Message from the Co-Chairs

Last March, at a meeting of the Board of Selectmen, School Committee and Finance Committee, a suggestion was made to form a committee to study the town's fiscal situation. In June, the Board of Selectmen announced the creation of The Fiscal Study Committee. The committee held its first meeting in June of 2006 and continued to meet through March 8, 2007. As you will see in the following report, numerous areas of town government were studied and analyzed. The report is the result of hundreds hours of meetings, interviews, research and discussion. We believe the report represents the very best efforts of the committee members.

We wish to thank all of the Fiscal Study Committee members for the generosity of their time, dedication to the task, and spirit of cooperation and compromise. For any large group to succeed, individuals, while maintaining their independent spirit, must put the collective wisdom of the group before their own personalities. We commend the committee members for accomplishing this, the most difficult task of their work.

We are proud of the work of Fiscal Study Committee members. We hope that as you read this document, you will learn more about the workings and issues facing our town government, and appreciate the work of this very diverse and talented group of people.

Respectfully,

Thomas A. Fiore	Maurice M. DePalo
Selectman Vice Chair	Selectman

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THE HEART OF THE MATTER

Having researched and analyzed, studied and debated, we come to the heart of the matter. The real issue facing the town is not about doing better or worse than someone else, nor is it about making little adjustments here and there. Rather, the issue is one of priorities. What is important to the residents of this town? What services do we believe this town should offer and at what level?
What is a reasonable and appropriate cost to pay for the level of services desired? How should they be funded? What services should be considered "core" services that ought to be provided through taxation? Should "optional" services be supported through taxation, through fees, or should they be eliminated?

It was not the role of this committee to answer these questions for the citizens of this town. Our fundamental task was to examine the financial condition of the town. This included all sources of revenues and whether the town has optimized these revenues; and all expenditures and whether their rate of growth can be reduced, either by cutting service levels or by cutting the costs of the services provided.

In recent years we have reduced some services by either reducing or freezing school/municipal staffing levels. The committee agrees that additional staffing reductions will have serious consequences on service levels. If we wish to maintain current service levels, the town will have to find ways to increase its revenue stream, negotiate contracts that reduce the rate of annual cost increases for services, and/or find more efficient ways to deliver town services and control the spiraling costs of health benefits and pensions.

The committee is satisfied that there are no major opportunities for the town to increase revenues from current sources. The committee also believes that the town must continue to make all efforts to control growth in costs. If we do not, any revenue increases that may be approved will only be a temporary solution.

If residents believe that the tax burden is already as much as they can bear, and if town officials are unable to moderate the growth rate in the cost of services, residents will have to choose which services to cut or possibly eliminate.

When we began this process many of us hoped to find additional revenue sources and easy expenditure reductions. We found neither. There is no list of simple suggestions to resolve our town's financial condition. There can be no substitute for citizens' participation in our political process. The decisions the electorate makes reflect values about governance and priorities. We challenge all residents of Shrewsbury to think seriously about these value issues and to become active in the process that will help decide the future of our town.

Fiscal Study Committee- BRIEF

Background:

The Fiscal Study Committee is a group of thirty Shrewsbury residents. Membership includes Board of Selectmen (2 members), Finance Committee (2 members), School Committee (2 members), Town Meeting Members (18 members appointed by the Town Moderator), and At-Large Residents (6 members appointed by the Selectmen.) Board of Selectmen Tom Fiore and Maurice DePalo were designated facilitators for Committee.

Mission Statement:

The Fiscal Study Committee's mission was to research two broad topics: the Town of Shrewsbury's expenditure and revenue status. This research is to be used as a reference and educational tool for all Shrewsbury residents.

1. **Expenditures:** Research expenditure items, both fixed and discretionary. Items that significantly impact the budget and give consideration to their effect on future expense trending for the Town of Shrewsbury.
2. **Revenue:** Research current revenue sources currently being performed as well as new possible sources of revenue for the Town of Shrewsbury.

Productivity Strategy:

The productivity strategy was to divide the Committee into two working groups: Revenue Sub-Committee and Expenditure Sub-Committee. Each committee was headed by one member of the Board of Selectmen. Within each committee, we further divided into smaller groups comprised of two to three members. These smaller groups were responsible for specific areas of research. This strategy greatly enhanced productivity.

Research Topics:

Expenditures:
1. Five-Year Trend Analysis
2. Human Resources (Benefits, Health Insurance, Pension and Salaries)
3. School Department Expenditures and Future Trending
4. Capital Expenditures Including Bond Debt
5. Mandated and Discretionary Spending

Revenues:
1. Revenue Collection (Taxation, State Aid, Fees-Municipal & others)
2. Fee Implementation and Philosophy
3. Town Treasury Management (Investment Strategy and Yield)
4. Understanding Grants

Committee Conclusions:

Expenditures Section:

1. Five-Year Trend Analysis

Committee Conclusion:
Graphic trending of Town expenditures provides the community with a visual analysis of budgetary consumption. Looking over the past five years we see schools, employee benefits and the Towns debt payment schedules as being the greatest consumers. This trend will not notably change as we move forward into the next few years. Major cost drivers will be Health Insurance (operating support), Schools, and Public Safety. As the Town continues to pay its debt obligations, the interest and principal costs will decline. This amortization will impact the likelihood of future large capital project approval.

2. Human Resources (Benefits, Health Insurance, Pensions and Salaries)

Committee Conclusion:
Town administrators are proactively and aggressively seeking ways to minimize the costs of healthcare and pension benefits. They are also acutely aware of the need to work with employees and collective bargaining units to keep the cost of salaries and fringe benefits in line with the Town's ability to raise revenue. Their major challenge will be finding ways to restructure salary and benefits programs while continuing to attract, motivate and retain high performing employees.

3. School Department Expenditures and Trending

Committee Conclusion:
The committee performed the described scope of work on the major areas in the school budget, which includes Administration, Teacher Salaries, Special Education and Transportation. Overall, the School Department keeps detailed cost records and has been successful in meeting its goals of providing a quality education to all students in the district within its budget restraints. Many costs, such as those associated with Special Education, are mandated by Federal and State law. Some of these costs are beyond the control of the school department. Other costs, such as teacher salaries, are impacted by collective bargaining agreements. In the remaining areas, we have presented specific recommendations, as warranted, for each of the areas reviewed. In addition, this committee is concerned that town resources will not be able to keep up with contracted annual salary increases.

4. Capital Expenditures including Bond Debt

Committee Conclusion:
Long-term debt and capital expenditures are an inevitable part of any well-managed community. Identifying the prudent way to structure this debt is the challenge. Two interesting approaches have been discussed:

1. Establishing an overall debt ceiling for the Town.
2. Capping the dollar amount a homeowner must pay towards the debt. The Committee recognizes the merit of each of these approaches and recommends they each be explored in more detail.

5. Mandated and Discretionary Spending

Committee Conclusion:
The Committee recognizes that during tight budgetary times, discussion of mandated versus non-mandated costs often evolve. What functions must we provide and at what level of service? A general overview of mandated and non-mandated municipal programs provides insight into these discussions. As the Town's financial situation tightens, we recognize that choices will have to be made regarding what services can continue and what level of service can be maintained.

<u>Revenues Section:</u>

1. Revenue Collection (Taxation, State Aid, Fees- Municipal & other)

Committee Conclusion:
The Committee believes the Town collects revenues effectively. The Town applies a single rate for both commercial and residential real estate taxes with the residential tax base representing approximately 88% of all real estate taxes collected.
Shrewsbury Electric Light and Cable at the present time is a good source of recurring revenue as well as other benefits and savings to our community. Tom Josie and the commission making prudent fiscal decisions allow SELCO to provide the town with substantially lower rates compared to other local providers (Charter, National Grid.) SELCO's goal is to provide the best possible service at the best rate.

2. Fee Implementation and Philosophy

Committee Conclusion:
The analysis demonstrated the challenge of cataloging the various fees, given the decentralized fee setting authority. Due to the town's disparate information systems, the committee found it difficult to collect the information in a standardized manner and compare it to related costs.
Some departments that set fees can retain those revenues to defray operating costs while other department fees flow to the general fund. Some fees are set by state mandates while others, set by the town department, can be adjusted as needed.

3. Town Treasury Management (Investment Strategy and Yield)

Committee Conclusion:
The Committee believes that Town funds are well managed. The Town employs a professional Treasury Management agent (Bartholomew and Co.) to invest funds prior to use. Returns on these investments are highly competitive and provide significant income to the Town.

The Committee also believes the Town's budgeting process works well to identify significant issues in advance of their impacting Town operations. An example of this is the Town's analysis and response to the pending significant increase in trash disposal costs (See Section 3.2 Fiscal Study Committee Final Report)

4. Understanding Grants

Committee Conclusion:
Town department managers are responsible for pursuing federal, state and private grants for their areas of responsibility.

The Committee recommends the Town consider the addition of a "dedicated human resource" (graduate student/college intern) specifically assigned to identify and apply for regional, state, federal and private grant programs.

- **For additional information on Research Topics or Conclusion please refer to the Fiscal Study Committee's Final Report.** **http://www.shrewsbury-ma.gov/fiscalpolicy/index.asp**

Final Revenue Report

Report of the Revenue Sub-committee
of the Shrewsbury Fiscal Study Committee

March 12, 2007

The following members of the Revenue Sub-committee of the Shrewsbury Fiscal Study Committee are pleased to present their final report.

Tom Fiore	Gene Buddenhagen	Andrew Carlson
Martha Deering	Michael Filiere	Nancy Gilbert
William Gooley	James Kane	Jonathan Mack
Judy Merriman	Greg Riedel	Carol Swydan
Walter Thomas	Michael Vescere	Virginia Winship

A. Committee Purpose

To investigate and report on all issues involving the Town's fiscal condition for the five (5) year period beginning July 1, 2006.

B. Revenue Sub-committee Scope of Work:

1. Examine and report on all current sources of Town revenue.
2. Examine and report on additional sources of Town revenue.
3. Develop specific recommendations (as warranted) for each areas studied in 1. and 2. above.

C. Committee Meetings

The Revenue Sub-committee met on each of the following dates. Meeting minutes are available.

June 13, 2006	July 13, 2006	August 17, 2006
September 14, 2006	October 5, 2006	October 12, 2006
October 26, 2006	November 9,2006	November 30,2006
December 14 2006	January 11 2007	January 25,2007
February 1, 2007	February 8, 2007	February 15, 2007
February 22,2007	March 1, 2007	March 8, 2007

D. Summary Findings

The Committee is pleased to present the following summary findings:

Overall Conclusion

The Committee has concluded that the Town has maximized revenues from existing sources. Opportunities for additional revenues from underdeveloped sources do exist (e.g. increased commercial tax base); however, the Committee believes that should the Town require additional revenues, the most likely source will be from residential real estate taxes and/or fees. The Committee has developed certain recommendations to the Town which are included below:

Revenue Collection: The Committee believes the Town collects revenues effectively. The Town applies a single rate for both commercial and residential real estate taxes with the residential tax base representing approximately 88% of all real estate taxes collected.

The Town is actively looking to expand its commercial tax revenue base in accordance with the Master Development Plan, the formation of the Shrewsbury Development Corporation to develop the "Allen Property" and, most recently, the creation of an Overlay District along Route 9 as accepted at the September 2006 Town Meeting. The Committee recommends the Town remain as aggressive as possible in promoting commercial development where appropriate.

Taxes appear to be collected in a timely fashion and delinquent taxes are minimal.

Fee Implementation and Philosophy: The Town has implemented fees for certain services. Although the Town's historical practice has been that the cost of most services would be covered by general tax receipts, fees are now an important component of total revenues (See section **3.1**. below). The Committee recognizes that certain fees have been increased recently to better match the fee charged to related cost. However, the Committee believes that more work needs to be performed by the Town to ensure that fees charged cover the desired percentage of actual costs incurred.

In addition, the Committee recommends that as fee based revenues become more prevalent, the Town provide residents an understanding of how fees are established including the targeted percentage of related costs the fees are designed to recoup. The Committee envisions that certain fees will be established to cover the total cost of a related activity while other fees may be established to cover a targeted percentage of related costs. The Committee believes it is important to educate Town residents on the rationale and financial objective of charged fees.

State Aid – A Two Edged Sword: The Town collects a significant portion of its revenues from traditional state aid and education aid under Chapter 70 (the ever changing State regulations which calculate the amount of education aid the Town receives).

The Committee recognizes the volatility of the amount of state aid received each year and the pressure its places on preparing and managing the Town's annual budget. The Committee recognizes the Town actively pursues all ad hoc State funding opportunities to supplement Town revenues. A most recent significant example of non-recurring aid received from the State is the reimbursement of a large percentage of Town school construction costs.

Grant Seeking Focus: Town department managers are responsible for pursuing federal, state and private grants for their areas of responsibility. The Committee recommends the Town consider the addition of a non-paid graduate student / college intern resource specifically assigned to identify and apply for regional, state, federal and private grant programs.

Unique Revenue Streams: The Committee recognizes that the Town generates revenues from atypical sources such as the Town's Light and Cable Operations ("SELCO") and the Coal Ash Disposal Facility. The Committee believes that the Town has maximized the revenue potential of these operations. The Committee notes that future annual revenues from these operations may be lower than historical revenues received for reasons as noted in Section E. below.

As part of the review of SELCO the Committee recommends that the Town request SELCO to provide comparative summary operating results and headcount information for inclusion in the Town's Annual Report.

Investment Philosophy and Methodology: The Committee believes that Town funds are well managed. The Town employs a professional Treasury Management agent (Bartholomew and Co.) to invest funds. Returns on these investments are highly competitive and provide significant interest income to the Town.

Municipal Budgeting and Forecasting: Finally, the Committee believes the Town's budgeting and forecasting function works well to identify significant issues in advance of their impacting Town operations. An example of this is the Town's analysis and response to the pending significant increase in trash disposal costs (See Section **3.2**. below).

The Committee recommends that the Town provide residents an annual 5 year summary projection comparing expected revenues and expenses, with a best estimate of the Town's ability to maintain present services. We recommend that these projections be made easily and widely available to all residents.

E. Revenue Sub-committee Focus:

The Revenue Sub-committee has focused on certain issues seen as most pressing to the Town that are within the scope of the Committee and identified by the Committee members as relevant to the Town taxpayers.

These issues include:

1. Understanding all existing revenue sources
2. Understanding property taxes
3. Understanding options to increase revenue through means other than the residential property tax
4. Town Treasury Management
5. Understanding "grants" as a means to supplement revenue needs
6. Expanding, enhancing and retaining the existing non-residential tax base
7. Understanding 5 year Projections

Analysis

1. Understanding all existing revenue sources

To ensure that all members started with the same framework of information and understanding in regards to the Town's existing revenue sources, the Committee reviewed the following summary revenue information from the Town's fiscal 2006 budget report

Estimated Revenues	Amount	Percentage
Taxation (residential and commercial)	$43,723,000	**52.5%**
State Aid, net	19,794,000	**23.7%**
Fees	10,388,000	**12.5%**
Specific Use Fees (e.g. water, sewage, etc.)	5,127,000	**6.2%**
Free cash and other transfers	3,253,000	**3.9%**
Town Light and Cable	762,000	**0.9%**
Other	297,000	**0.4%**
	-------------------	**------------**
Total	$83,344,000	**100.0%**

2. Understanding property taxes

Each year property taxes make up approximately half (see table above) of the revenue of our Town budget. Property taxes are complex and include classifications called residential, commercial, open space, industrial and personal property. In Shrewsbury, all classifications are taxed at the same base rate of $8.66 per thousand of assessed value.

Fiscal Year 2007 Tax Classification

Tax Classification	Assessed Value	Tax Levy	Tax Rate
Residential	4,549,474,405	39,398,448	8.66
Open Space	3,129,400	27,101	8.66
Commercial	366,235,728	3,171,601	8.66
Industrial	194,877,975	1,687,643	8.66
Personal Property	41,561,998	359,927	8.66
Total	5,155,279,506	44,644,720	

All cities and towns in Massachusetts are, by law (Proposition 2 ½), limited in the total amount of taxes levied as well as the amount they can increase each year. The following paragraphs are a direct excerpt from the Massachusetts Department of Revenue ("Mass DOR") website and are contained in a document entitled, "Levy Limits: A Primer on Proposition 2 1/2."

2.1 What is a Levy?

The property tax levy is the revenue a community can raise through real and personal property taxes. We will refer to the property tax levy simply as the levy. In Massachusetts, municipal revenues to support local spending for schools, public safety and other public services are raised through the property tax levy, state aid, local receipts and other sources. The property tax levy is the largest source of revenue for most cities and towns.

2.2 What is a Levy Ceiling? What is a Levy Limit?

Proposition 2 ½ places constraints on the amount of the levy raised by a city or town and on how much the levy can be increased from year to year.

A levy limit is a restriction on the amount of property taxes a community can levy. Proposition 2 ½ established two types of levy limits:

First, a community cannot levy more than 2.5% of the total full and fair cash value of all taxable real and personal property in the community. We will refer to the full and fair cash value limit as the levy ceiling.

Second, a community's levy is also constrained in that it can only increase by a certain amount from year to year. We will refer to the maximum amount a community can levy in a given year as the levy limit. The levy limit will always be below, or at most, equal to the levy ceiling. The levy limit may not exceed the levy ceiling.

