

March 15, 2016

Fellow Town Meeting Members,

The Finance Committee is pleased to present both its 105th Annual Report to Town Meeting and our recommended operating budget for Fiscal Year 2017. Needham remains fiscally sound, with strong revenue growth which is expected to continue for the near future and likely beyond. Needham has experienced substantial new growth, resulting in significant increases in property values. This new growth has become part of Needham's property tax base. At the same time, the Town has entered a phase of extensive capital planning and spending. We need to be vigilant to restrain the costs of each project so that the tax burden is not unduly increased and future projects are not jeopardized. We also need to account for additional operating expenses that come with new buildings or additional space. Unlike the cost of construction that is often supported by one-time override costs, operating expenses associated with these projects remain in operating budgets going forward and will certainly increase over time. The Town also seeks to expand certain services that are currently provided, the cost-benefit of which will need to be analyzed. The Finance Committee remains committed to ensuring that taxpayer monies are expended appropriately and in the best interests of the entire Town.

We continue to face some of the same budgetary pressures as in recent years. Health insurance costs are growing faster than revenue. While the Town administration had been able to effectively contain health insurance cost increases in recent years, they are now researching available alternatives to keep the budget increases reasonable. Electricity and natural gas costs continue to increase as well, although we have seen a decrease in vehicle fuel costs.

The School Department budget also continues to grow at a rate that exceeds the Town's historical revenue growth. Overall enrollment growth has eased, but the costs of special education and transportation continue to outpace other increases. The School Department is working to find cost effective ways to deliver these services while meeting the needs of the student population, and the Finance Committee continues to support a budget recommendation that is both reasonable and meets all critical needs.

The Finance Committee began its preparation of the FY17 budget in November 2015 when Committee liaisons participated in the Town Manager's departmental budget meetings. At least one Finance Committee liaison was assigned to work with each Town department. The Finance Committee held its own budget hearings from December 2015 through late February 2016. The Finance Committee asks detailed and sometimes pointed questions in order to get a comprehensive understanding of each department's operations and spending needs. The Finance Committee requires this information in order to balance competing spending needs and to develop a sound budget that will serve the best interests of the entire Town.

The Finance Committee appreciates the efforts of the Board of Selectmen and their Town Manager and the School Committee and their Superintendent in striving to build sustainable programs that both address current needs and make the investments necessary to meet future needs.

Revenue Summary

In FY17, total General Fund revenue is projected to increase by 4.6% from three principal sources of revenue: property taxes, state aid, and local receipts. Property tax receipts comprise the largest source of revenue for Needham, accounting for 81.9% of projected General Fund Revenues in FY17. Property tax receipts are expected increase by approximately \$5.7 million or 4.8% in FY17.

New growth remains strong, although it is projected to be \$575,151 lower than FY16. The level of new growth will fluctuate depending for the most part on the number of large commercial projects in a given year. The decrease in new growth is not a concern because, as noted above, the property tax values that are new growth become part of the property tax base for future years. 90.6% of the property tax levy in FY17 is anticipated to be supported by the tax base from the prior year.

The portion of property taxes allocated to debt exclusions will decrease in FY17, since the Town has passed the peak debt service payment years for all currently authorized projects funded through debt exclusion. Tax revenues for excluded debt will be approximately \$5.9 million, which is 4.7% of the anticipated tax levy for FY17. This compares to excluded debt service revenue of approximately \$6.1 million for FY16, which was 5.1% of the tax levy.

Total state aid, which is primarily Cherry Sheet aid, is determined as part of the state budget process. (The Cherry Sheet is the official notification of aid and assessments from the state to municipalities, once issued on red colored paper.) State aid accounts for 7.2% of the projected General Fund revenue for FY17. The proportion of state aid to revenue is decreasing slightly from 7.4% in FY16, since state aid is projected to increase by only 1.9% in FY17.

