Commonwealth. In fiscal 2012 the Town of Natick has yet another opportunity to strengthen this framework and further enhance our overall financial stability through the creation of a third reserve or stabilization fund.

Reserve Position

Maintaining adequate reserves is a prudent financial move for anyone - whether it is an individual, a company, or a community. Reserves can be used for many different purposes. They serve as the town's general emergency fund in case of catastrophic problems. They can be used to pay for capital projects. And they can be used to support operations, but only in certain circumstances and with limitations. One of the key focuses of the last several years has been to highlight and, to the greatest extent possible, to reduce, the town's reliance on one-time revenue sources (such as reserves), for ongoing operations.

Previous years have assumed a baseline of \$1,500,000 in one-time revenues (Free Cash) used for operations, with more being used only when necessary. Over the last 5 fiscal years, the Town has always used more than the \$1,500,000 base line of Free Cash to subsidize operations. The Fiscal 2012 budget proposes using \$2,600,878 for the purpose of supporting operations in FY 2012 - or only 2.34% of net operating revenues.

Although FY 2012 generally progresses in remains a pattern of financial behavior which cannot be sustained. Efforts have been made, and must continue to be made annually, to reduce our collective reliance on these funds which cannot be counted on from one year to the next in order to ensure continuity of service delivery to our residents. In other words, we must live within our means.

One of the other changes of the last several years has been a gradual shift from relying upon the combination of Free Cash, Overlay Surplus and Stabilization Funds to make up the Town's reserves to one where multiple Stabilization Funds contribute to the Town's reserve position. This change has occurred for several reasons:

- 1) In the mid-2000's, the Commonwealth liberalized the creation of and uses of Stabilization Funds. In the past, they could only be used for capital and debt related purposes, but now can be used to hold money in reserve for any lawful purpose.
- 2) Stabilization Funds are more secure and accessible year-to-year than the Overlay Surplus or Free Cash. Free Cash can fluctuate from year to year (see the Town's certification in FY 2010 - \$3,327,659 to this year FY 2011 - \$5,899,906). Some years it can be significantly higher, and some years significantly lower. This unpredictability within the Town's reserve gives not only the administration pause, but also our credit rating agencies and creates a false sense of security for the community at large. Overlay Surplus, though a sum which does not fluctuate, is only available when the Board of Assessors feels confident the Town is protected from liability of potential abatement cases. This means that although significant sums of money are sometimes allocated within Overlay Surplus accounts, they are not always available when the Town might need them.
- 3) Stabilization Funds are the most transparent form of reserves. They require a higher threshold by Town Meeting (2/3rds vote) to appropriate funds both in and out, and are not subject to changes in fund balance at the end of a fiscal year. Truly, they are the safest place for the Town's reserves available to us today.

As of today the Town has two Stabilization Funds – a General Stabilization Fund and a Capital Stabilization Fund. We propose adding a third Stabilization Fund – an Operational Stabilization Fund or a “Rainy Day” Fund for the purpose of augmenting operations in times of economic downturn. The summaries for each reserve fund, and their anticipated FY 2012 balances are included on the next page.

ARTICLE 2
Stabilization Fund
(Town Administrator)

To see if the Town will vote to appropriate a sum of money from available funds for the purpose of supplementing the stabilization fund under Article 22 of the warrant for Annual Town Meeting of 1961, as authorized by Chapter 40, Section 5B of the General Laws, as amended, or otherwise act thereon.

Current Balance:	\$4,300,000 (approx.)
Proposed Appropriation:	\$ 0
Balance as of 7/1 (proj.):	\$4,300,000 (approx.)

A Town the size of Natick with a budget approaching \$115,000,000 in all of its General and Enterprise Funds should maintain approximately 2%-5% of its annual operating budget in general reserves. The \$4.3 million currently in the Town's General Stabilization Fund meets this threshold. We do not propose adding more at this time.