Proposition 2 ½ does provide communities with some flexibility. It is possible for a community to levy above its levy limit or its levy ceiling on a temporary basis, as well as to increase its levy limit on a permanent basis.

The following Mass DOR chart shows Shrewsbury's Levy Limit and Ceiling:

Fiscal Year 2007 Proposition 2½ Levy Capacity

New Growth	997,304
Override	0
Debt Exclusion	3,566,945
Levy Limit	44,686,208
Excess Capacity	41,487
Ceiling	128,881,988
Override Capacity	87,762,725

The Committee noted that there is tax relief for qualified seniors through the state Circuit Breaker Program, a deferral of $1,000 and an exemption program of $175. There is a 100% reimbursement of the Circuit Beaker Program from the state to offset the Town's loss of revenue. The Town also has a Property Tax Work-Off Program.

Please see the "Levy Limits: A Primer on Proposition 2½" exhibit in the Reference Section published by Mass DOR, for additional information.

3. Understanding options to increase revenue through means other than the residential property tax.

The Committee created smaller working groups to examine the following issues:

3.1 Town Department Fees

The Committee reviewed an analysis of fee receipts noting that actual Town fees collected totaled $11,971,000 versus the estimate of $10,388,000 noted above. A summary of fees follows:

Fees	Amount	Percentage
Auto Excise	$4,688,000	**39.2%**
Water and Sewer	$2,840,000	**23.7%**
Investment Income	$1,127,000	**9.4%**
Licenses and Permits	$1,238,000	**10.3%**
Ash Disposal	$580,000	**4.8%**
Other (no single item greater than $300,000)	$1,499,000	**12.6%**
	-------------------	**------------**
Total	$11,972,000	**100.0%**

The Committee notes that almost 40% of fee receipts are received from Auto Excise at rates prescribed by the State.

Committee members coordinated an analysis of fees. Summary information of fees by department including the amount of fees collected, the basis for the fee, and a comparison of fees collected to the actual costs incurred by the Town in providing fee related services was reviewed.

Through this review and conversations with Department personnel, the following observations were noted:

- The analysis demonstrated the challenge of completely cataloguing the various fees given the decentralized fee setting authority
- Due to the Town's disparate information systems, information could not be collected in a standardized manner nor compared to related costs.
- The several departments that set fees may retain those revenues to defray operating costs while other fees flow to the general fund.

3.2 Sanitation Fees

Committee members met with Nancy Allen, Director of Public Health, to discuss the situation relating to Town rubbish disposal.
On January 1, 2008, a new rubbish disposal contract with Wheelabrator will begin. Disposal costs will increase from the current $37.33/ton to $70.50/ton. Consequently, disposal costs will approximately double from about $412,000/yr to about $821,000/yr and will continue to increase at a negotiated rate thereafter.

In addition, landfill revenues from the Coal Ash Disposal Facility, which from 2000 through 2005, ranged from $575,000 to over $2,000,000 per year (averaging $1,300,000) are estimated to be $550,000 for 2008. This decline in revenue, due to the state's reclassification of ash (which had been the mainstay of the landfill), will further increase the revenue needed to cover the increasing costs of trash disposal.

In addition, there are trash collection costs which are forecast to total $1,240,000 for 2008.

In summary, the total cost of trash collection and disposal (including recycling and yard waste) will total approximately $1,950,000 for 2008 with approximately $550,000 offset by landfill income, leaving $1,400,000 to be covered by general tax revenue. The total increase from 2006 to 2008 is approximately $480,000.

To address this issue Nancy Allen, working with her Board, the Town Manager, and other appropriate bodies, has researched a Pay As You Throw (PAYT) trash disposal fee program to meet this need.

When combined with revenue from the Town landfill, the proposed program could generate sufficient revenue to cover the costs of trash and recycling collection and disposal.
A Committee member also met with Fred Litchfield of the Northboro Engineering Dept., which manages Northboro's PAYT program.

A more comprehensive report on findings is in the appendix as Exhibit III
(The Dirt on Trash).

The Committee discussed this report and the following options.

1. Continue with the present curbside program and fund trash/recycling collection and disposal from increased tax revenue and/or cuts in other services.

2. Continue as at present, but institute a program to radically increase recycling (which cuts disposal costs) and include new laws and penalties for those who fail to recycle adequately.

3. Continue as at present, but institute a trash/recycling collection and disposal fee that would be calculated on the basis of number of households or number of residents or some similar formula. Businesses and apartment buildings could be included in this, in order to further broaden the base of support; some costs would increase, as well.

4. Institute a PAYT program, such as the one researched by the Town's Health Dept.

5. Develop a Town-owned and operated transfer station and require residents to bring their trash/recycling there.

6. Terminate all Town-sponsored waste collection and disposal, leaving it to individuals to contract individually with businesses for such services.

7. Any meaningful combination of options 1 through 6. above.

The advantages and disadvantages of each option are discussed in Exhibit B of the appendix **"**The Dirt on Trash". Based on increased disposal costs, a "ballpark" estimate of total annual trash disposal and collection costs is approximately $60 per person or $200 per household in 2008, before applying landfill revenue.

3.3 Water and Sewer Accounts

The Committee discussed water and sewer fees noting that fees collected are usually specifically allocated for water and sewer requirements. The Committee discussed the appropriateness of limiting water and sewer fees to water and sewer requirements and concluded that the current practice allows the Town needed flexibility.

The Committee noted that the Town's future increasing commitments to the waste water treatment facility shared with Westboro would limit the opportunity for water and sewer fees to be used for other purposes.

The Committee reviewed the current water and sewer scaled rate structure. It was noted that in almost all cases, residential user rates exceed commercial user rates. The consensus of the Committee was that this structure remains an effective tool to promote both residential water conservation, and helps encourage economic development.

3.4 Town Light And Cable ("SELCO")

Committee members met with Thomas Josie, General Manager**,** to discuss the operations of the Shrewsbury Cable/Phone/Internet ("Cable") and Light Companies ("SELCO").

Mr. Josie informed the Committee that SELCO is a municipally owned system with a vision to provide state of the art energy and Cable and telecommunication services to a 100% satisfied residential, commercial and industrial customer base.

SELCO's mission includes the following objectives:

1. To make cash and other service contributions to the Town while providing services including electric, CATV, and Internet at competitive rates.

2. Those rates for all services provided by SELCO shall be at or below rates charged by other companies offering similar services in neighboring communities.

3. That the Town, acting through the Light Commission, shall maintain control of energy and cable and telecommunications type services and infrastructure for the benefit of the customers while ensuring that the range of products and services are equal or greater than those provided by other companies.

4. That quality and reliability of services shall be superior when compared to services provided in neighboring communities by private companies with industry accepted service standards used as the basis to measure performance.

5. To provide essential cable, telecommunication and energy infrastructure to encourage and support economic development.

6. To work cooperatively with the Town in all matters including help to ensure that an index of cost for all Town services including water, sewer, taxes, electric, CATV, and Internet, is lower than surrounding communities

SELCO is an independent entity that is wholly owned by the Town. In lieu of taxes, SELCO remits an amount to the Town each year based on the following formula:

Light:	$30,000 per year, plus 10% of the difference between the year-ending General Cash Balance and the month of December's Power Cost bill.
Cable:	5% of annual gross revenues plus ($0.50 x the number of subscribers). $454,691 for FY 2007

From a Town revenue perspective, Mr. Josie believed these payments represented an appropriate level of contribution to the Town while providing SELCO the appropriate level of operating cash to fund ongoing operations and required future investments.

Mr. Josie informed the Committee that the opportunity to provide additional revenues from Cable operation to the Town was highly limited. In fact, future year transfers to the Town may be under pressure to be lowered to fund investments required to respond to competitive customer pricing pressures and the requirement to continue to make investments to provide enhanced competitive products and services (e.g. VOIP). In addition, Mr. Josie also pointed out that any annual cash payment may be adversely affected by extraordinary infrastructure repairs due to severe weather (e.g. ice, wind damage to connection lines).

The Committee discussed SELCO's contribution to Town revenues and the tangible and intangible benefits these operations provide the Town. These benefits include, among others, free Internet services to Town offices and the School System and access to and broadcasting on the dedicated Town TV stations. Between the cash contribution and the intangible benefits identified above, the Town receives an average of $1.0 million per year from SELCO.

The Committee concluded that the Cable and Light Companies represent good sources of recurring revenue for the Town and that the opportunity for the Town to receive additional revenues from these operations was limited.

The Committee discussed the question as to whether the Town should consider selling SELCO. The Committee strongly believes that a sale would not be in the best long-term interest of the Town. In addition to the tangible cash remittances and intangible benefits identified above, there are additional benefits as well. Town residents realize significant savings from subscribing to SELCO services. In 2004, (latest calculation available), the Committee compared SELCO's residential rates for electric service with those from National Grid. Similarly, we compared SELCO's basic and expanded rates with Charter Communications. The difference in rates, when applied to all SELCO's residential electric customers and cable customers, represents an aggregate annual savings of $2.5 million for electric and $3.3 million for cable.

While it appears that SELCO retains significant cash balances, Mr. Josie stated that SELCO requires certain reserves to respond appropriately to maintenance requirements due to natural disasters (e.g. high winds and ice damage) and other unforeseen events. In addition, reserves are used to stabilize rates (3rd lowest in the state) through periods of cost spikes (e.g. the recent increase in energy costs).

Responding to the question of a potential sale of SELCO, Mr Josie commented, "The SELCO Vision and Mission" (see Reference Section) sets a policy direction and guides management in planning, business and operating decisions. My role as manager and custodian of SELCO's assets is to optimize the benefits of those assets to the residents of Shrewsbury.

In the past when the future viability of SELCO's Electric and Cable operations were questioned, the Light Commission made the statement that if or when we can no longer provide a value to the Town of Shrewsbury and its residents, the Light Commission would be the first to recommend alternatives to the current operating and control for the Electric and Cable systems."

3.4.1 Conclusion

The Committee recommends that the Town request SELCO to provide comparative summary operating results and headcount information for inclusion in the Town's Annual Report.

4. Town Treasury Management

Committee members met with Bartholomew and Company Incorporated to discuss the Treasury Management of Town funds. Presenting at the meeting was Bartholomew & Company Incorporated; Thomas Bartholomew, President, Joshua Paul, Vice President, Charles Patterson, Vice President, and Carolyn Marcotte, Town Treasurer. Bartholomew & Co invests the Town's General and Operating funds, Trust funds and School Bond accounts.

The Town has realized investment income over the past 5 years as follows:

2006	$ 1,126,738
2005	$ 932,675
2004	$ 1,229,491
2003	$ 1,561,044
2002	$ 980,007

The investment strategy involves rolling balances of free cash on a short-term basis. A review of the Town's portfolio as of July 18, 2006 was presented and involved the Town's operating fund, fixed income fund, trust fund, middle school west and the school bond account. The Town is invested in capital risk-free, highly-liquid investments. The average duration for all investments is 2 years with many being as short as 3 months and others being longer to lock in higher yields. On a consolidated basis, the Town was earning 5.5 % on approximately $27,900,000, as of July 19, 2006. The Town pays fees to Bartholomew and Company ranging from 0.165% to 0.20% of invested balances. These fees are consistent with fees charges to other municipalities.

Town Treasurer, Carolyn Marcotte, has the authority, through Massachusetts General Laws, to invest the Town's short-term operating funds where she can find the best available rates and yields. These investments are made mostly through the Massachusetts Municipal Depository Account via the State Treasurer's office and can also include short- term certificates of deposit.

5. Understanding “grants” as a means to supplement revenue needs

Committee members met with Town Manager Daniel Morgado and Assistant Manager Michael Hale to discuss the Town’s procedures for accessing available grants.

A historical overview was presented regarding the evolution of obtaining grants, and how those conditions from the 1970’s had changed. Obtaining grants was far easier thirty years ago as both State and Federal Monies for many areas of municipal life were more plentiful, and the only requirement was a written request. Two areas of money are still available to some extent: public works monies and special earmarks. However, there are few grants that do not have conditions attached, and sometimes these conditions can have unintended consequences. (Mr. Morgado noted that an article on the warrant for the upcoming Special Town Meeting would involve returning grant money to the State because the terms of accepting it would mean the Town would lose money in the end.) They both noted that grants accounted for approximately 4-5% of revenues in Fiscal 2006.

In the Town, department heads have typically known what grants are available and have been responsible for obtaining them. Additionally, Mr. Morgado and Mr. Hale also seek them, and they receive information about them from numerous sources, such as our political representatives in Boston and Washington.

When asked about more aggressively seeking grant monies, they noted that the Town could indeed become more aggressive in this area. Mr. Morgado noted, however, that a possible drawback to this approach was that the Town might be getting “into businesses you don’t know”, and thus getting away from the essential tasks of Town governance.

It should be noted that the entire Committee discussed this perspective and that a majority of those participating believed that the Town should be more involved in seeking grants. The Committee noted that the Town received approximately $3.8 million in grants for the 2006 fiscal year. (Please see FY 06 Grants in the appendix page II)

5.2 Conclusion

The Committee recommends the Town consider the addition of a non-paid graduate student / college intern resource specifically assigned to identify and apply for regional, state, federal and private grant programs

6. Expanding, enhancing and retaining the existing non-residential tax base

6.1 Expanding the Town’s Non-residential Tax Base

A Committee member met with Town Manager Daniel Morgado and Assistant Manager Michael Hale to discuss the Town’s efforts to expand its non-residential tax base.

In recent years, the Board of Selectmen has adopted a strategy of economic development that places great emphasis on retaining and expanding the existing non-residential tax base.

Part of the effort of retention and expansion is preparing the environment for investment in the form of available infrastructure and receptiveness to development proposals.

A primary action has been the adoption of favorable changes to the Zoning By-law which were the primary result of the master plan process started in 2000. In every instance, the changes were made to enhance parcel value by allowing wide discretion for developers to make proposals to the community.

As a means of economic development, the Selectmen have maintained a single tax rate in hopes to attract businesses to Shrewsbury rather than surrounding towns.

The Town has introduced other means of attracting business. A development team has been created to meet with potential developers to provide immediate feedback and support which have resulted in some projects being brought forth with several others under development. Rapid turnaround is a critical part of any good economic development strategy.

A second strategy has been partnerships formed with state and quasi-state agencies like the Worcester Business Development Corporation and the Massachusetts Office of Business Development who have assisted the Town in its efforts. The Town has also reached agreement with the Town of Grafton and Grafton Water District to provide sewer and water services to the Shrewsbury portion of CenTech Park and CenTech Park-East.

The Town has taken advantage of other incentives such as Tax Increment Financings (“TIFS”) to attract commercial development.

Infrastructure improvements have been pursued to construct or make improvements to CenTech Boulevard, Town Center and the Rte 9 Lakeway District.

6.2 Sale of Town owned land

A Committee member met with Town Manager Daniel Morgado and Town Engineer Jack Perrault for the purpose of understanding what commercially zoned property owned by the Town could be sold for revenue and to increase the commercial tax base.

In addition to the Allen Farm property, two parcels were identified:

- A small parcel adjacent to Centech Park that may be of value in coming years as the Park is developed
- Two small parcels at Rte 9 and Fruit Street that may become attractive to a larger re-development of the nearby private property holdings.

Private purchase of these parcels and resulting transition to the commercial tax base will be market driven and most likely as part of a larger real estate development.

In regards to tax title properties, Carolyn Marcotte, Town Treasurer, provided a list of Tax Title Accounts and Foreclosed Properties. Tax Title Accounts are properties that are in tax arrears for a variety of reasons. The Treasurer's Office works with these accounts to settle the balance owed. Foreclosed properties consist of pieces of land that builders are turning over to the Town as open space and for one reason or another, do not pay the balance of the tax owed. Such properties transition to Town owned status over time and often as a component of Planning Board permitting process. The Committee believes that when taken collectively these properties are immaterial to total Town real estate and are managed appropriately.

7. Understanding 5 year Projections

As part of its budget and forecast process, the Town prepares multi-year forecasts for building and infrastructure needs.
However, like many other communities, we have not developed long-term revenue and operating expense projections because of the uncertainty of revenue streams from local, state and federal sources and the uncertainty of forecasting certain expense levels. In some cases, revenue sources and expense levels are unpredictable even in the short term.

Despite the uncertainty of long-term financial forecasting, the Committee believes there is value in going through a strategic thought process and discussion. Building consensus about the Town's fiscal position and creating awareness by communicating to a broad group of constituencies is equally important as the forecasted numbers themselves. In the end, a multi-year revenue projection, coupled with a similar expense projection, will provide a relative picture of our Town's fiscal requirements.

The forecasting methodology should rely heavily on our historical experience, adjusted with our best estimate of how these trends will change based on the current and predicted climate. Shrewsbury's Master Plan and the Town Manager's statistical projections should provide an indication of how these trends should be depicted.

7.1 Conclusion

The Committee understands that it is difficult to implement a 5-year forecast. However, a summary projection can provide visibility to the Town's continuing ability to provide those services that residents have grown accustomed to and expect to receive. Therefore, the Committee recommends that the Town provide residents an annual 5 year summary projection comparing expected revenues and expenses, with a best estimate of the Town's ability to maintain present services. The committee recommends that these projections be made easily and widely available to all residents.