Local receipts are another important General Fund revenue source, comprising 6.2% of FY17 General Fund revenue. Local receipts include revenues received for automobile, hotel room, and meal excise taxes, licensing and permitting fees, fines and penalties, and income from departmental activities and services. Local receipts can fluctuate greatly, so revenue projections are based on conservative assumptions in order to protect against an unexpected drop in one of the revenues. A bump in local receipts is expected in FY17 due to the additional revenue from the new solar electricity plant, including the sale of energy to the grid, and fees from permits and licenses. For FY17, local receipts are projected to increase by over \$1 million, approximately \$750,000 of which is due to the sale of solar generated electricity.

Free Cash is another substantial component of General Fund revenue. Free Cash results from revenue collections that exceed estimated revenue and from expenditures that are lower than appropriations at the end of the prior fiscal year (FY15). After a fiscal year closes out, the amount of Free Cash must be certified by the Department of Revenue and then becomes available for appropriation. As of the writing of this letter, the amount of Free Cash has not yet been certified. The FY17 budget assumes that free cash will be \$6 million, but we anticipate that there will be additional Free Cash available for appropriation at the Annual Town Meeting. The average amount of Free Cash over the prior three years is \$6.17 million. We recommend

Free Cash in FY17 be used to fund cash capital and financial warrant articles, to bolster reserves, and to partially support the operating budget.

The Town is careful to rely on only recurring revenues to support ongoing operating expenses. Because the Town consistently budgets each year in a conservative manner, a portion of Free Cash each year is fully expected to be recurring and therefore that portion can and should be used to support operating expenses. The balance of Free Cash is used for various one-time needs or for reserves. The formula used to determine the amount of the recurring portion of Free Cash that can be used for operations is the lesser of 2% of the adjusted operating budget for the prior fiscal year or the actual turn-back from departmental appropriations. This formula will be modified beginning in FY17 because the budget has been restructured. The FY17 operating budget includes a new line in Townwide expenses called Needham Electric, Light and Gas Program. Expenses for electricity and natural gas, accounted for in departmental budgets, including Public Facilities, Public Works and Municipal Lighting, have been consolidated and reallocated to this new budget line. The calculation for determining the recurring portion of Free Cash will use the lesser of the actual turn-back or 2% of the final adjusted operating budget, excluding the Reserve Fund. In prior years, the calculation was based on 2% of the departmental operating budget, thus excluding all Townwide expenses.

The actual turn-back from FY15 unexpended budgets was \$1.9 million. 2% of the adjusted FY15 budget is \$2.6 million. The recommended FY17 budget uses \$1,763,165 of Free Cash toward the operating budget. While this amount is lower than the calculation would allow, it is sufficient to meet the budget needs of the Town for FY17. This will also allow for more Free Cash to be used to fund additional one-time needs and operating reserve accounts.

At the time of this writing, the estimated total General Fund Revenue for Fiscal Year 2017 available for appropriation is \$151,009,403.

FY17 Operating Budget

The total recommended operating budget for FY17 is \$144,228,127, which is 5.6% higher than the current FY16 operating budget. The recommended increase for FY16 was 5% while the FY15 recommended budget increase was 4.1%. It is important to note that in the past two years, the Town has been shifting the costs of certain items that were previously funded through cash capital into the operating budget because they do not meet the Town's definition of capital for budgeting purposes. In addition, the FY17 budget reallocates costs for natural gas and electricity from the Municipal Department budgets into Townwide Expenses. Thus, some of the increases to the operating budgets are due to reallocation of costs rather than a higher level of spending. The increases in the three major components of the FY17 budget are:

Townwide Expenses	15.5%
Municipal Departments (excluding Education)	-5.3%
Education	6.1%

Townwide Expenses

The FY17 budget recommendation includes an increase of 15.5% in Townwide Expenses. The primary reason for this considerable increase is the reallocation of regulated energy costs, specifically electricity and natural gas, to the new budget line entitled Needham Electric, Light and Gas Program. The increase from FY16 to FY17 Townwide Expenses excluding the Electric Light and Gas Program is 6.4%. Other significant increases in Townwide Expenses include Group Health Insurance/Employee Benefits, Retirement Assessments, and Classification, Performance and Settlements.