ARTICLE 3
Capital Stabilization Fund
(Town Administrator)

To see if the Town will vote to appropriate a sum of money from available funds for the purpose of supplementing the Capital Stabilization Fund under Article 2 of the warrant for Fall Annual Town Meeting of 2010, as authorized by Chapter 40, Section 5B of the General Laws, as amended, or take other action relative thereto.

Current Balance:	\$ 307,913
Proposed Appropriation:	\$ 687,440
Balance as of 7/1 (proj.):	\$ 995,353

The administration has recommended a far more robust capital budget for FY 2012 than in the previous several years. Of \$1,500,000 set aside in Free Cash for Capital-related projects, \$712,560 is requested for appropriation in Articles 12 and 13 (Capital Equipment and Improvement, respectively) and \$100,000 in Article 15 (re-write of the Zoning By-Law). The balance, \$678,440 is proposed to be appropriated to the Capital Stabilization Fund at the 2011 Spring Annual Town Meeting for future use. (\$650,340 is planned to be appropriated at the 2011 Fall Town Meeting).

ARTICLE 4
Create Operational Stabilization Fund
(Town Administrator)

To see if the Town will vote to create an Operational Stabilization Fund for the purpose of supplementing declines in revenues during periods of economic downturn, as authorized by Chapter 40, Section 5B of the General Laws, as amended, or take other action relative thereto.

To further enhance our reserve position, and to help the Town weather fluctuations in revenues from year-to-year, we recommend that Natick create a "rainy day" reserve account, to be known as the Operational Stabilization Fund. This reserve (one-time revenues) would be available to augment operations in case of sustained economic downturn and associated loss of revenues in support of operations. A sustained economic downturn is defined as any situation whereby State Aid and/or local

receipts are significantly reduced from one-year to the next. ("Significantly" being defined as more than 5% of the total for the respective revenue category.)

ARTICLE 5
Funding of Operational Stabilization Fund
(Town Administrator)

To see if the Town will vote to appropriate a sum of money from available funds for the purpose of supplementing the Operational Stabilization Fund under Article 4 of the warrant for Spring Annual Town Meeting of 2011, as authorized by Chapter 40, Section 5B of the General Laws, as amended, or take other action relative thereto.

Current Balance:	\$ 0
Proposed Appropriation:	\$ < 777,525
Balance as of 7/1 (proj.):	\$ < 777,525

This amount, \$777,525 would be available to appropriate to begin building the Operational Stabilization Fund for FY 2012 and beyond AFTER the amount necessary to settle the Fire FLSA backpay cost has been determined and subtracted. This FLSA figure is being calculated currently – it will be a significant portion of this amount.

Reserve Policies

Originally proposed by Town Administration in January, the following changes are recommended to the Board of Selectmen's adopted Financial Management Principles (proposed changes in italics)

Reserves: Use and Recommended Balances

Reserves and one-time revenues should be used only for capital or other non-recurring expenses, *except as noted below.*

The Town will strive to maintain unappropriated free cash at a minimum of 1% of revenues, and unappropriated free cash should never be less than ½ % of revenues.

The Town will maintain a diversified series of permanent reserves in the form of stabilization funds. These stabilization funds will consist of three types:

- 1. A General Stabilization Fund should be maintained for the purpose of unforeseen and catastrophic emergencies. It should, at a minimum, be at a level equal to 2% of revenues, with the target being 5% of revenues.*
- 2. An Operational Stabilization Fund should be maintained for the purpose of augmenting operations in case of sustained economic downturn and associated loss of revenues in support of operations. Sustained economic downturn will be any situation whereby State Aid and/or local receipts are significantly reduced from one-year to the next. ("Significantly" being defined as more than 5% of the total for the respective revenue category.) The target amount of money in the Operational Stabilization Fund should be sufficient to sustain operations through a three-year period of economic downturn. This shall be equivalent to 10% of State Aid Revenues and 5% of Estimated Receipts cumulative for a three-year period.*
- 3. A Capital Stabilization Fund should be maintained for the purpose of funding any capital related project, or pieces of capital equipment, or debt-service payment related thereto. It shall be funded through local option taxes.*

Existing reserves should be enhanced whenever possible.