Comparisons to Other Towns: The Need for Them and Their Uses

Newspaper, public officials, and ordinary citizens often make comparisons of Shrewsbury to other towns. The Committee recognizes the importance of these comparisons and agrees that appropriate comparisons have an important place in decision making. The key question in making such comparisons is what other towns should be used in these comparisons. The simple answer is that Shrewsbury should be compared to similar towns. The problem lies in choosing which data points to use to identify appropriate communities with which to compare ourselves.

The Committee recognizes that town comparisons do not always take into full account the wide spectrum of a town's characteristics. We decided that the best way to select appropriately similar towns was first to identify important social, economic, educational, and demographic criteria, and then to select those towns which most closely resembled Shrewsbury in terms of these criteria. For purposes of this report, the Committee did agree that towns should be defined as similar based on similarities such as economic wealth, composition (% commercial/industrial), demographics, enrollment, and geographic proximity.

After reviewing statistics available on the websites of the Massachusetts Department of Revenue and Department of Education, we performed a preliminary analysis using the following data points: population, median family income, total non-residential and total residential property tax levies, town operating budget data, total school expenditures, and school enrollment. Exhibit <u>COMPARING COMMUNITIES</u> in the appendix helps illustrate the challenge of identifying towns for meaningful comparison.

Our initial analysis shows that it is difficult to find towns whose statistics are similar enough to Shrewsbury's to compare them to Shrewsbury. For example:

A. Shrewsbury is often compared to Westboro, but the analysis shows that not only does Westboro have a median family income over 20% higher than Shrewsbury, but Westboro also has a non-residential tax levy of $18 Million compared to only $5 Million for Shrewsbury.
B. Shrewsbury is also compared to Marlboro, and while Marlboro's median family income is 9% lower than Shrewsbury, Marlboro receives $27 Million more in non-residential tax levy than Shrewsbury.

Once the Committee became fully engaged in the process of examining the town's historical and projected revenue and expenses, it became evident that the Committee had neither the expertise nor the time to fully develop a benchmarking plan. Given the number of criteria that could be used in such an analysis, and the difficulty of identifying objective data, the Committee makes no recommendation at this time concerning which towns are appropriate for comparison to Shrewsbury. However, we note that the Board of Selectmen is exploring the possibility of outsourcing a study to determine appropriate comparison communities and we believe that this would provide the community with consistent, objective and useful information for the future.

Final Expense Report

Report of the Expense Sub-committee
of the Shrewsbury Fiscal Study Committee

March 12, 2007

The following members of the Expense Sub-committee of the Shrewsbury Fiscal Study Committee are pleased to present their final report.

Mary K. Alexander	Alicia Howe	John Lukach
Andrew Carlson*	Jim Kane*	Moira Miller
Peter Collins	Kathleen Keohane	Dina Nichols
Richard Czerniak	Paul Keegan	Deborah Peeples
Maurice DePalo	Stan Koch	

*Served on Revenue and Expense Committees

A. Committee Purpose

To investigate and report on all issues involving the Town's fiscal condition for the five (5) year period beginning July 1, 2006.

B. Expense Sub-committee Scope of Work:

1. Examine and report on all personnel operating and fixed cost charges both discretionary and mandated.
2. Examine and report on all capital and facility needs for the study period.
3. Present findings as warranted for each of the study areas listed above.

C. Expenditure Sub-Committee Focus

The Expenditure Sub-Committee focused on certain issues within the scope of the Committee that were seen as pressing to the Town and relevant to taxpayers. These issues include:

Identifying past and future high growth spending areas
Rising health care costs and measures to control increases
Maintaining competitive municipal salaries and fringe benefits in tight fiscal situations
Unfunded pension liability and maximizing the rate of return on investments
School budget issues, with special focus on teacher salaries, administrative staffing, transportation, and special education
Funding long-term debt and capital expenses
Determining the value of discretionary services

D. Committee Meetings

The Expense Sub-committee met on each of the following dates. Meeting minutes are available.

June 13, 2006	July 13, 2006	August 17, 2006
September 14, 2006	October 5, 2006	October 12, 2006
October 26, 2006	November 9, 2006	November 30, 2006
December 14, 2006	January 11, 2007	January 25, 2007
February 1, 2007	February 8, 2007	February 15, 2007
February 20, 2007	February 22, 2007	March 1, 2007
March 8, 2007		

E. Summary Findings

The Committee is pleased to present the following summary findings:

Overall Conclusion
The Committee has concluded that the Town is critically aware of impending expenses it need incur over the next few years, particularly with regards to health insurance costs and unfunded pension/healthcare liabilities. Labor costs, our largest operating expense, must continue to be controlled while preserving a healthy labor dynamic. Municipal and school expenditure reduction strategies have been implemented. These efforts must continue, however, given the current revenue forecast.

Subject Area Conclusions:

5-Year Trend Analysis: Graphic trending of Town expenditures provides the community with a visual analysis of budgetary consumption. Looking over the past five years we see schools, employee benefits and the Town's debt payment schedules as being the greatest consumers. This trend will not notably change as we move forward into the next few years. Major cost drivers will be health insurance (operating support), schools, and public safety. As the town continues to pay its debt obligations, the interest and principle costs will decline. This amortization will impact the likelihood of future large capital project approval. Attention to capital budget requests will also challenge our ability to maintain a structural balance.

Human Resources: Town administrators are proactively and aggressively seeking ways to minimize the costs of healthcare and pension benefits. They are also acutely aware of the need to work with employees and collective bargaining units to keep the cost of salaries and fringe benefits inline with the Town's ability to raise revenue. Their major challenge will be finding ways to restructure salary and benefits programs while continuing to attract, motivate and retain high performing employees.

School Department: The committee performed the described scope of work on the major areas in the school budget, which includes Administration, Teacher Salaries, Special Education and Transportation. Overall, the School Department keeps detailed cost records and has been successful in meeting its goals of providing a quality education to all students in the district within its budget restraints. Many costs, such as those associated with Special Education, are mandated by Federal and State law. Some of these costs are beyond the control of the school department. Other costs, such as teacher salaries, are impacted by collective bargaining agreements. In the remaining areas, we have presented specific recommendations, as warranted, for each of the areas reviewed. In addition, this committee is concerned that town resources will not be able to keep up with contracted annual salary increases.

Capital Expenditures and Bonded Debt: Long-term debt and capital expenditures are an inevitable part of any well-managed community. Identifying the prudent way to structure this debt is the challenge. Two interesting approaches have been discussed: 1) establishing an overall debt ceiling for the Town and 2) capping the dollar amount a homeowner must pay towards the debt. The Committee recognizes the merit of each of these approaches and recommends they each be explored in more detail.

Mandated and Discretionary Services: The Committee recognizes that during tight budgetary times, discussion of mandated versus non-mandated costs often evolves. What functions must we provide and at what level of service? A general overview of mandated and non-mandated municipal programs provides insight into these discussions. As the Town's financial situation tightens, we recognize that choices will have to be made regarding what services can continue and what level of service can be maintained.

Analysis

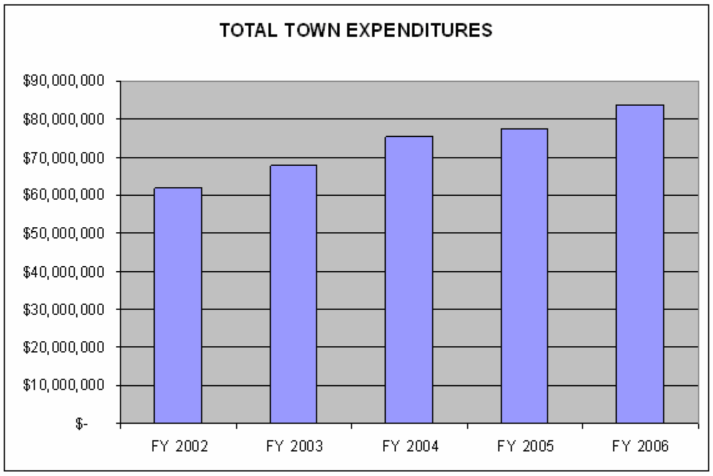
1. 5-Year Trend Analysis and Forecasting

Methodology

Expenditure data has been provided by the town manager and represents the total of expenditures in various categories for the past five years.

1.1 Five Year Historical Analysis

The total of town expenditures for FY 2006 ending on June 30, 2006 was $83,549,523, an increase of 7.9% over the FY 005 and a 34.7% increase from 2002 to 2006. This data represents actual expenditures made by the town and differs from the budgetary data contained in the town meeting reports. The growth over the past five years is shown in graphical and tabular form in the following chart:



The table shows total expenditures for each of the past five years and also shows the annual increase first as a dollar amount and then as a percentage of the previous year. The table also shows in the last two columns the increase in expenditures from 2002 to 2006.

Total Town Expenditures (Actual in Millions of Dollars)							
	FY 02	**FY 03**	**FY 04**	**FY 05**	**FY 06**	**FY 02-06 Increase**	**% Increase**
Total Town Expenditures	**$62.0**	**$67.7**	**$75.2**	**$77.5**	**$83.5**	**$21.5**	**34.7%**
Annual Dollar Increase	-	$5.7	$7.5	$2.2	$6.1		
Annual Percent Increase	-	9.2%	11.1%	3.0%	7.9%		

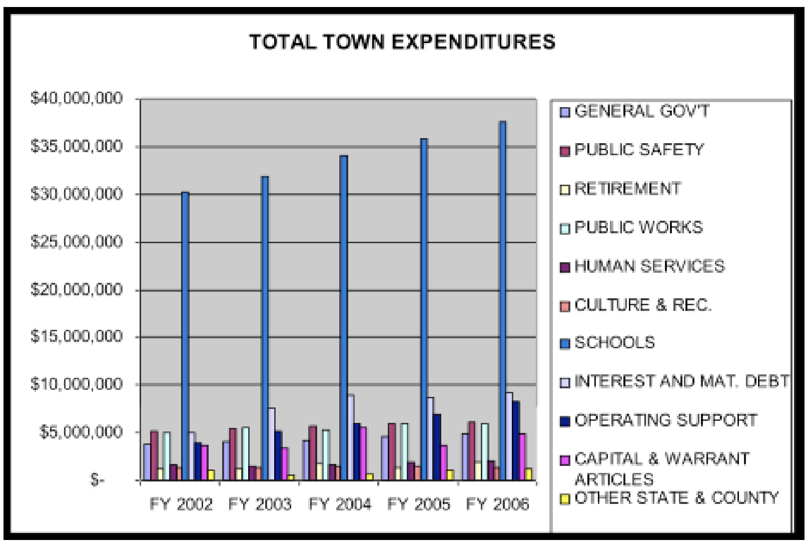
The total of town expenditures can be further broken down into three high level categories that match those used in the Town Meeting report. The first category is the Operating Budget and is composed of the following components and their descriptions:

1. General Government – includes salaries for the Town Manager, Town Clerk, Town Counsel, and expenses for public buildings including schools.
2. Public Safety – includes police, fire, and building inspectors.
3. Retirement – covers retirement contributions for all town employees, except teachers.
4. Public Works – includes the town engineering, highway, sewer, water, and cemetery departments.
5. Human Services – covers the Health Department, Council on Aging, and Veteran benefits.
6. Culture and Recreation – includes the library and parks and recreation expenditures.
7. Schools – includes all staff and teacher salaries, contractual services, transportation expenses, and educational expenses, but not health insurance.

8. Interest and Maturing Debt – includes interest and principal payments on debts incurred for school construction, land acquisition, cable service, and electrical service.
9. Operating Support – covers group health and life insurance, unemployment compensation, Medicare payments, general insurance, and ambulance service.

The second category contains capital budget items and warrant articles. Capital budget items typically include large expenditures for items such as trucks and fire equipment. Warrant articles typically cover construction items such as water main repairs and street renovations.

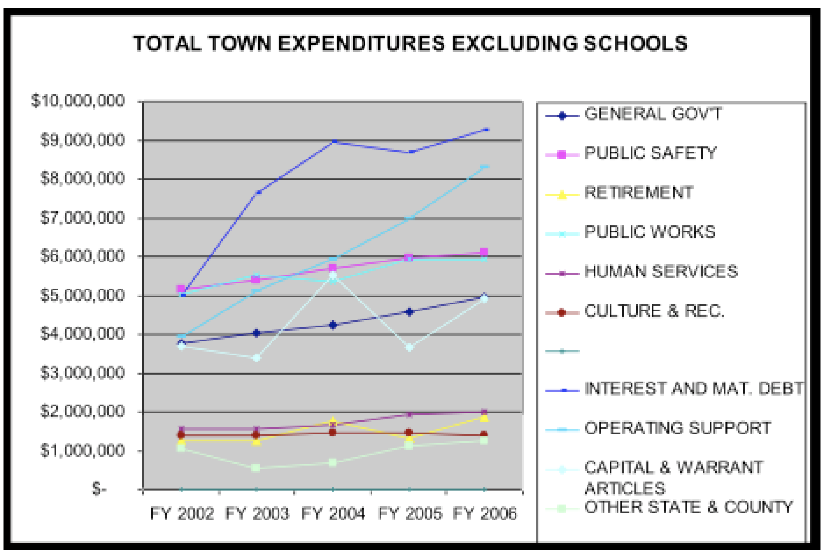
The third category is named Other State and County and includes state and county charges, overlay charges, and cherry sheet offset items such as school lunch grants and public libraries grants.
These three categories comprise the Total Town Expenditures for each year. All of the categories and their components expenditures are shown for each year with the last two columns showing the total dollar increase and percent increase for the past five years. This breakdown is shown in graphical and tabular form.



The largest dollar increase was in Schools at $7.4M followed by Operating Support at $4.3M, and Interest and Maturing Debt at $4.2M. The largest percent increase was in Operating Support reflecting health insurance increases at 110% from 2002 to 2006. Next largest increase was Interest and Maturing Debt at 84.9% followed by Retirement at 50.4%.

Total Town Expenditures (Actuals in Millions of Dollars)							
	FY 02	**FY 03**	**FY 04**	**FY 05**	**FY 06**	**FY 02-06 Increase**	**% Increase**
Operating Budget							
General Government	$3.8	$4.0	$4.2	$4.6	$4.9	$1.2	**31.6%**
Public Safety	$5.2	$5.4	$5.7	$6.0	$6.1	$0.9	**18.4%**
Retirement	$1.2	$1.2	$1.8	$1.3	$1.9	$0.6	**50.4%**
Public Works	$5.0	$5.5	$5.3	$5.9	$5.9	$0.9	**18.4%**
Human Services	$1.6	$1.6	$1.7	$1.9	$2.0	$0.4	**27.5%**
Culture and Recreation	$1.4	$1.4	$1.5	$1.5	$1.4	$0.0	**0.9%**
Schools	$30.2	$31.9	$34.0	$35.9	$37.6	$7.4	**24.4%**
Interest and Maturing Debt	$5.0	$7.6	$9.0	$8.7	$9.2	$4.2	**84.9%**
Operating Support	$3.9	$5.1	$5.9	$7.0	$8.3	$4.3	**110.1%**
Capital Budget & Warrant Articles	$3.7	$3.4	$5.5	$3.7	$4.9	$1.2	**33.1%**
Other State and County	$1.1	$0.6	$0.7	$1.1	$1.3	$0.2	**20.5%**
Total Town Expenditures	**$62.0**	**$67.7**	**$75.2**	**$77.5**	**$83.5**	**$21.5**	**34.7%**
Annual Dollar Increase	-	$5.7	$7.5	$2.2	$6.1		
Annual Percent Increase	-	9.2%	11.1%	3.0%	7.9%		

The next table uses the same data as above except the Schools expenditures have been zeroed out to magnify the changes in the other areas.



1.2 5 Year Projections
The committee attempted to develop 5 year projections following the format above. It was determined that adequate information was not available to make fair and accurate projections. Inflation, changes in insurance costs, government mandates and changes in the law, are unpredictable variables that affect future costs and revenues. For that reason, the committee decided not to bring any projection data forward. This number will be affected if any new large capital projects are approved during this time period.

The committee did, however agree that major cost drivers in the next 5 years will be Health Insurance (operating support), Schools, and Public Safety. As the town continues to pay its debt obligations, the interest and principal costs will decline.

1.3 Conclusion
The committee recommends that the town develop a formal 5-year revenue and expenditure forecast, updated annually, to assist the town's leaders in predicting future needs and resources.

2. Human Resources

2.1 Health Benefits
The 351 municipalities throughout Massachusetts, including Shrewsbury, typically offer their employees health insurance benefits as part of a complete benefit package. Although MA state law does not currently require such benefits be provided[1], cities and towns have historically provided health benefits to their employees. These benefits are included in all collective bargaining agreements, as well. Shrewsbury's FY 07 budget identifies health care, a fixed cost, as consuming 7.63% of the FY 07 operating budget.

Providing healthcare benefits is costly. Between 2001 and 2005 municipal health care costs grew 63% according to a study by the Massachusetts Municipal Association and the Massachusetts Taxpayers Foundation. There are no simple solutions to the rising costs of healthcare.