Included in the Needham Electric, Light and Gas Program budget is the entire Municipal Lighting budget, \$2,739,942 for energy costs previously in the Public Facilities budget, \$52,214 previously in Public Works, and \$9,500 previously in Park and Recreation. The Finance Department will be responsible to oversee these expenses, negotiate prices and manage the contracts for electricity and natural gas. This budget will fund payments associated with generating power at the new solar electricity plant. The revenues from the solar project, which are expected to be twice the amount of the costs cannot be used to offset the costs and will be part of the Town's General Fund revenues.

The Casual, Liability, Property and Self-Insurance line item accounts for the insurance coverage that the Town receives through the Massachusetts Inter-local Insurance Agency (MIIA) for buildings, vehicles, property damage, and liability, as well as a small contingency for non-covered claims. This line item is increasing by 4.0%, or \$22,400 in FY17, to cover premiums for the Town's inventory of facilities and equipment.

The Debt Service budget line is decreasing in FY17 for the third consecutive year. This line item, which covers payments for outstanding debt obligations, is decreasing by 2.7%, or \$312,462. Debt service includes payments for excluded debt, Community Preservation Act debt, and debt within the levy. FY14 was the peak year for the Town Hall, and for the Newman School and other projects funded with excluded debt.

The Employee Benefits line (Group Insurance, Employee Benefits, Assessments and Administrative Costs) is increasing by 12.1%, or \$1,427,484. The increase is a result of a projected 9% increase in health insurance costs combined with an increase in the number of benefit eligible employees. The Town continues to evaluate different health insurance providers and collaboratives to keep health premium increases in check. The increase in the assumed number of benefit eligible employees includes additional staff and additional hours for positions that will then qualify for benefits, for an aggregate increase of \$215,820.

The FY17 Retirement Assessments line item is increasing by 8.7%, or \$539,188. This line item covers pensions for retirees as well as unfunded pension liability. In FY16, the Retirement Board reduced the assumed rate of return of pension assets from 8.00% to 7.75%. The funding schedule in the most recent actuarial analysis includes at least three more years of continuing increases to the Town's annual contribution to make up for the increased unfunded liability resulting from the reduced rate of return assumptions.

The Retiree Insurance Program and Insurance Liability Fund line is increasing by 4.4%, or \$232,621. The program, also known as "OPEB" (other post-employment benefits), funds other benefits provided to eligible retirees such as health insurance. The 4.4% increase follows a 2013 funding schedule. A new actuarial analysis is underway, which the Finance Committee anticipates will increase the required funding beginning with the FY18 budget. Workers' compensation is increasing 4.0% in the FY17 budget based on the average projected growth in salaries and wages.

The Classification, Performance, and Settlements line item serves as a reserve for personnel-related needs during the fiscal year, such as performance-based salary increases for managers, or changes due to new collective bargaining agreements. This line item is budgeted at \$600,000 because of a number of outstanding contracts. As of this writing, collective bargaining agreements have not been settled for FY17 with the Fire Union, the Police Superior Officers Association, and the Building Custodian Tradesman Independent Association.

The Reserve Fund provides for extraordinary or unforeseen budget needs that arise during the fiscal year. The Reserve Fund has been used to fund expenses such as unexpected legal costs, replacement of damaged equipment, and extraordinary snow and ice removal. The recommended Reserve Fund appropriation for FY17 is \$1,584,124, an increase of 3.9% over the FY16 budget. Even with the extraordinary snow and ice removal expenses of FY15, the Town did not exceed its Reserve Fund appropriation. The Finance Committee feels that this amount is prudent to cover extraordinary needs.