In an attempt to better control our community's healthcare costs, Shrewsbury joined the West Suburban Health Group (WSHG) in 2005. With 16 municipal entities participating, WSHG is one of the two largest municipal joint healthcare purchase groups in Massachusetts. WSHG membership offers premium costs that are more stable and predictable because the risk is pooled with other municipal employers. Membership in WSHG also provides Shrewsbury with healthcare purchasing advantages available to larger employers, such as reduced cost margins and administrative expenses through volume pricing. In FY 07, the Town had 723 active employees participating in 6 health plan offerings through WSGH and 279 retired employees participating in 6 WSGH plan offerings. Total budgeted F Y07 health care expenditures are $6,075,000.
The Town contribution for each of these plans varies from 50% - 85% with the highest percentage paid toward the plans with the lowest monthly premium. Third-party insurance carriers are used to administer claims.

[1] Per John O'Herron, MA Division of Insurance/Consumer Information Division

The WSHG board, on which Shrewsbury has a voting seat, sets a single rate annually for each plan offered and then allows each community to decide how they'll split that cost with its employees and retirees. Plan design decisions, i.e. plan offerings, co-pays, deductibles, etc are also made by the WSHG board. Participation in WSHG also saves time and dollars because Town administrators deal with a single, central office instead of directly with many insurance companies.

The Sub-Committee finds that the town administrators are acutely aware of the need to manage spiraling health care costs as aggressively and proactively as possible. Our conversations with them, as well as our independent research, indicates that the town administrators possess a solid understanding of the many variables that contribute to minimizing health care costs for Shrewsbury. They recognize the cost control measures necessary and have taken steps to ensure that these controls are in place. It is important to note that some cost control options used in private sector business are either not options for Shrewsbury because of restrictions placed on the Town by state regulations or are cost savings that would have to be negotiated in bargaining unit contracts.

Various measures to control costs have been instituted by the Town Manager, some in partnership with municipal and school collective bargaining units. One notable example was the decision to modify employee and retiree health & welfare plan options when Shrewsbury joined the West Suburban Health Group in FY 2005.

In FY 06 the amount spent on health insurance decreased from the previous year as illustrated in the following chart. $6,075,000 is budgeted for health insurance expenditures in FY 07. We note that the FY 06 decrease is partly due to affiliation with the WSHG but is also the result of a change of policy whereby the School Department is now reimbursing the general fund for health care costs associated with the lunch and extended day programs.

Fiscal Year	Amount Expended
2006 *	$5,376,598
2005	$5,529,698
2004	$4,483,109
2003	$3,836,906
2002	$2,991,004
2001	$2,573,606
2000	$1,879,964
1999	$1,701,899
1998	$1,637,322
* Member of WSHG	

Another example of cost control measures is the Town’s adoption of Chapter 32B, Section 18 (May 2005) requiring retirees who are Medicare eligible to take Medicare A & B and not remain on the Town’s active health plan.

This change will shift costs to the Federal government and will have some negative impact on some retirees, depending on personal circumstances.

Adoption of Section 18 will also reduce the Town's unfunded liability for retiree health insurance that must be accounted for to comply with the a new requirement issued by the Government Accounting Standards Board, GASB 45. This is important because, beginning next year, Shrewsbury and all municipalities must identify and report the true cost of other post-employment benefits (OPEB), which includes healthcare, vision, life and dental, much as they now report pension obligations. Under the new requirement issued by the Government Accounting Standards Board, Shrewsbury must report this liability as a current cost during the working years of an employee. Although the new rules do not require governments to fund the liability, only report it, eventually failure to pre-fund this obligation may impact future borrowing costs, credit ratings and the overall financial health of the Town.

In spite of the efforts to manage expenditures, rising healthcare costs continue to be a pressing concern. If the state and nationwide trend for double-digit increases continues, then healthcare costs will continue to grow at levels that may seriously affect the Town's ability to pay for the same level of employee and retiree benefits. How do we make limited funds go further? What are the options and what is the potential impact for both the Town and employees?

If more of the healthcare premium costs are shifted to employees and retirees, at what point will increasing employee costs decrease the Town's ability to attract and retain quality workers? Should it allocate more funds to cover rising healthcare costs even if this means postponing or rejecting or reducing or eliminating current or new programs?

Many of these are value questions with no cut and dried answers. They are, however, areas for discussion that should be taken into consideration as the Town explores options for controlling and, where possible, reducing healthcare costs.

2.1.1 Options to Consider

We strongly encourage the Town to continue to work in conjunction with employees and collective bargaining units to find ways to reduce costs.

a. Consider tightening the eligibility rules that define who can participate in a Town offered plan.

b. Consider changes to the way the Town contribution is applied to health plans. For example, the Town will pay a certain percentage on the lowest cost plan. That same dollar amount will then be applied to all other plans.

c. Consider whether the Town can save by joining the state's group insurance pool (GIC), should the state pass recently filed legislation which provides a local option for municipalities to purchase their health plans through the GIC.[2]

d. Informed about their healthcare options and the cost to provide these benefits, better educated consumers, making wiser choices that affect their health, can potentially decrease their own spending on health care. Since the introduction of managed care programs, healthcare consumers have largely been shielded from the actual cost of care because of low co-payments and deductibles. Also, people in these programs rarely, if ever, see a bill for service since healthcare provides submit these bills directly to the insurance carriers.

e. Continue to monitor national healthcare trends, such as Consumer-Drive Health Care. If an opportunity is presented through the WSHG or other venues, explore Consumer-Drive Health Plan (CDHP) options, such as Health Savings Accounts and Health Reimbursement Arrangements. CDHP's encourage employees to be more engaged in all aspects of their health and make more cost-conscious personal healthcare decisions.

f. Consider establishing an OPEB trust fund, similar to our pension reserve fund, designed for paying future retirees health care costs.

g. Continue to offer and expand on programs that promote an active and healthy lifestyle.

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[2] Highlights of the healthcare proposal (Seachange Bulletin, January 17, 2007):

"It would create a local option for cities and towns to purchase health insurance through the GIC. Analysis shows that the GIC's high quality plans are generally significantly less expensive and provide more choices to employees and retirees than typical municipal options. Under the proposal, no community would be mandated to join the GIC.

A decision to join the GIC would be made collectively among municipal leaders, public employee labor representatives, and retiree representatives. The proposal uses the existing mechanism called "coalition bargaining" to broaden stakeholders together to make health care decisions.

All decisions about contribution ratios – i.e., the percentage of health insurance premiums that are borne by employees or retirees, and the percentage borne by the municipality – would continue to be made at the local level. The GIC, however, would have responsibility for contracting with health care insurers and making plan design decisions. Municipal employees would be in the same insurance pool as all state employees, which currently covers more than 265,000 people in the Commonwealth.

Municipalities would pay all costs associated with purchasing health insurance through the GIC, including a small administrative fee to the Commission. The proposal is structured to be self-financed and start-up costs for the Commonwealth would be nominal.

As part of the proposal, the coalition seeks to expand the Commission by adding representatives of municipal management and public employee unions. These new additions would not change the balance of the Commission. "

2.2 Municipal Wages and Fringe Benefits

Salaries and fringe benefits continue to be an important cost area when evaluating expenses. With approximately 240 full time municipal employees, total wages and salaries (excluding schools) in the FY 06 municipal budget was $11.4M[3] or 26.9% of the $42.2M municipal budget**.** Much like health insurance, these costs need controls.

The Town Manager and Assistant Manager, in conjunction with the Personnel Board, administer the Personnel function for all non-union employees, which include Department Heads (DH) and Professional, Administrative and Technical (PAT) staff. The Fiscal Study Committee has spent extensive hours meeting with administrators, reviewing data and conducting independent research on these job groups. Similar efforts have been made by the Committee to objectively review salaries and fringe benefits for Shrewsbury's unionized employees, which include Public Buildings, Public Works, Police, Fire and Dispatch.

The Committee finds that PAT's and DH's have a fairly lean staffing structure, a job classification plan that is current and a salary structure that successfully strives for the median of the market. The system for personnel administration seems to work effectively, with the Personnel Board playing an integral role in personnel administration and policy-making. As an independent working committee and overseer of human resource operations, the committee is comprised of current and former human resource professionals. This committee regularly makes recommendations to the Town Manager, Selectmen and Finance Committee on issues ranging from annual salary adjustments to department reorganizations.

The town continues to successfully consolidate functions as positions are eliminated through attrition. Town Hall prides itself on professionalism and a cooperative culture. Evidence of this is reflected in feedback town administers regularly receive from visiting professionals (lawyers, engineers, etc) regarding the exceptional level of service delivered by front line staff[4].

The wage pattern for municipal department employees, FY 02 through FY 07 is outlined in the following chart. Please note that these numbers represent an annual cost of living adjustment only and do not include step increases.[5]

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[3] Per Report and Recommendations of Finance Committee for Town Meeting, May 16, 2005

[4] Per Michael Hale, Asst. Town Manager

[5] The following employees are at top step of the pay scale for FY 07 and therefore no longer eligible for step increases: Police Superior Officers and Public Works (100%); Firefighters and Captains (97.2%); Department Heads (87.5%); PAT's (86%); Patrolmen (80%) ; Teachers (33%).

Unit	FY 02	FY 03	FY 04	FY 05	FY 06	FY 07	Comments
Department Heads (DH)	3.5%	3.0%	3.5%	3.0%	3.0%	3.0%	Additional 2% market adjustment in FY 04
Professional, Administrative and Technical (PAT)	3.5%	3.0%	3.5%	3.0%	3.0%	3.0%	Additional 2% market adjustment in FY 06 (effective April 1st)
Police Officers	3.5%	3.0%	3.5%	2%,1%	3.0%	3.0%,1.0%	Officers received holiday benefit equal to 1% in FY 04; Detail rate increased $1/hr in FY 05 and $1/hr in FY 06, additional 1% in 07 effective last day of contract
Police Supervisors	3.5%	3.0%	3.0%	2.0%/1.0%	3.0%	3.0%, 1.0%	Detail rate increased $1/hr in FY 05 and $1/hr in FY 06, addition 1% in 07 effective 1/1/07
Custodians	3.5%	3.0%	3.0%	3.0%	3.0%	3.0%	Custodians received .5% adjustment in FY 02
Dispatchers	3.5%	3.0%	3.0%	3.0%	3.0%	3.0%	Wage and Benefit study recently completed by MMA Consulting Group
Public Works	3.5%	3.0%	3.5%	3.0%	3.0%	3.0%	Reclassifications to Highway and Water positions during this period
Firefighters	3.5%	3.0%	3.5%	2.0%/1.0%	3.0%	3.0%,1.0%	FF's received a training stipend equal to 1% in FY 04, additional 1% in 07 effective last day of contract
School Teachers	4.0%	4.0%	3.0%	3.0%	3.0%	2%	2.5% for FY 08; 3.5 for FY 09

2.2.1 Conclusions:

The Committee is concerned that continued annual across-the-board increases of 3% combined with annual step increases are unsustainable without the possibility of additional revenue or trade-offs elsewhere. Annual across-the-board increases of 2-2.5% are becoming a reality[6] and our community must recognize this as an option.

Re-evaluating the labor negotiation process and finding a means to secure changes and savings is paramount. The same is true for non-union benefit administration. The Committee acknowledges that town administrators are taking this initiative in many cases, e.g. a rollback of fringe benefits such as tuition assistance, a working group cost/benefit evaluation of Sick Plan 2, etc. However, this work must continue. The final challenge will be in ensuring that the quality of services provided by dedicated employees is not diminished.

[6] Department of Revenue, Div. of Local Services, Salary and Benefits Survey; c.f. Town of Brookline 2007 Fiscal Plan

2.3 Pension

The Shrewsbury Retirement System is governed by MA General Laws, Ch.32, with the Public Employee Retirement Administration Commission (PERAC) as its regulatory authority. The town-operated retirement system is an example of Shrewsbury's historical emphasis on self-management.

A five-member board administers the town's Retirement System. The Board and office staff, which consists of one employee, are responsible for all active and inactive members; all retirees, survivors and beneficiaries; all financial transactions, investment activity, member accounts, retirement and pre-retirement counseling and government reporting. There are currently 615 active employees in the plan, as well as 225 retirees including beneficiaries and disabled employees. Teachers are not members of the Shrewsbury Retirement System; they are covered under the Massachusetts Teachers Retirement System.

2.3.1 Investments

According to the National Association of Retirement Investors,[7] two-thirds of public pension revenues have come from investments since 1982. Taxpayers and employers pay the rest. Low returns drive up costs to taxpayers.

The Shrewsbury Board, in conjunction with its professional investment advisors, determines the mix of investments it will choose for the funds assets, which were valued at $54,782,543 on 1/1/06. Preliminary information indicates a 12.6% realized return on investments for FY 06. Shrewsbury's annualized return of from 1985 to 2005 was 10.42%.
Both of these numbers are well above the 8.5% actuarial target established by PERAC.

A comparison of investment results from surrounding communities[8] is as follows:

How area retirement boards fared

The investment records of public employee retirement funds for area communities over the past two decades reflect a wide range of returns, based on state records. A number of communities belong to consortiums and therefore show identical returns. Ashland, Holliston, Hopkinton, Hudson, Lincoln, Sherborn, Stow, Sudbury, Wayland, and Weston are part of the Middlesex Retirement Board. Bellingham, Dover, Franklin, Medfield, Medway, Millis, Norfolk, Plainville, and Wrentham are part of the Norfolk County Retirement Board. Berlin, Bolton, Boylston, Northborough, Southborough, Upton, and Westborough are part of the Worcester Regional Retirement Board.

Municipality	Return 2005-2006	Average annual return since 2001	Average annual return since 1985
Ashland	7.47	4.37	9.64
Bellingham	6.69	5.54	9.93
Berlin	5.44	3.15	9.58
Bolton	5.44	3.15	9.58
Boylston	5.44	3.15	9.58
Dover	6.69	5.54	9.93
Framingham	12.73	6.28	10.84
Franklin	6.69	5.54	9.93
Holliston	7.47	4.37	9.64
Hopkinton	7.47	4.37	9.64
Hudson	7.47	4.37	9.64
Lincoln	7.47	4.37	9.64
Marlborough	7.04	6.02	9.6
Maynard	9.49	7.13	9.09
Medfield	6.69	5.54	9.93
Medway	6.69	5.54	9.93
Milford	9.56	7.34	9.93
Millis	6.69	5.54	9.93
Natick	5.46	2.26	9.37
Needham	12.61	6.97	11.44
Newton	6.7	4.61	10.06
Norfolk	6.69	5.54	9.93
Northborough	5.44	3.15	9.58
Plainville	6.69	5.54	9.93
Sherborn	7.47	4.37	9.64
Shrewsbury	8.82	5.28	10.42
Southborough	5.44	3.15	9.58
Stow	7.47	4.37	9.64
Sudbury	7.47	4.37	9.64
Upton	5.44	3.15	9.58
Waltham	6.98	4.6	10.09
Watertown	5.76	5.03	9.47
Wayland	7.47	4.37	9.64
Wellesley	9.98	6.03	12.05
Westborough	5.44	3.15	9.58
Weston	7.47	4.37	9.64
Wrentham	6.69	5.54	9.93

SOURCE: Public Employee Retirement Administration Commission

[7] Per Keith Brainard, Research Director, National Assoc. of State Retirement Administrators
[8] From Boston Globe article, 7/27/06, Pension Returns Vary Widely by Christina Pazzanese

Our investment strategy has resulted in asset allocations for 1/1/06 as follows:

Domestic Equity	50%
International Equity	10%
Fixed Income	30%
Real estate	10%

The Retirement Board is in regular communication with its investment advisors to ensure that assets are properly positioned and in accordance with the town's investment philosophy.

2.3.2 Unfunded Pension Liability

The cost of future pension benefits is a part of the cost of providing public service today and therefore must be accounted for. Shrewsbury is on a schedule to achieve full funding for future pension benefits by the year 2022. This schedule prepares us for full funding six years ahead of the state-established deadline of 2028. The payment schedule provides for future unforeseen expenses or declines in revenue. As of 1/1/06, Shrewsbury was 71.3% funded; a funding ratio that puts us in the top quarter of all 106 retirement boards in Massachusetts.

Every 2 years, an actuarial study is conducted. The results of the most recent study indicate the town will need to increase our pension allocation by $607,000 for FY 08 in order to keep on schedule for 2022. Despite the significant impact this expense will have on our FY 08 budget, the Town Manager is recommending we continue on this funding schedule, particularly in light of GASB reporting requirement which takes effect next year. The town's Moody's bond rating is influenced by how fully funded our pension system is.

2.3.3 Alternative Asset Management Considerations

An alternative for communities, with regard to managing their pension fund monies, is participation in the state's Pension Reserve Investment Trust (PRIT) Fund. As of 1/1/07, there were a record high 74 retirement systems investing with PRIM (Pension Reserve Investment Management) Board, almost double the number that participated four years ago. Twenty-four of those participating are fully invested in PRIT funds. The remainder, like Shrewsbury, are purchasing groups and invest only in a segment of their funds to compliment our existing portfolio. Shrewsbury has 10% of its assets in real estate funds managed by PRIM, one of PRIM's most successful fund groups.