Municipal Departments (excluding Education)

The Municipal Departments category includes 19 different budgets encompassing operational departments, boards and committees, and the municipal parking program. This report groups those budgets within Municipal Departments by functional groups.

General Government and Land Use

The FY17 proposed budget for all General Government and Land Use departments is 2.4% higher than the FY16 budget. While individual budget increases vary, all budgets include a new salary structure for management and other non-union administrative employees that were voted by the Board of Selectmen in the summer of 2015.

The Board of Selectmen/Town Manager budget line item is 2.6% lower than FY16 because the Management Fellow pilot position is eliminated in FY17. While the Town Manager felt that the pilot program was successful, the position is not being requested at this time.

The Town Clerk and Board of Registrar's FY17 budget is increasing by 8.6%, in part due to an increase to three scheduled elections in FY17 from two elections in FY16. The Town Counsel's budget is level funded for FY17 as is the Personnel Board budget. In FY16, the Personnel Board funding was transferred to the salary line to partially support the salary of the Management Fellow position in the Town Manager's office. The funds are allocated to the expense line in FY 17 to be used for consulting work as they have been in the past.

The Finance Department budget is increasing 3.1% in FY16. The budget now includes \$30,000 for the annual cost of network servers, switches and technology replacements which was previously funded in the Annual Town Meeting Warrant Cash Capital article. The Finance Committee's budget is increasing 5.0% from FY15 due to an increase in salary, reflecting the management salary adjustment.

The Planning and Community Development Department budget is increasing by 4.8%. In addition to increases in salaries, the Finance Committee recommends funding additional hours for an existing benefit-eligible administrative employee.

Public Safety

The Public Safety Departments, which include the Police, Fire, and Building Departments, have a combined increase of 3.0% in the FY17 budget. The Police Department budget is increasing 4.1%, reflecting salary increases and the police vehicle replacement cycle. The Finance Committee did not recommend funding four additional police officers for FY17. The Police Department expects an increase in service calls resulting from redevelopment at Needham Crossing, including new businesses and potential new residential housing. However, the anticipated increase in police calls is not expected to occur within the FY17 time frame and the Finance Committee will be reviewing the necessity of increased staffing in future budget years.

The Fire Department budget is increasing by a modest 1.0% in FY17, because the Fire Union contract is not settled at this time. The Finance Committee deferred the Fire Department's request for four additional Firefighter/Paramedics in F17 to staff an additional ambulance that would be housed at Fire Station 2. The Finance Committee will review the request once the feasibility study for Fire Station 2 establishes the cost-benefit analysis of a second ambulance and the location of the infrastructure to house and run an additional ambulance.

In FY16, the Board of Selectmen implemented new fees and fee increases for building permits and inspections. The Finance Committee determined that the cost of some additional staffing requested by the Building Department would be offset by the new fee structure. The Building Department budget is increasing 15.1% due to the reallocation of the Fire Engineer Consultant from the Fire Department budget (a change in the building code has transferred this function to the Building Department rather than the Fire Department) as well as the addition of two part-time inspectors. The \$20,000 for the Fire Engineer Consultant is included in the FY17 expense line. The additional \$61,542 for part-time Plumbing and Gas Inspector and Wiring Inspector is included in the salary line. Timely inspections are critical to construction projects. These positions will meet the increased volume of requests for inspection resulting from the increased construction activity in Needham. The Finance Committee did not recommend funding an additional administrative position in the Department.

Public Facilities and Public Works

The total combined budget for the Public Facilities Department, the Department of Public Works (DPW), and the Municipal Parking Program, is decreasing by 17.8% in FY16 from the reallocation of costs for regulated energy to the new line item in Townwide expenses.

The Public Facilities Department budget is decreasing by 28.2% in FY17. The department contains two divisions, Construction and Maintenance. At this time there is no settled agreement with the Building Custodian Tradesman Independent Association for FY17, which would affect the Maintenance Division budget.