Annual returns have been favorable for the PRIM in recent years. Treasurer Timothy Cahill recently announced the PRIT Fund grew 16.7% in 2006. This puts it in the top 2% of state-run pension funds in the country.[9] A ten-year comparison with Shrewsbury's annualized returns is as follows:

Shrewsbury	1985-2005	10.42%
PRIT	1985-2005	11.27%

[9] Per Mike Reardon, Sr. Client Services Officer, PRIM

Despite the impressive returns, maintaining our existing asset management structure has certain benefits not available through PRIM.

- Local control of monies
- Direct say in asset management
- Can adjust risk as we see fit
- Control over who we hire; we pick managers

PRIM's asset allocation strategy is very different from Shrewsbury's. A snapshot of PRIM's Capital Fund Asset Allocation as of December 31, 2006 is as follows:

Domestic Equity	28.7%
International Equity	20.4%
Emerging Markets	6.4%
Fixed Income	14.8%
High Yield Debt, TIPS And Commodities	4.8%
Alternative Investments	6.5%
Real Estate	10.1%
Timber	3.1%
Absolute Return	5.1%

The continued success of the PRIT Fund bears watching. Full investment relieves a community such as Shrewsbury from paying fees directly to consultants, money managers and custodians. In lieu of direct fees, PRIM charges 63 basis points[10] when a community fully invests in their funds. The net cost benefit for switching from fees to strictly basis points would need to be analyzed fully. There are no time commitments when joining the state-run plan; they provide 30-day liquidity, with no ramifications or costs for pulling out of PRIT. What Shrewsbury loses is local control and the ability to determine an investment philosophy consistent with our community's fiscal policies.

2.3.4 Conclusions:

The Committee recommends the Shrewsbury Retirement Board continue its prudent payment schedule towards unfunded liabilities. In addition, the Committee recommends undertaking a thorough fiscal analysis of continuing local fund management vs. the state plan.

3. School Department

3.1 School Budget

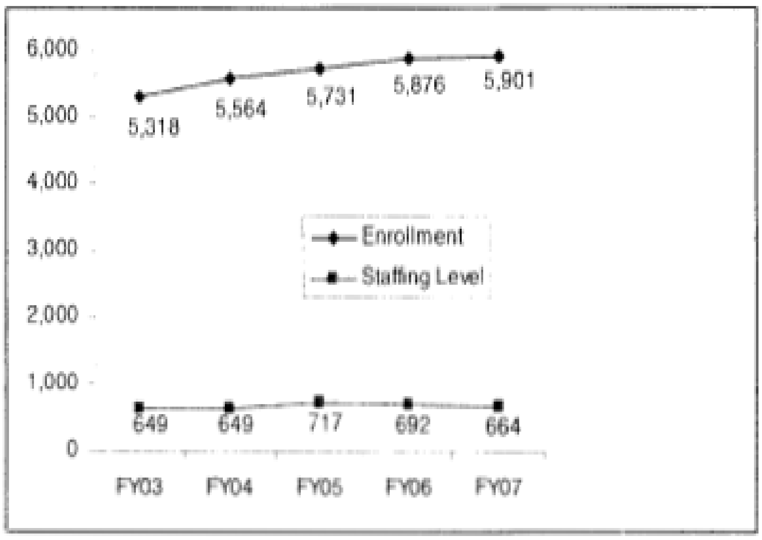
Of the 397 public school districts in Massachusetts, the Shrewsbury School District ranks 41st in size. With a student population of 5,901, it is not surprising that the Education budget comprised 49.3% of all General Fund Expenditures for FY 07, making it the towns' largest cost center.
(It should be noted that fixed costs such as health/life insurance and support services such as heat, light, cleaning and maintenance are expenditures funded through other municipal budgets.)

[10] 63 basis points is equivalent to 0.63% of the average net asset value of the PRIT Fund.

Shrewsbury's population growth over the past fifteen years put demands on the schools for increased staff and facilities. The Town responded with new schools, teachers and support staff. In our current fiscal reality, however, we have seen the rate of growth in the school budget declining. The result has been a cut in school services. Staff reduction, student fee implementation and program elimination are some of the strategies undertaken over the past two years.

3.1.1 Staffing and Enrollment Levels

3.1.1.1 Historical Data



Note: Enrollment figures include pre-kindergarten students (exclude out-of-district students).

3.1.1.2 Enrollment Projections

As of October 1, 2006, enrollment in kindergarten through Grade 12 (excluding Pre-K and out-of-district pupils) was reported to the state at 5728 students, an increase of 40 students over the 2005 reported number of 5688. This 2006 increase of only 40 students follows a lower than expected increase of 131 in 2005. (See School Enrollment October 2006 in the appendix).

Current enrollment is 277 students less than the total that the Town Managers office forecast for this school year in a May 2004 (produced 10/08/2003) enrollment projection report. However, the Fiscal Year 2005 Report (dated 11/24/2004), using updated data, projected the total enrollment at 5904. The Fiscal Year 2006 Report (dated 10/31/2005), again using updated data projected total enrollment at 5818. It is important to note the lower grades are where the student numbers have been lower than expected. This shift will affect the higher grades in future years.

Latest school enrollment projections show total enrollment stabilizing around 6000 students through 2015. There is some reason to believe that there may be some decline in enrollment projections.

This is supported by the School Enrollment Projections produced by the Town Managers Office. The latest projection for 2015 dated 12/31/2006, is projecting the K-12 enrollment at 6017 (excluding pre-kindergarten and out of district placements).

3.1.1.3 School Expenditure Research

The Expenditure Sub-committee obtained a detailed report of actual expenditures by department and account from the school department for FY 03-FY 06. Members analyzed the data, and identified major spending categories for further analysis. The major areas selected for analysis were Teacher Salaries, Administration, Special Education and Transportation. These areas are discussed in the following sections.

In addition, we summarized the expenditure report by account, reviewed accounts with major fluctuations over time, and reviewed a sample of department/account lines as to purpose. We did not identify any significant issues with the individual lines sampled.

The Committee, recognizing the value of comparative data when evaluating community best practices, also spent extensive hours discussing and debating the topic of benchmarking. This dialogue resulted in the prepared Committee statement, Comparisons to Other Towns: The Need for Them and Their Uses, found on page 15 .

3.1.1.4 School Department Salaries

In June of 2006, the School Committee finalized a new three-year contract with the teachers union. The negotiated contract included across the board annual salary increases of 2%, 2.5%, and 3.5% beginning in FY 07 (the current fiscal year). This contract resulted in the lowest percent yearly increase of any FY 07 town contract, due to the step freeze in the first year of the new three-year contract.

In addition to annual increases, teachers are also eligible for step increases which are based on a combination of years of service and educational achievement. The current salary structure includes thirteen step and seven educational levels, a structure typical among area school departments. In the new contract agreement, teachers agreed to a one year freeze on step increases for FY 07, the first year of the contract. There were no significant changes in the benefits package in this contract compared to the prior contract.

In order to understand the projected cost of recently negotiated annual salary and step increases on future annual school budgets, the School Department provided us with dollar cost estimates. The estimates assume no changes in staffing levels. We used this data to calculate the combined annual percentage increases as shown in the following chart.

Teacher Payroll		Increase / Decrease	% Increase
Yr 1 2006-2007	$23,856,624		
Yr 2 2007-2008	$25,020,737	$1,164,112	4.9%
Yr 3 2008-2009	$26,451,898	$1,431,161	5.7%
Cumulative Increase		$2,595,273	10.9%
Average		*$1,297,637*	*5.3%*

Starting salaries or Step One salaries for Shrewsbury teachers generally appear higher than many area districts.[11] After the first year, however, the disparity levels off, and salaries begin to fall to the mid-point of other communities (based on available teacher salary data). At the same time, annual step and salary increases combined typically exceed wage indicators such as that reported by the Bureau of Economic Analysis (BEA). The BEA, which compiles Personal Income by Metropolitan Area, reported that personal income in Worcester increased 3.3% in 2005, while the increase for Boston was 4.4%.

While the Committee recognizes the role that salaries play in attracting, retaining and motivating employees, we note that increases averaging greater than 5% annually present a budget challenge to the town. Coupled with potential double-digit growth rates for health care costs, and barring additional state aid increases, it is difficult to see how these increases can be sustained without obtaining a substantial increase in revenue in ensuing years.

3.1.1.5 School Expenditure Reporting Recommendations

MA General Law c71, section 34, states that the School Committee has authority to determine expenditures within the total budget appropriation voted by the town. Unlike other town budgets, in which the town votes on how money is to be appropriated, school committees have discretion to determine all appropriations within the total budget approved by Town Meeting. This element of the school budgeting process can prove challenging to the average citizen.

The School Department endeavors to make their budget allocation process as transparent as possible, via public workshops, cable shows, etc. Providing additional reporting mechanisms to the public would complement their ongoing efforts. One example of budgetary information that the public might find useful are budget-to-actual expenditures for the same fiscal year. Another suggestion is to provide exhibits showing the total budget impact of salaries and wages of existing staff separate from the expected salaries of new staff.

Total expenditures in support of schools, i.e. the cost of services provided by other departments to support school operations, is another expenditure area where additional reporting may prove valuable, as this data is used to calculate per pupil expenditures. Last year's annual school budget presentation included a summary called 'Expenditure History: All Sources of Funds', which presents all school spending, not just School Committee expenditures, in one exhibit. This is a very useful report that could be amended to allow cross-referencing to the states new per-pupil calculations.

The committee recommends improving useful summary to allow cross-referencing to the state's new per-pupil calculations. For example, the summary should separate capital and debt service expenditures from operational expenditures and include separate totals for both spending categories."

[11] TEC Teacher Salary Survey FY 07

3.1.1.6 Conclusions

Fixed costs continue to increase. Discretionary spending must be monitored closer than ever. In regards to school spending, Town Departments need to decide how much they can pay based on a conservative forecast, and create a backup plan in case the cash flow is not as hoped. Opportunity for citizen feedback on budgetary issues must continue as well.

3.2 Administration: School Administrative Positions

Shrewsbury Public Schools central office administration is comprised of five positions: Superintendent of Schools, Assistant Superintendent, and Directors of Business Services, Human Resources and Special Education. The support staff in school department's business office totals 3.5 employees.

Shrewsbury High School, with an approximate population of 1550 students from grades 9 through 12, operates with a Principal and three Assistant Principals. Shrewsbury has two middle schools, each with approximately 950 students; grades 7 and 8 housed in one building, and grades 5 and 6 in the second. Each of these middle schools operates with a Principal and two Assistant Principals.

Shrewsbury has five elementary schools, including the Beal Early Childhood Center, which houses all but three kindergarten and some first grade classes. All except Floral Elementary operate with one principal. Floral Street School, with a population of approximately 750 students, has an assistant principal. Parker Road Preschool/Little Colonials, with approximately 185 students combined is administered by one School Director.

The Superintendent of Schools is chief administrator for all school staff in operational matters. The School Committee determines compensation for the Superintendent. Currently, the Superintendent works under a six-year contract, with salary negotiated annually. The current compensation packages consist of base salary plus benefits.

3.2.1 Conclusions:

The Committee recommends that further study be done by the School Committee to determine if School Department administrative staffing levels can be restructured and/or reduced to allow for added resources and funding for teachers and direct student services. Any feasible and prudent consolidation of duties should be considered.

3.3 School Transportation

3.3.1 State Regulations and Town Contract Regulations

Procurement of the school district bus service is regulated by the Massachusetts General Law Uniform Procurement Act, Chapter 30B. The current contract is with AA Transportation of Shrewsbury, MA and runs August 2005 - August 2008. (In accordance to the Town of Shrewsbury By-Law the contract cannot run more than three years).

The cost to the town for FY 07 is $3,406,343 or $267 per bus per day and includes:

- Home to School
- Vocational High School
- Athletics and field trips

Factors impacting rate include:

- Age of fleet (AA Transportation maintains a four year old fleet to help keep maintenance cost low and resale value high)
- Special equipment (on board camera's, etc. – AA Transportation includes options at no charge, such as AM/FM radios and tinted windows again to maintain a higher resale value for their equipment)
- Length of service day
- (Bell times - Tiers in AM, mid-day, PM with a 30 minute maximum target ride)

An additional requirement mandated by the town in the contract is that the vendor houses his equipment within the town. This results in the town receiving estimated excise revenue of $35,000 - $40,000.

The current contract does not include a fuel escalation clause. Although the state recommends the adoption of this option it presents issues in both the budget process and in the administration and management of monthly billing.

The fuel escalation clause makes the transportation budget variable rather than fixed thereby adding the potential to exceed the budget in a situation where gas prices significantly spike.

The district plans to revisit the fuel escalation clause with the next contract bid. One version of the option they may consider is a "catastrophic" fuel escalation option that would protect the vendor if fuel prices jumped more than say, $.50 in any agreed upon period.

3.3.2 Mandated Service Levels

The bus service itself is stipulated by Massachusetts General Law Chapter 71. Free bus service must be provided to K-6 students living two or more miles from the school and to all vocational high school students. Shrewsbury children attending DOE approved private schools are eligible for similar service levels as the public school children. The town can, and does, charge a fee for grades 7-12 students and for grades K-6 students living less than two miles from the school.

3.3.3 Operations Management

Currently the district employs one Transportation Coordinator. AA Transportation employs a branch manager, dispatcher, and all drivers. The district utilizes Versatran Routing Software to determine optimal routing schedules. Our transportation vendor is required to access this system via a network.

3.3.4 Ridership and Route Information

Currently there are 49 buses servicing 4,677 students (75% of enrolled students) on 278 daily bus routes (AM, mid-day, PM). The buses deliver students to 14 different public and private schools in Shrewsbury and 1 private school in Marlboro.

3.3.5 Out-of District Transportation

The Shrewsbury School District participates in the Assabet Collaborative to share out-of-district SPED transportation costs across the member districts. Significant cost increases are coming due to increased enrollment and fuel prices. In some cases transportation costs for a single student are almost equal to the tuition paid to the placement facility (for example, a daily run to West Newton is $324 per day or $58,370 annually).

3.3.6 Fee Program

The District is currently in the second year of the bus fee program, a program which recoups approximately 16% of the cost. This school year the district has introduced improvements such as an on-line payment system, longer payment period (March – mid June), a late fee for missing application deadline (which brought down the number of last minute applications), and a new plastic bus pass (which is still being produced in house).

3.3.7 Budget Plan Factors

There are no plans to increase the number of buses for FY 08. The bus fee will remain at $210 per student with a $420 family cap.

3.3.8 Conclusion:

The Committee supports the districts plan to revisit the option of including a fuel escalation clause when renegotiating their next contract with a transportation vendor.

3.4 Special Education

3.4.1 Federal and State Statutory Basis*:*

- The current standard for educating students within the special education program is Free and Appropriate Public Education.
- Federal and State law, and resulting regulations, establish thresholds to qualify for the program and shape the environment and standards for the level of education to be provided to the student.
- Director of Special Education oversees teams of parents, teachers and other professionals who tailor an education program for students within the program, consistent with Massachusetts educational law. In order to provide an appropriate level of education, accommodations are made within the education effort while seeking to give the student the greatest possible access to the curriculum. An example would be the use of book on tape rather than expecting a dyslexic student to read a book.
- Students in the program are educated within the school district or through out of district placements in private schools depending on the students needs.

- Where possible, special needs students are educated with in the classroom with typical students to maximize learning opportunities for both sets of students.

3.4.2 Practical Implications to the System:

- As of October 2006, Shrewsbury Public Schools are serving 995 special education students, or 16% of the school population.
- Of the 995 students, 62 students are schooled in out of district placements due to the severity or complexity of their educational needs.
- Out of district expenses have doubled in the past five years. There are a number of factors that we believe have contributed to this:
  1. The increase in district-wide enrollment has resulted in more students in special education. The percentage of students in out of district may not have increased substantially but the number will have grown by virtue of increased population.
  2. There are more students with serious mental health issues now than in past years, which have resulted in out of district placements.
  3. Prior to five years ago, Shrewsbury Public Schools did not enter into legal agreements with parents around out of district placements. All placements were made through the Team meeting with full agreement of the school staff and Team members. There were a number of these legal agreements in the recent past especially for students with language based learning disabilities and reading issues.
  4. There has been an increase in the number of students in Shrewsbury Public Schools who are on the autism spectrum. While we service most of these children in house, some of them exhibit symptoms or behaviors that warrant an out of district placement.
  5. Once a student is placed in an out of district placement, it is generally very difficult to return that student to the public schools. Parents particularly appreciate the very low student/teacher ratio that cannot be matched in public schools. When appropriate, however, we do make every effort to bring students back.
- Tuitions for the 62 out-of-district SPED placements range from $20,000 to $155,000 per student costing the system $3.4 million, averaging $55,000 per student.
- In an effort to both provide a quality education and manage costs, Shrewsbury has internalized certain educational programs for specifically impaired children (e.g., education for children with certain autism-spectrum disorders). Currently, 29 students are served by this in-district program. Providing this level of education in district results in a current year savings of $31,110 per child, for a total of $902,190.
- Shrewsbury provides these services with teachers where necessary, and with aides, and with other specially trained staff.
- The district successfully seeks to have services provided by appropriate personnel (e.g., a teacher will not provide a service when it can be appropriately provided by an aide).

3.4.3 Where Do We Stand?

According to the Massachusetts Department of Education, 18.5% of the total Shrewsbury School Department budget is spent on Special Education programs compared with a statewide average of 18.9%.