The FY17 Public Facilities budget includes an increase of \$40,469 to partially fund a request for a new Project Manager position in the Construction Division. This position was added due to an expected increase in the volume and complexity of capital projects being undertaken. The balance of the salary for the new position will be charged to the budgets of specific projects.

The FY17 budget for the Department of Public Works is increasing by 2.3%. The budget includes an increase \$12,788 to fund two summer laborers. The FY17 budget also provides a one-time expense of \$30,000 to complete fence repairs throughout the parks system. It is expected that after FY17, the annual DPW operating budget will cover regular fence maintenance. The FY17 budget funds a request for a one-time purchase of a GPS unit compatible with the Engineering Division's existing survey system and a small ongoing subscription expense for this equipment.

There are no significant changes to the Municipal Parking budget.

Community Services

While the Community Services budget is only 2.6% of the overall operating budget, the six divisions that comprise Community Services receive substantial funding from fees, grants, and donations, and benefit from volunteer services. The Community Services budgets are increasing 1.6% in FY16.

The Health and Human Services (HHS) budget, which was newly merged into one budget in FY16, is increasing 3.8% in FY17. This budget includes the Health Department, Council on Aging, Youth Commission, and Veterans Services. The FY17 budget includes additional hours for a social worker for the Council on Aging. The funding was achieved through reallocation of funds from a program coordinator position that will be covered by a recently secured federal grant, and also by moving funds from a separate part-time outreach position.

During our budget deliberations, the Finance Committee assessed the need for a requested additional Environmental Health Agent by the Health Department. The Health and Human Services Department was merged into one budget in FY16 and is being reorganized. During our budget hearings, it became clear that while there may be a need for additional staffing in the Health Department, the structure of the department after reorganization may result in a different staffing approach. The Finance Committee felt that it is critical that the Town be able to keep up with increasing demand for Public Health inspection and enforcement work but that it would be best to wait until after the reorganization to determine the need and function of any new position. The Finance Committee indicated that it would be willing to discuss funding this position at the Fall 2016 Special Town Meeting, although typically new positions are usually considered only during the budget process culminating at the Annual Town Meeting. As part of its budget hearings and voted budget, the Finance Committee identified the possibility of

transferring from the Reserve Fund \$61,305 for salary plus \$22,819 for benefits for a new position in the Health and Human Services Department.

The Commission on Disabilities budget is level funded at \$2,050 in FY217, for a stipend for the Town Liaison to the Commission and ADA training for members of the Commission. The FY17 budget for the Historical Commission is also level-funded at \$1,050, which covers expenses relating to its activities of preserving and protecting the Town's historical buildings and maintaining the historical inventory.

The Library budget is increasing 0.8% for FY17. In recent years, efforts have been made to transition certain essential positions that are being funded from the State Aid account into the operating budget to protect against unexpected fluctuations in that account. We anticipate reduced funding in FY17 for Library State Aid. For FY17, the Finance Committee recommends funding additional circulation desk hours in the operating budget, as well as funding Sunday hours in June. Both of these functions are integral parts of the Library's services, and are appropriate for inclusion in the operating budget. Wireless internet service, book and DVD downloading subscriptions, and an online reference database will continue to be funded through the State Aid account in FY17.

The Park and Recreation Budget is decreasing 1.7% in FY17 from reduction in energy expenses transferred to Townwide Expenses. The Memorial Park budget remains level-funded at \$750 to cover expenses relating to purchase of flags and minor maintenance to the memorials. The costs for operating and maintaining the Memorial Park building and fields are in the Park and Recreation, Public Works and Public Facilities budgets.