3.4.4 Conclusions:

- School officials are caught between federal and state statutes and regulations mandating certain levels of performance and doing so without corresponding sources of funding.
- Special education costs are by their nature expensive. Shrewsbury has sought to provide a quality, appropriate education for this population of students while seeking to manage those costs.
- Special Education staff consults with legal counsel regularly to ensure Federal and State statutory requirements are followed appropriately, particularly in the context of conflicting regulations.
- The Committee supports the district's plan to continue to manage special education costs by providing innovative in-district programs for groups of students who would otherwise require out –of –district placement. Not only will this result in lower special education costs, but the overall educational experience for these students will be enhanced because they will not need to travel great distances for services, or, in some cases, require residential placement.

4. Long Term Debt

Long term debt is used in the acquisition of large equipment and facilities because these are expensive items that usually have long life spans. It is both necessary and preferable to pay for these over a period of years. The town meeting authorizes the borrowing and bonds are issued to pay for the debt. All bonded debt must be approved by town meeting. The time required to pay off the bonds varies typically by the size of the project and is regulated by state law. The debt is comprised of two segments- principal and interest. The method that the town uses to pay the debt is to pay a constant principal amount with declining interest. This method pays down debt over the shortest period of time and thereby reduces the total interest costs as opposed to other methods.

Debt is funded by two principal methods. The first is paid from revenues generated by various departments such as water, sewer and light. Tax dollars are not used to pay for this type of borrowing.

The second is debt paid by taxation. This can be in two forms - debt within the levy limit and debt outside the levy limit, usually referred to as exempted debt. Debt within the levy limit is paid from funds derived from taxation and other sources within the statutory limits of proposition 2 ½. Exempted debt is authorized by a debt exclusion.
This has to be approved by Town Meeting and a vote of registered voters. The required payments are added to the levy limit as exempted debt. When the debt is retired (paid off) the authorization to borrow goes away.

4.1 Topic of Discussion: Limits on the Amount of Debt by Taxation
This topic has arisen as an attempt to give our taxpayers some degree of certainty of the total amount of bonded debt to which the town will commit beyond the levy limit (i.e.: debt exclusion).

There are two basic approaches that have been discussed. The first is the total amount of debt at any given time. (E.g. a debt ceiling). This means that the total of all projects funded by debt exclusions could not exceed the amount at any given time.

The second approach is to determine an amount the homeowner of the average valued house will be expected to pay for exempted debt. (Ex: the average single family home's taxes to pay for debt exclusions will not exceed $400 per year)

This method gives certainty to homeowners that the cost of exempted debt will not exceed a certain amount and may be lower as debt is retired. Under this approach, the debt ceiling may rise or fall based upon the interests rates at the time of the proposed borrowing. The benefit to the homeowner is that the homeowner will know the payment will not exceed a certain amount per year.

Both approaches require careful planning through the capital budget to assure that projects are sequenced not only by need, but also by the borrowing costs as related to the ceiling.

4.2 Conclusion
The Fiscal Study Committee recommends that the options listed above should be explored in more detail and that the Town should consider a more formal capital planning process. (See proposed FY 08 Capital Spending Recommendations in the Appendix).

5. Mandated and Discretionary Services

A study of the services that towns are required by state law to provide reveals some interesting information. Chapter 41 is the law that essentially creates the basic structure of town government. Chapter 41 defines what offices and services must be created by the town. Other chapters of the law also define additional required town services and offices. Surprisingly, they do not require many of the offices and services that many would consider basic and necessary. The town offices required include the following: Town Accountant, Assessors, Health Inspector, Building Inspector, Cemetery, Constables, Town Clerk and Election & Registration, Finance Committee, Town Moderator, Highway Commissioners, Lake Quinsigamond Commission, Planning Board, Schools & School Committee, Selectmen, Sealer of Weights & Measures, Town Treasurer and Tax Collector, Tree Warden, Veterans Services, and Zoning Board of Appeals. In addition, town meetings are required for our form of government. Towns are also required to provide and maintain school buildings.

Some of the offices that most consider essential, but that are not required and are established by local acceptance of various provisions in that law, include the following: Police and Fire, Ambulance Service, Library, Parks, Town Counsel and Water and Sewer. The Commission on Disabilities, Council on Aging, Light Department, Historic District Commission, Historical Commission, Cultural Council, and several others are also not required and are also created by local acceptance. Pensions and group insurance are not required by law, but are provided by local acceptance of state programs. However, once these two provisions are accepted at the local level they can not be rescinded.

While there are other offices or services not mentioned, the collection above represents the majority and most significant.

While some of the required offices and services must be provided, there are not always direct costs or only minor costs associated with them. Typically these are boards and commissions. The duties of many, but not all, the boards and commissions can actually be carried out by the Board of Selectmen if so decided by Town Meeting.

A review of the discretionary services reveals that many could be characterized as "Core Services" that are important to provide for the public safety of the residents of our town. Others provide the basic utilities that usually can be provided in a more cost effective manner than what could be provided by private sector utilities.

The last group of discretionary services are those that address the quality of life in our town. While these are not required, these services contribute significantly to what make our town a place in which people want to live and work. (See Exhibit I "Mandatory vs. Discretionary Services" in the Appendix).

5.1 Conclusion

As the town's financial situation tightens, choices will have to be made to determine how all of the above services can or will continue to be provided at the level of service that our residents have come to expect.

As we end our report, the heart of the matter remains unchanged: it is about values and choices. So, we end by reiterating some comments from the beginning of our report. When we began this process many of us hoped to find additional revenue sources and easy expenditure reductions. We found neither. There is no list of simple suggestions to resolve our town's financial condition. There can be no substitute for citizens' participation in our political process. The decisions the electorate makes reflect values about governance and priorities. We challenge all residents of Shrewsbury to think seriously about these value issues and to become active in the process that will help decide the future of our town.

APPENDIX

MANDATED VS. DICRETIONARY TOWN SERVICES MATRIX

NOTE: Although services or offices may be required by law, there is no requirement as to how much must be spent to carry out the function.

DEPARTMENTS/ COMMISSIONS	REQUIRED	LOCAL ACCEPTANCE	Required Services 2007 Budget	Discretionary Services 2007 Budget	Required MGL LAWS	Discretionary MGL ENABLING LAWS	
Accountant	**YES**		$ 178,539		Ch 41 Sec. 1		
Assessors	**YES**		$ 224,569		Ch 41 Sec. 1	Chapter 41: Section 24	
Board of Assessors	NO	YES				Chapter 41: Section 26	(7)
Board of Health	**YES**	YES	$ 229,255	$ 1,550,111	Chapter 41: Section 1		(7) (8)
Health Inspector	**YES**	YES			Chapter 41: Section 102B.		(8)
Building Inspector	**YES**		$ 193,026		Chapter 143: Section 3		
Cemetery	**YES**		$ 116,731		Chapter 114: Section 10		
Cemetery Commission	NO	YES				Chapter 114: Section 22	(7)
Commission On Disabilities	NO	YES		$ 500		Chapter 40: Section 8J.	
Conservation Commission	NO	YES		$ 6,450		Chapter 40: Section 8C	
Constables	**YES**				Ch 41 Sec. 1		
Council On Aging	NO	YES	$ 239,143			Chapter 40: Section 8B	
Cultural Council	NO	YES				Chapter 10: Section 58	
Donahue Rowing Center Committee	NO	YES			local initiative		
Municipal Light Department	NO	YES			Chapter 164: Section 34		
Election & Registration	**YES**		$ 107,354				
Electric Light Commission	NO	YES			Chapter 164: Section 55.		(7)
Emergency Management (Civil Defense)	**YES**		$ 2,080		Civil Defense Act of 1950		
Engineering	NO			$ 470,472			
Finance Committee	**YES**		$ 281,325		Chapter 39: Section 16		
Fire Department	NO	YES		$ 2,523,718		Chapter 48: Section 42.	
Forestry (Tree Warden)	**YES**		$ 47,265		Ch 41 Sec. 1		
Highway	**YES**		$ 1,449,001		Chapter 84: Section 1	Chapter 84: Section 7 (1)	(7)
Highway/ Road Commissioners	**YES**	YES				(3)	(7)
Historic District Commission	NO	YES				Chapter 40C: Section 3	
Historical Commission	NO	YES				Chapter 40: Section 8D	
Industrial Development Commission	NO	YES				Chapter 40: Section 8A	
Lake Quinsigamond Commission	**YES**				Chapter 294 of the Special Acts of 1916		
Library	NO	YES		$ 1,104,533		Chapter 78: Section 7	
Library Trustees	NO	YES				Chapter 78: Section 10 (2)	
MIS	NO			$ 383,697			
Parks	NO	YES		$ 443,009		Chapter 45: Section 2	
Parks Commission	NO					Chapter 45: Section 2	(7)
Personnel Board	NO	YES			Personnel By-Law		
Planning Board	**YES**		$ 3,300		Chapter 41: Section 81A.		
Police	NO	YES		$ 3,919,901		Chapter 41: Section 97A	
Retirement Board	NO	YES				Chapter 32: Section 20	
Schools	**YES**		$ 40,187,737		Chapter 71 sec 1	Article 3 of The State Constitution	
School Committee	**YES**				Ch 41 Sec. 1		

MANDATED VS. DICRETIONARY TOWN SERVICES MATRIX

NOTE: Although services or offices may be required by law, there is no requirement as to how much must be spent to carry out the function.

Sealer of Weights & Measures	**YES**		$ 3,000		Chapter 98: Section 34		
Selectmen	**YES**		$ 22,113		Ch 41 Sec. 1		
Sewer	NO	YES		$ 2,514,639		Chapter 83: Section 1	
Sewer Commission	NO	YES				Ch 41 Sec. 63	
Tax Collector	**YES**		$ 352,217		Ch 41 Sec. 1		
Town Clerk	**YES**		$ 152,807		Ch 41 Sec. 1		
Town Counsel	NO	YES		$ 56,400		Town Manager Act	
Town Manager	NO	YES		$ 288,167		Town Manager Act	
Town Moderator	**YES**				Chapter 39: Section 14		
Treasurer	**YES**				Ch 41 Sec. 1		
Veterans Services	**YES**		$ 35,817		Chapter 115: Section 10		
Water System	NO	YES		$ 1,698,595		Chapter 40: Section 39A	
Water Commission	NO	YES				(4)	
Zoning Board of Appeals	**YES**		$ 670		Chapter 40A: Section 12		
		SUBTOTAL	**$ 43,825,949**	**$ 14,960,192**			
Ambulance Servcie	NO	YES		$ 70,422	Chapter 40: Section 5F		
Health Insurance	NO	YES		$ 6,075,000	Chapter 32B: Section 10		(5)
School Building Maintainence	YES		$ 3,136,947		Chapter 71 sec 68		(9)(10)
Pensions	NO	YES		$ 1,931,719	Chapter 32		(6)
			$ 3,136,947	**$ 8,077,141**			
		TOTAL	**$ 46,962,896**	**$ 23,037,333**			

Note: The amounts on this table are not the total FY2007 budget total because they do not include debt and interest and several other accounts.

(1) State laws requires the maintenance of public roads including clearing snow
(2) Trustees are required if the town creates a public library
(3) Board of Selctmen are the road commissioners in Shrewsbury
(4) Board of Selctmen are the Water commissioners in Shrewsbury
(5) Although not required, once this Chapter of the law is accepted by a town, it can not be rescinded. Shrewsbury accepted this in 1957
(6) Although not required, once this Chapter of the law is accepted by a town, it can not be rescinded. Shrewsbury accepted this in 1940
(7) Selectmen can act in this capacity per Ch 41 sec 21
(8) While the health inspector is required by law, trash collection and disposal is not
(9) There are also other chapters of the law that address providing schools and maintaining them.
(10) 90% of the public buildings budget is used to maintain the school buildings

Town of Shrewsbury FY 06 Grants

	Account Title	7/1/2005 STARTING BALANCE	REVENUE RECEIVED FY 06	EXPENDITURES SPEND FY 06	6/30/2006 ENDING BALANCE
Federal Grants - Town					
101001	Cops Fast Grant	$ 19,390			$ 19,390
101004	Law Enforcement Block Grant	$ 6,897			$ 6,897
101006	Problem Solving Partnership	$ 17,213			$ 17,213
101009	Live Scan Fingerprint	$ 4,024			$ 4,024
	Total	$ 47,523			$ 47,523
State Grants - Town					
111103	DARE Tobacco Grant	$ 4,920		$ 55	$ 4,865
111104	Community Policing	$ 5,587	$ 71,904	$ 13,823	$ 63,668
111105	Police Pedestrian Grant	$ 1,637			$ 1,637
111106	Regional Drug Task Force	$ 55,724	$ 59,381	$ 43,400	$ 71,705
111109	NSSW Tobacco Control	$ 2,234			$ 2,234
111110	Elder Affairs Grant	$ 2,516	$ 37,019	$ 32,499	$ 7,036
111111	Library Equalization Grant	$ 154,214	$ 46,022	$ 16,817	$ 183,419
111112	Cultural Council Grant	$ 7,048	$ 585	$ 3,350	$ 4,283
111113	Juvenile Delinquency Prevent	$ 3,817			$ 3,817
111114	Combat Domestic Violence	$ 12,715			$ 12,715
111115	Bulletproof Vests	$ 2,808	$ 900		$ 3,708
111116	Title V Septic	$ 12,418		$ 1,000	$ 11,418
111117	Violence Against Women Act	$ 4,404			$ 4,404
111119	Governors Highway Safety FY 98	$ -		$ 3,862	$ (3,862)
111121	VIN System	$ 75		$ 75	$ -
111137	Flint Pond Drawdown	$ 140		$ 140	$ -
111138	State Safety Grant-Fire	$ 409			$ 409
111139	Police Safety Equipment	$ 10,707			$ 10,707
111140	Title V Loan #3	$ 51,200	$ 63,495	$ 114,695	$ -
111142	Medication Mgmt COA	$ 500			$ 500
111143	MEMA Equipment	$ (6,967)	$ 18,957	$ 11,990	$ -
111144	Lakeway - State	$ (3,955)	$ 75,000	$ 71,045	$ -
111146	Homeland Security	$ 38,534	$ 1,994		$ 40,528
111147	Firefighter Equipment	$ 3,234		$ 3,234	$ -
111148	Safe Grant - 2005	$ 4,532	$ 4,532	$ 5,014	$ 4,050
111149	MEMA Grant		$ 750	$ 609	$ 141
111150	Martarp Equipment		$ 495	$ 495	$ -
111151	Discovery Kits - Library		$ 7,457	$ 3,562	$ 3,895
111152	Homeland Security Training			$ 3,784	$ (3,784)
	Total	$ 368,452	$ 388,490	$ 329,449	$ 427,493

Town of Shrewsbury FY 06 Grants

	Account Title	7/1/2005 STARTING BALANCE	REVENUE RECEIVED FY 06	EXPENDITURES SPEND FY 06	6/30/2006 ENDING BALANCE
Federal Grants - School					
202017	Virtual HS Consortuim	$ 9			$ 9
202044	Title I 305	$ 316			$ 316
202047	Learn & Serve Sch Based 354	$ 5,610		$ 48	$ 5,562
202076	Title I 305	$ 2,357		$ 2,340	$ 17
202078	Title II Part A Teach Qual 140	$ 1,123		$ 888	$ 235
202079	Title II Part D En Ed Tech 160	$ 765		$ 534	$ 231
202080	Fed SPED Entitlement 240	$ 51,204		$ 51,149	$ 55
202081	Early Childhood SPED 262	$ 589		$ 589	$ -
202082	SPED Program Imp 274	$ 2,330		$ 2,330	$ -
202083	Title V Innovative Prog 302	$ 1,233		$ (0)	$ 1,233
202084	Title I 305	$ 6,570		$ 6,570	$ 0
202085	Title VI Safe & Drug Free 331	$ 884		$ 884	$ 0
202087	SPED 94-142 Allocation 240		$1,215,496	$ 1,157,798	$ 57,698
202088	SPED Prog Improve 274		$ 15,000	$ 15,000	$ -
202089	Enhanced Ed Through Tech 160		$ 8,774	$ 8,774	$ -
202090	Title I Distriburtion 305		$ 297,652	$ 320,579	$ (22,927)
202091	Teacher Quality 140		$ 112,471	$ 106,751	$ 5,720
202092	Drug Free Schools 331		$ 21,644	$ 21,094	$ 550
202093	Title V 302		$ 9,328	$ 9,328	$ -
202094	Learn & Serve 354		$ 12,000	$ 10,703	$ 1,297
202095	LEP Support 180		$ 22,017	$ 16,814	$ 5,203
202096	Katrina Aid		$ 3,750	$ 3,750	$ -
	Total	$ 72,991	$1,718,132	$ 1,735,923	$ 55,200
State Grants - School					
212126	Adv. Placement Program C590	$ 15			$ 15
212155	Advanced Placement 590	$ 50			$ 50
212175	Mental Health Support 216	$ 1,120		$ 906	$ 213
212177	KINDER ENCHANE PROG 701	$ 692			$ 692
212178	Early Child Mental Health 216B	$ 58			$ 58
212179	Circuit Breaker	$ 138,910	$1,518,717	$ 1,455,094	$ 202,533
212182	SPED Corrective Action 632	$ 1,595		$ 1,595	$ -
212183	Mental Health Support 216	$ 935		$ 935	$ -
212184	Kinder Enhance Prog 701	$ 5,021		$ 5,021	$ -
212186	Foundation Reserve Award	$ 2,502		$ 2,502	$ -
212187	Kinder Enhance Prog 701		$ 44,925	$ 38,321	$ 6,604
212188	Mental Health Support 216		$ 6,000	$ 11,094	$ (5,094)
212189	Early Childhood SPED 262		$ 32,498	$ 32,177	$ 321
212190	Academic Support 632		$ 6,880	$ 5,652	$ 1,228
212191	Foundation Reserve 2006		$ 75,000	$ 75,000	$ -
	Total	$ 150,898	$1,684,020	$ 1,628,298	$ 206,620
	Total ' 06 grants		**$ 3,790,642**		

THE DIRT ON TRASH: COLLECTION, DISPOSAL, AND RECYCLING

PROBLEM

On January 1, 2008, a new rubbish disposal contract with Wheelabrator will begin. Disposal costs will increase from the current $37.33/ton to $70.50/ton. Consequently DISPOSAL costs will increase from about $419,000/yr to about $811,000/yr. Moreover, the fee will increase at a negotiated rate to $72.30/ton on 7/1/08 and will be adjusted each succeeding July 1st. Thus, disposal costs for FY 09, the first full fiscal year (7/1/08-6/30/09), will be about $831,450. In short, DISPOSAL costs will soon double (from $419,000 to $831,000) and will continue to increase.

In addition to trash DISPOSAL costs, there are costs for COLLECTION of trash, recycling and yard waste. Collecting and disposing of these three categories of items make up the bulk of the cost of managing municipal waste. The total cost of collection and disposal for 2006 was $1,462,165 which is about $150 per household or $50 per person.

Historically, some of the costs of waste disposal have been offset by income from the landfill. That income has ranged from about $550,000 to about $1,200,000 per year. Ash has been the mainstay of the landfill. However, in 2006, Massachusetts reclassified ash so it may now be used as a landfill cover; therefore, that source of revenue is already declining. The Town Manager and the Director of Public Health have met with two solid waste engineering/consulting firms and a solid waste disposal company and Wheelabrator to seek solutions. About 2.5 million tons of waste is sent out of state for disposal each year, so there is a large enough waste stream for Shrewsbury to replace ash with other waste that would be non-polluting and not attract vermin or cause odors. The basis for Shrewsbury's landfill design is 150,000 to 200,000 tons per year for 20 years. That is a fairly small amount compared to the millions of tons seeking disposal out of state. Landfill revenue is expected to be $550,000 in 2008, but the future of this revenue source is still unsettled.
<u>CONTEXTUAL DATA:</u> To put the following discussion in some perspective, we provide the following historical data for collection and disposal costs, 2000 through 2009:

Year	Houshlds	tons	dsp rate	cost	trash coll.	recy coll	yard coll	TOTAL
2000	8820	10,862	31.91	$346,606	$391,000	$258,000	$22,500	$1,018,106
2001	9015	11,039	32.90	$363,183	$406,000	$263,000	$23,500	$1,055,683
2002	9213	11,518	33.40	$384,701	$422,000	$268,000	$23,500	$1,098,201
2003	9411	12,297	34.25	$421,172	$439,200	$273,000	$24,000	$1,157,372
2004	9614	12,128	35.09	$425,571	$456,600	$278,000	$24,500	$1,184,671
2005	9686	11,432	35.49	$405,721	$700,000	$301,653	$27,000	$1,434,374
*2006	9786	11,272	36.52	$411,653	$721,000	$301,702	$27,810	$1,462,165
*2007	9886	11,500	37.33	$429,295	$742,630	$320,023	$28,644	$1,520,592
*2008	9986	11,500	**71.40	$821,000	$764,909	$329,624	$29,504	$1,945,0370
*2009	10886	11,650	***73.20	$852,780	$787,656	$339,513	$30,389	$2,010,338

* # of Households is estimated, assuming 100 new households per year.
* Tons of trash is actual for 2006, estimated for future.
** This is an average of 70.50 for first 6 months and 72.30 for last 6 months.
*** This is an average of 72.30 for first 6 months and 74.10 for last 6 months.

NOTE: Increasing recycling decreases costs because it eliminates the need for disposal. For example, a 20% decrease in disposable trash in 2006 would have saved Shrewsbury taxpayers $82,330; in 2008 it would save $164,220.

SOLUTIONS

The Committee considered the following solutions to the waste management problem:

1) Continue with the present curbside program and fund trash/recycling collection and disposal from increased tax revenue and/or cuts in other services.
2) Continue as at present, but institute a program to radically increase recycling (which cuts disposal costs) and include new laws and penalties for those who fail to recycle adequately.
3) Continue as at present, but institute a trash/recycling collection and disposal fee that would be calculated on the basis of number of households or number of residents or some similar formula. Businesses and apartment buildings could be included in this, in order to further broaden the base of support; some costs would increase, as well.
4) Institute a PAYT program, such as the one researched by the Health Dept.
5) Develop a town-owned and operated transfer station and require residents to bring their trash/recycling there.
6) Terminate all Town-sponsored waste collection and disposal, leaving it to individuals to contract individually with businesses for such services.

A BRIEF REVIEW OF PRO's and CON's:

1) Continuing the present system.

PRO: a) waste disposal is a health issue, not an individual option; the community has a vested interest in assuring that waste is collected and disposed-of properly; b) the system is already in place and works well; therefore, c) any changes ought to be in the realm of improving and fine-tuning this system.

CON: a) the system seems to work adequately until you consider that Shrewsbury fares poorly in terms of recycling; thus, the status quo continues to harm the environment; b) the system does not reward those who recycle more or who generate less trash, so it is unfair; c) the system has become too costly.

2) Continue the present system, with recycling incentives.

PRO: a) this retains the advantages summarized above and b) helps to reduce costs for everyone by requiring recycling and penalizing those who do not comply with this civic duty.

CON: a) this introduces an unwelcome element of coercion; b) it would be difficult to develop criteria and systems to enforce any new requirements; c) it would require a new "trash police" or would put an additional burden on the Police Department.

3) ***Continue as at present, but fund it with a new waste collection and disposal flat fee*****.**

PRO: a) this has the advantages outlined in #1, including convenience; b) a fee can be more fair because it collects more revenue from those who use the service more heavily; c) it has the advantage to the Town of removing the costs from the tax-based operating budget, freeing revenue for other services; d) the fees can be adjusted annually without the complexity of Prop 2 ½ complications.

CON: a) fees place an unfair burden on the poor, those with fixed incomes, and those with larger families; b) a fee based on households or number of members in a household does not necessarily reflect the amount of waste actually generated by that unit, therefore c) there are no clear incentives to recycle and reduce waste and d) those who already do recycle, etc. would continue to subsidize those who do not

4) ***Institute a Pay As You Throw (PAYT) program.***
PRO: a) PAYT is fair because it places the cost burden directly on those who generate the most waste; b) like a flat fee, it takes costs out of the tax-supported services, freeing funds for other services and c) avoiding the complications of Prop. 2 ½; d) wherever it has been implemented, PAYT has resulted in an increase in recycling, averaging about 30%, ranging from 20% to 40% (occasionally higher: in Northboro, trash decreased by 45% by the fourth year of PAYT); e) PAYT makes it viable to include businesses and apartment buildings in the system, giving the Town more control over proper disposal of waste (a health and environmental issue).
CON: a) like any fee, this one unfairly burdens the poor, larger families, and those on fixed incomes; b) such a system is burdensome, inconvenient, and complicated: it would require about one million bags per year and raises new problems like: what happens if a bag breaks? c) PAYT usually leads to some (usually small) group of people disposing of trash illegally by dumping it in the woods or quiet streets or in privately owned dumpsters (usually at businesses or apartment buildings); Shrewsbury experiences some of this illegal dumping from Worcester and Northboro; d) such a system must be mandatory so that the base is large enough to make it viable, therefore, e) it raises enforcement issues, as noted in #3 above.

5) ***Develop a transfer station.***
PRO: a) this eliminates collection costs and b) provides an opportunity for the Town to retrieve recyclable materials; c) it provides some incentive for people to reduce trash generation; d) it positions the Town to sell the transfer service to other towns in the area, thus generating additional revenue.
CON: a) for citizens, this is the most inconvenient way to collect waste, therefore, b) there is an incentive for people to circumvent the system with illegal dumping; c) transfer station typically work well in small towns, but d) would result in long lines and delays in a town as large as Shrewsbury.

6) ***Terminate all Town-sponsored waste services***.
PRO: a) this gets the Town out of the waste business, which is philosophically appealing to backers of small government; b) it opens opportunities for tax-paying private businesses, thus creating an additional tax benefit; c) it takes waste costs out of the tax-based services, freeing funds for other purposes; d) because it allows them to find the best deal for their needs, it is fair to everyone.

CON: a) since waste impacts both health and environment, it is a rightful concern of a government serving all the people; b) there is no guarantee that the new providers will be paying taxes in Shrewsbury; c) options 3 and 4 free funds without such a radical change; d) siting, building and operating a transfer station are a very expensive. Northboro studied the cost before it began PAYT four years ago; it realized it would be more expensive than curbside collection. The Northboro consultant determined that it would cost $3.82 million to permit, construct and finance a transfer station project. Operating costs would total approximately $222,500 per year. These costs are for a town half the size of Shrewsbury; construction costs have increased substantially in the past 4 years.

Pay As You Throw
In order to clarify some cost issues, and because Shrewsbury is bordered by two PAYT programs, (Northboro and Worcester), we provide the following informational discussion. We wish to be clear that presenting this discussion does not indicate that the Committee endorses this approach; it is purely informational. Examples of what is done in Northboro are offered simply for context, to give some idea of what can be done in this area. Committee member William Gooley met with Nancy Allen, Shrewsbury Director of Public Health and he interviewed Fred Litchfield of the Engineering Dept. in Northboro, among other sources of data. The figures in this report have been recalculated by Dr. Gooley to make them as current as possible; any errors are his own.

<u>THE BASICS:</u>
PAYT works by charging a fee for each bag of trash disposed. Fees are commonly $1.50-$3.00 for a 33-gallon (25lb) bag and $0.75-$1.50 for a 15 gal (12lb) bag. (For comparison, a standard Kitchen-sized bag is about 13 gallons). Bag fees are set at levels to encourage participation, while still recovering as much of the costs as possible. (Northboro currently charges $3.00 and $1.50, but started lower). To be successful, PAYT programs require high levels of participation; sometimes, the programs are mandatory; Northboro allows a private service to compete, but requires that service to provide recycling, too. In addition, there is usually a fee for stickers for bulky items, typically $10 to $20 each. In Sept. 2005, Northboro added a $10.00 fee for bags of hazard waste. Typically, municipal buildings do not pay a fee. There may be a program to offset the cost for eligible poor citizens; for example, Northboro wrote to churches asking them to buy bags to give to the poor or to sell to them at a discount. If PAYT were adopted in Shrewsbury, all of these details would have to be decided.
The basic pro's and con's of PAYT are discussed in Solution #4 above.

<u>INCOME AND SAVINGS:</u>
To get an idea of the financial aspects of PAYT let us consider how the numbers would look in 2008, using the estimate of 11,500 tons of disposable trash.

a) 11,500 tons = 23,000,000 pounds.
b) Typically, about 2/3 of trash is in large bags, 1/3 in small.
c) 23,000,000 pounds X 2/3 = 15,333,333 pounds; 1/3 = 7,666,667 pounds
d) 15,333,333 lbs divided by 25 lbs = 613,333 bags x $2/bag = $1,226,666.
e) 7,666,667 lbs divided by 12lbs = 638,889 bags x$1/bag = $638,889.
f) Total income generated, at these rates is $1,865,555.

To cover the projected cost of all waste collection and disposal -- $1,945,037 – would require bag fees of slightly higher than $1 for small and $2 for large.
Of course, it is not that simple. For example, if we continued to use Landfill revenue to offset waste costs, the $1 and $2 fees could be reduced, or any surplus could be set aside for the future or used for other services.
In addition, since PAYT virtually always reduces disposable trash by at least 20%, we can project a disposal cost savings of $164,220 (11,500 tons x 20% = 2300 tons @ $71.40/ton = $164,220). Again, fees could be kept lower or used as noted above. A 30% decrease in trash would provide savings of $ 246,330 (11,500 x 30% = 3450 tons @ $71.40/ton = 246,330). Northboro has seen a 45% decrease in trash over the past 4 years.

Of course, reduction of trash through increased recycling might be accomplished through the existing service or some of the alternatives outlined above. We do wish to alert citizens to the idea that increasing recycling, no matter how accomplished, can yield savings in the hundreds of thousands of dollars.

The Revenue Subcommittee had several questions about PAYT. Those questions were asked of Director Allen and the answers follow. (Note: some things have changed since this exchange in Sept. 2006).

Q1. What will happen to landfill income, with the recent reclassification of ash? Even if we can find materials, will there be a gap in income before that happens?

A1. The reclassification of ash will not significantly impact the income from the landfill. Two to two and a half million tons of waste generated in Massachusetts is sent out of state for disposal each year. 150,000 to 200,000 tons per year for 20 years is the basis for Shrewsbury's landfill design. That is a fairly small amount compared to the millions of tons seeking disposal out of state. The Town Manager and the Director of Public Health have also met with two solid waste engineering/consulting firms and a solid waste disposal company and Wheelabrator. They discussed with each of them the impact of the new regulations, which allow ash residue to be used as landfill cover. The experts are confident that there will be plenty of non-putrescible waste materials (that is, waste that would not cause odor or attract vermin) available for disposal to meet our goal of a consistent revenue stream over the 20-year term of the contract.

The negotiated contract will define acceptable materials. It will be the responsibility of the contractor to find the acceptable materials in adequate quantity and to enter into contracts for their disposal. The town entered into negotiations now for the next 20 year contract so that there will not be a gap in landfill operations. Once the negotiations are complete and the contract is signed, the contractor will construct the first cell of the new landfill and be ready to accept waste before Phase 4 (the fourth and final cell in the area under contract at this time) reaches capacity.

Q2. Why don't we set a fee to cover collection AND disposal? That is, why don't we try to recoup the real or complete cost?

A2. The price per bag would be very high if we tried to recoup both the collection and disposal costs. Studies of existing PAYT programs show that if the bag fee is too high people hire rubbish removal companies to pick up their trash or they take it to work with them or toss it illegally. Anticipated revenue is lost for every non-participating residence. The fees suggested [$0.75 and $1.50] are about midway between those charged by Worcester and Northboro.

Q3. Why do we have to pay for recycling? -- doesn't the collector get to sell the material and make back their cost?

A3. The Request for Proposals issued by the town in 1999 and earlier for rubbish collection made the recyclable material picked up at the curb the property of the contractor. We did this for two reasons: to keep collection costs at a minimum and to avoid financial risks. The market value of paper and plastics, metal and glass fluctuate greatly. If the town owned the materials, there would have been times when we would have had to pay for them to be processed and sold and other times when we would have made a profit. It is hard to fit that type of risk into a municipal budget.

Q4. Suppose we set up a transfer station, sort of like Dennis, and dispensed with collections altogether? Could we still charge PAYT but sell the recyclables while avoiding the cost of collection? OR, why not just stop collections and get the town out of the trash/recyclables business altogether, putting the burden on citizens to find their own trash haulers, and backing it up with stiff fines and enforcement for littering?

A4. Siting, building and operating a transfer station are a very expensive. Northborough recently studied the cost and realized it would be more expensive than curbside collection. The Northboro consultant determined that it would cost $3.82 million to permit, construct and finance a transfer station project. Operating costs would total approximately $222,500 per year. That includes salary plus benefits for three full time employees, fuel and maintenance costs for the vehicles to truck solid waste to Wheelabrator Millbury for disposal, and trucking recyclable materials to a recycling facility, plus the handling charge for the recyclables. This estimate is based on a community half the size of Shrewsbury. Our building and operating cost would be higher because we are a bigger community and have more residents. Shrewsbury residents generate twice as much trash as this comparison community and would pay about twice as much to haul the waste.

It is very interesting to look at the Town of Dennis fee schedule. Dennis is one of those communities that has many residents in the summer and few in the winter. Most property owners pay for the dump sticker and only use it for a few weeks or months each year. Every one pays the same price and those who use it only in the summer in effect subsidize those that use the service year round.

In Shrewsbury, a town with more than 33,000 residents, it is difficult or impossible to run a transfer station without long lines and many inconveniences. Shrewsbury is known for providing an excellent curbside collection program. In comparison, no drop-off program would be considered convenient. In that context, ceasing all waste collection services would likely result in a steep increase in illegal dumping, as well as a severe decrease in recycling. Both effects would harm the environment in Shrewsbury and deteriorate the quality of life here. Virtually all available studies and experience indicate that making trash collection and recycling convenient and affordable is the most effective way to handle this public health problem. As for Police enforcement, that is something they already do, along with the Public Health Dept. However, illegal dumping is very difficult to stop and it is unlikely that the Police Dept., faced with the same budget constraints as the rest of the Town, will be able to devote more resources to this issue.