Education

The recommended FY17 Education budget is \$65,910,351, which represents 45.7% of the total General Fund operating budget. The Education section of the budget is comprised of the Town's assessment for the Minuteman Regional High School and the operating budget for the Needham Public Schools. The Minuteman Regional High School's preliminary assessment for FY17 is \$720,437, an increase of 10.1% from FY16 due to an increase in Needham student enrollment. The Minuteman School District Agreement has been amended by a unanimous vote of the member districts. Town Meeting voted in favor of the amendment at the March 2016 Special Town Meeting. The formula for assessments will change, and the number of member communities may change. As a result, Needham's assessment may be amended. The Minuteman district also plans to begin a capital building project, the costs of which will be apportioned among member towns. The details and financial implications of the Minuteman School capital project will be included at the May 2016 Special Town Meeting.

The FY17 budget for the Needham Public Schools totals \$65,189,914, an increase of \$3,709,227, or 6.0%, over the FY16 appropriation. The Finance Committee's recommended FY17 budget fully funds the School Committee's voted budget and provides added funding of \$131,200 for two additional staff needed to initiate a new therapeutic program at the High School. Benefits costs of \$37,540 were also added to the Employee Benefits line in Townwide expenses to cover

related costs. The new therapeutic program at the High School is being implemented to meet the needs of certain students who might otherwise not be able to remain at the High School. The Finance Committee encourages these types of cost efficient initiatives which better serve the community.

The School Committee voted budget of \$65,058,714 funded the Superintendent's initial budget request, less \$220,865 of reductions identified by the Superintendent during budget liaison meetings with the Finance Committee. An additional \$340,700 was added to the School Department's budget to fund the FY17 school technology request. The technology request includes funding for the continued implementation of the 1:1 technology program. The Finance Committee is mindful that growing technology needs and costs could potentially crowd out other educational needs in the School Department operating budget.

The Finance Committee continues to monitor other volatile costs within the School Department budget including special education tuitions and transportation costs. Several new programs are underway to strengthen and broaden special education programs. In addition, a new task force will be examining School transportation costs.

Cash Capital

The Finance Committee has not yet completed its review of the Cash Capital requests as of this submission. The Cash Capital article includes \$1,491,117, most of which will be funded with Free Cash, which has not yet been certified. As mentioned above, some annual cash capital items have been moved from Cash Capital to the operating budget since they have been found not to align with the Town's definition of capital. We will continue to carefully review these operating expenses to make sure that cost fluctuations do not cut into operations.

Closing Comments

The Finance Committee's recommended operating budget for FY17 will allow the Town to continue providing a high level of services to residents and businesses. The Town will be able to maintain its strong financial condition and also to meet increasing demands for services for the next year, with an eye toward the long term. It is critical for the Town to continue to engage in very careful capital planning as many large projects are scheduled in the upcoming years. The Annual Town Meeting Warrant includes a number of articles that aim to provide substantial funding to reserve funds to offset the anticipated costs of these capital projects. The Town must consider not only the benefits of each project and the capital costs, but the effects on the Town's overall debt capacity, the long-term implications to the operating budget, and the burden on individual taxpayers. The Finance Committee looks forward to working closely with the other Town Boards and Committees as well as Town and School administrators during this process.

The Finance Committee would like to recognize the hard and excellent work of Town and School Administration and the Directors of Finance for the Town and Schools, and the department heads and managers who all worked closely with the Finance Committee

throughout the budgeting process. The Finance Committee greatly values the creative and constructive approaches often presented to address competing operational needs. The Finance Committee would also like to recognize the residents who dedicate their time and effort to serving our community through elected and appointed positions. We could not accomplish our mission effectively without their generous assistance and support.

Finally, I would also like to thank each member of the Finance Committee for their dedication and meticulous work examining and prioritizing financial issues, balancing the budget, and reviewing the Town's capital plans and investments. It has been a privilege and a pleasure to serve with such dedicated and talented people as we strive to achieve the best for the Town and its residents.

Respectfully submitted on behalf of the Finance Committee,

Louise L.E. Miller, Chair

Committee Members:

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