There is, however, one other option: a Prop. 2½ override to fund waste management. The 2005 Shrewsbury Town Survey (p.8) reported that the majority of those polled supported a Proposition 2 ½ override "as the means to fund trash collection, followed by the fee-per-bag option". Thus, including rubbish collection expenses in an operational override could be considered as an alternative to the PAYT option.

Written by Committee member William Gooley

COMPARING TOWNS

Massachusetts Dept of Revenue
Division of Local Services
Municipal Data Bank/Local Aid Sect

Comparison Criteria Report

Massachusetts Department of Education
Office of School Finance

			Socio-Economic Measures					Town Statistics		FY05 Per Pupil Expenditures Day Programs			
DOR Code	Municipality	2004 Estimated US Census	1999 Median Family Income	Residential Tax Levy $	2006 Total Non-Residential Tax Levy	2006 Total Tax Levy	2006 Non-Residential as % of Total	FY06 Operating Budget	Total 2005 General Fund Expenditures Per Capita	Gra-des	Total Expenditures	N of Pupils (FTE Average Membership)	Per Pupil Expenditures
271	SHREWSBURY	33,161	77,674	38,039,674	5,174,841	43,214,515	12.0%	84,716,869	2,134	K-12	43,431,717	5,695	7,626
141	HUDSON	18,726	70,145	20,266,103	8,772,463	29,038,566	30.2%	51,362,560	2,402	K-12	24,733,580	2,713	9,115
170	MARLBOROUGH	37,699	70,385	40,262,394	31,919,166	72,181,560	44.2%	113,464,777	2,136	K-12	46,899,757	4,810	9,751
174	MAYNARD	10,322	71,875	14,712,793	3,832,474	18,545,267	20.7%	29,831,036	2,723	K-12	13,057,612	1,378	9,478
328	WESTBOROUGH	18,737	94,610	30,116,450	18,472,957	48,589,407	38.0%	75,116,115	3,152	K-12	33,858,418	3,513	9,638
	Wachusett												
215	|| NORTHBOROUGI	14,320	90,480	22,996,770	5,703,879	28,700,649	19.9%	40,909,482	2,476	K-08	16,309,902	1,983	8,225
277	V SOUTHBOROUGI	9,549	119,454	22,212,878	4,420,600	26,633,478	16.6%	38,611,927	3,367	K-08	13,632,549	1,624	8,397
Other Towns Compared to Shrewsbury													
101	FRANKLIN	30,192	81,826	33,885,538	8,643,798	42,529,336	20.3%	97,794,917	2,499	K-12	46,562,553	5,969	7,800
198	NATICK	32,113	85,715	48,312,860	12,856,402	61,169,262	21.0%	100,785,887	2,635	K-12	41,357,675	4,542	9,105
317	WELLESLEY	26,515	134,769	64,422,675	7,360,966	71,783,641	10.3%	105,013,986	3,024	K-12	42,789,933	4,385	9,759
Some Other Worcester County Towns													
017	AUBURN	16,381	60,805	14,959,438	10,712,643	25,672,081	41.7%	39,376,199	2,146	K-12	19,338,917	2,302	8,401
110	GRAFTON	16,297	66,396	18,988,208	1,564,282	20,552,490	7.6%	39,272,070	1,827	K-12	19,166,705	2,549	7,519
134	HOLDEN	16,595	73,614	22,574,628	1,290,700	23,865,328	5.4%	39,126,176	1,820	* K-12	48,962,386	7,015	6,980
151	LEICESTER	10,904	64,202	8,904,180	675,953	9,580,133	7.1%	24,271,679	2,002	K-12	14,400,485	1,903	7,569
185	MILFORD	27,410	61,029	28,683,568	12,631,982	41,315,550	30.6%	67,806,951	2,159	K-12	34,279,344	4,163	8,235
186	MILLBURY	13,376	62,564	13,037,985	2,876,031	15,914,016	18.1%	31,923,050	1,875	K-12	15,770,876	1,948	8,097
216	NORTHBRIDGE	13,882	62,095	12,141,671	1,329,391	13,471,062	9.9%	38,751,600	2,320	K-12	20,832,887	2,581	8,071
290	SUTTON	8,878	81,000	11,526,913	1,075,326	12,602,239	8.5%	23,312,230	2,279	K-12	12,651,564	1,691	7,482
304	UXBRIDGE	12,243	70,068	14,704,020	1,732,096	16,436,116	10.5%	36,163,995	2,354	K-12	16,481,627	2,131	7,734
316	WEBSTER	16,880	48,898	11,544,008	3,166,435	14,710,443	21.5%	34,709,066	1,578	K-12	15,579,655	1,813	8,595

Note: Towns with a small 2004 Estimated US Census (less than 8,000) were not considered for inclusion in this exhibit.

* Combined with 3 other towns

SCHOOL ENROLLMENT OCTOBER 2006

Shrewsbury Enrollment by Grade
K - 12 (excludes Pre-K and Out-of-District Pupils)

Exhibit E1

Grade (a)	Oct. 1, 2004	Oct. 1, 2005	Incr/(Decr) 05 vs. 04	Oct. 1, 2006	Incr/(Decr) 06 vs. 05	Incr/(Decr) 06 vs. 04	May 2004 Estimate for 2006 (b)	(Over)/Under Estimate
K	384	394	10	378	(16)	(6)	408	(30)
1	449	452	3	440	(12)	(9)	500	(60)
2	489	466	(23)	468	2	(21)	514	(46)
3	464	502	38	452	(50)	(12)	497	(45)
4	504	466	(38)	507	41	3	528	(21)
Total 1 - 4	1,906	1,886	(20)	1,867	(19)	(39)	2,039	(172)
5	463	502	39	462	(40)	(1)	500	(38)
6	492	461	(31)	488	27	(4)	505	(17)
7	444	486	42	449	(37)	5	482	(33)
8	441	443	2	501	58	60	512	(11)
Total 5 - 8	1,840	1,892	52	1,900	8	60	1,999	(99)
9	413	425	12	408	(17)	(5)	395	13
10	360	402	42	436	34	76	395	41
11	334	345	11	388	43	54	395	(7)
12	320	344	24	351	7	31	374	(23)
Total 9 - 12	1,427	1,516	89	1,583	67	156	1,559	24
Total K - 12	5,557	5,688	131	5,728	40	171	6,005	(277)

Notes:
(a) Current Alignment of School Buildings is Elementary School Grades 1 - 4 and Middle School Grades 5 - 8.
(b) Source: School FY05 Budget Request Revision 2 presented to Town Meeting May 17, 2004.

Understanding Property Tax

Each year **Property Taxes** make up approximately half of the revenue of our town budget. Property taxes are complex and include classifications called residential, commercial, open space, industrial and personal property. In Shrewsbury, all classifications are taxed at the same base rate of $8.66 per thousand.

Fiscal Year 2007 Tax Classification

Tax Classification	Assessed Values	Tax Levy	Tax Rate
Residential	4,549,474,405	39,398,448	8.66
Open Space	3,129,400	27,101	8.66
Commercial	366,235,728	3,171,601	8.66
Industrial	194,877,975	1,687,643	8.66
Personal Property	41,561,998	359,927	8.66
Total	**5,155,279,506**	**44,644,720**	

All cities and towns in Massachusetts are by law (Proposition 2 ½) limited in the total amount of taxes levied as well as the amount they can increase each year. The following paragraphs are a direct excerpt from the MA Department of Revenue website and are contained in a document called
“ Levy Limits: A Primer on Proposition 2 1/ 2 .”

What is a Levy?

The property tax levy is the revenue a community can raise through real and personal property taxes. We will refer to the property tax levy simply as the levy. In Massachusetts, municipal revenues to support local spending for schools, public safety and other public services are raised through the property tax levy, state aid, local receipts and other sources. The property tax levy is the largest source of revenue for most cities and towns.

What is a Levy Ceiling? What is a Levy Limit?

Proposition 2¹/2 places constraints on the amount of the levy raised by a city or town and on how much the levy can be increased from year to year.

A levy limit is a restriction on the amount of property taxes a community can levy. Proposition 2¹/2 established two types of levy limits:

First, a community cannot levy more than 2.5 percent of the total full and fair cash value of all taxable real and personal property in the community. In this primer we will refer to the full and fair cash value limit as the levy ceiling.

Second, a community’s levy is also constrained in that it can only increase by a certain amount from year to year. We will refer to the maximum amount a community can levy in a given year as the levy limit. The levy limit will always be below, or at most, equal to the levy ceiling. The levy limit may not exceed the levy ceiling.

Proposition 2¹/2 does provide communities with some flexibility. It is possible for a community to levy above its levy limit or its levy ceiling on a temporary basis, as well as to increase its levy limit on a permanent basis.

The following DOR chart shows Shrewsbury’s Levy Limit and Ceiling:

Fiscal Year 2007 Proposition 2½ Levy Capacity

New Growth	997,304
Override	0
Debt Exclusion	3,566,945
Levy Limit	44,686,208
Excess Capacity	**41,487**
Ceiling	128,881,988
Override Capacity	**87,762,725**

The last DOR report shows the revenue sources for Shrewsbury for 2007:

Fiscal Year 2007 Revenues by Source

Revenue Source		**Percent of Total**
Tax Levy	44,644,721	49.9
State Aid	23,727,465	26.5
Local Receipts	11,400,000	12.7
Other Available	9,677,482	10.8
Total	**89,449,668**	

The complete reports quoted are available from the MA DOR website. Use the following links for the complete reports:

http://www.mass.gov/Ador/docs/dls/mdmstuf/aag/aag271.doc
http://www.mass.gov/Ador/docs/dls/publ/misc/levylimits.pdf

REFERENCE

RAPPAPORT
Institute for Greater Boston
Kennedy School of Government, Harvard University

POLICY BRIEFS

PB-2005-7 | November 2, 2005

Local Services, Local Aid, and Common Challenges

***By Phineas Baxandall**, Rappaport Institute for Greater Boston*

Virtually all of Massachusetts' cities and towns face long-term financial problems. Many costs, particularly health insurance costs, are rising faster than revenues from local taxes and fees. Localities have virtually no ability to tap new sources of revenue or to significantly increase revenue from existing taxes and fees. State aid for localities dropped dramatically in recent years and since the mid 1990s, a growing proportion of local aid has been reserved for education and comes with restrictions that do not allow local governments to redirect this revenue to non-education uses.

Combined these problems create "a system of municipal finance and local aid that… is broken and needs attention," asserts John Hamill, CEO of Sovereign Bank who chaired a task force on municipal finance that issued a report on local finance last September.[1] He adds, "Massachusetts residents across the state… have a common experience with local government over the past five years: Their family's property tax bill has increased significantly, they are now paying fees for many services that used to be covered by general revenues, and, still, core local government services are being cut."[2]

The task force, which was convened by the Metropolitan Mayors Coalition, a group of ten mayors from Boston and surrounding cities, has not been alone in raising the alarm. In October, the Massachusetts Municipal Association released a study that reached many of the same conclusions. That same month, The Boston Municipal Research Bureau issued a report warning that city revenues are unlikely to rise fast enough to cover the cost of recent contracts with the unions representing many city workers, which means the city will likely have to make painful cuts in key services. A few months earlier, the Massachusetts Taxpayers Foundation released a study showing the localities' health insurance costs have been rising faster than their revenues, which has forced them to cut back in other areas. Several recent national studies, finally, suggest that contrary to popular perceptions, localities in Massachusetts have fewer workers and spend less on personnel that localities in other states and also face particularly difficult constraints in dealing with their fiscal challenges.

When Four Forces Collide

Local governments in Massachusetts are inadvertently trapped by the convergence of four major forces:

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Phineas Baxandall

Phineas Baxandall is assistant director of the Rappaport Institute for Greater Boston. He was a technical advisor to the Municipal Finance Task Force. This brief is based chiefly on the task force's September 2005 report, "Local Communities at Risk: Revisiting the Fiscal Partnership Between the Commonwealth and Cities and Towns," which is available online at http://www.mapc.org/.

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Proposition 2½, the state's landmark 1993 Education Reform Act, rising health insurance costs, and recent cuts in local aid.

Proposition 2½, which passed via a referendum in 1980, limits the total amount that localities can raise from taxes and also how fast those revenues can increase each year. The impact of the new law was initially buffered by new infusions of local aid, which on a constant-dollar, per capita basis, grew by 10.4 percent a year between 1981 and 1984 and by 8.4 percent a year from 1985 to 1989. During the sharp recession of the 1980s and early 1990s, however, real per capita local aid fell 13.3 percent a year from 1989 through 1992. As a result of these cuts, local aid which peaked in fiscal year 1988 at 20 percent of total state expenditures fell to 13.4 percent of state spending in fiscal year 1993.[3]

Local governments in Massachusetts are inadvertently trapped by the convergence of four major forces: Proposition 2½, the state's landmark 1993 Education Reform Act, rising health insurance costs, and recent cuts in local aid.

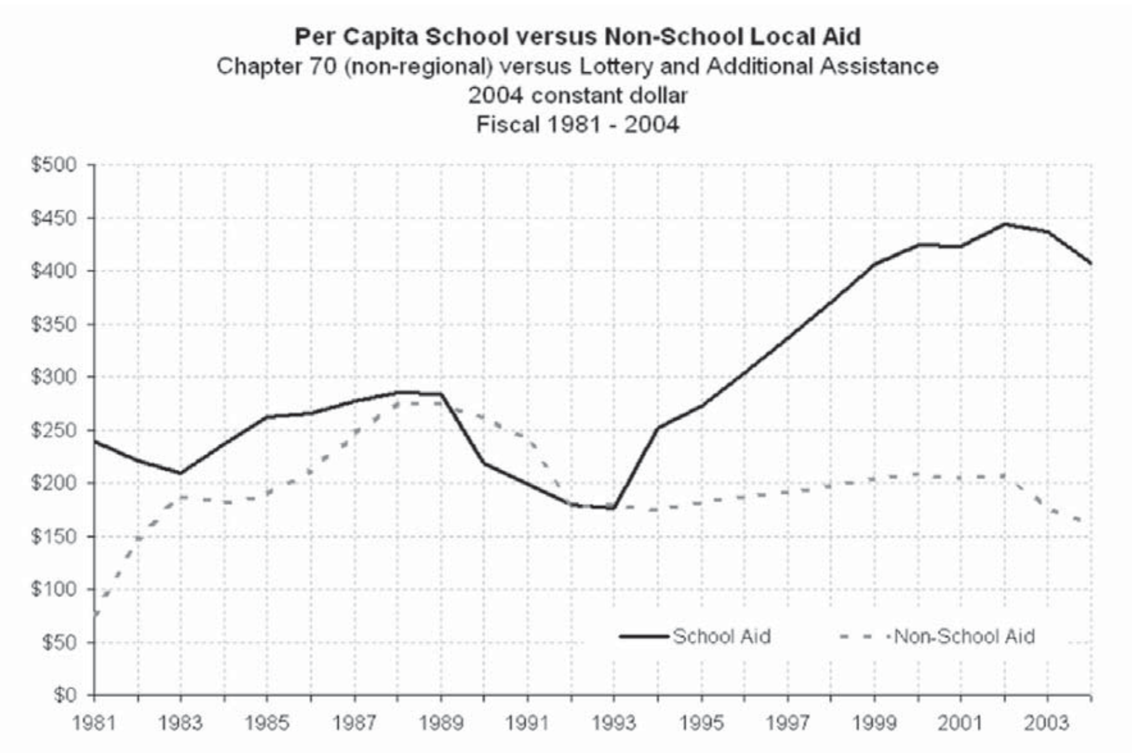
Patterns of local aid began to change dramatically in 1993 after the state's Supreme Judicial Court ruled that great disparities in funding between schools in poor communities and those in affluent ones meant that the state was not meeting its constitutional obligation to provide an adequate level of education for all students. The state's Education Reform Act of 1993, which was signed into law soon after the court's ruling, greatly increased state aid for education and revamped the formulas used to distribute that aid. Under the law, the state calculates each locality's "foundation budget"—how much each locality needs to spend to provide an adequate education for students in its schools. The state also calculates how much each locality can (and must) raise in local property taxes and, where needed, the state makes up the difference between needed spending and available funds.

As a result of that law and an improved state economy, per capita, constant-dollar state aid for K-12 education, which had increased modestly in the mid 1980s and declined sharply during the recession, increased by 8.6 percent per year until 2004. In contrast, per capita, constant-dollar state aid for the two major local-aid programs that can be used for non-educational purposes —Additional Assistance and Lottery Aid—declined during the same period of time. The state cut the former program sharply in the late 1980s recession and has reduced or level-funded it every year since. While per capita local aid from the lottery grew (after inflation) by 11.3 percent between 1981 and 1992, a maturing lottery market and legislative diversion of some proceeds into the Commonwealth's general fund has meant that such aid grew by only 3.5 percent between 1993 and 2004. (See Figure 1)

The recession of the early part of this decade along with cuts in the state income tax rate caused state revenues to plunge by 15 percent in 2002. As a result, per capita local aid including education, which had risen 5.3 percent per year in inflation-adjusted terms between 1992 and 2002, fell by 8.6 percent a year between 2002 and 2004.

The reductions in local aid came at a time when health insurance costs were rising rapidly. These increases particularly strained local governments because public services tend to be highly labor-intensive. In addition, public employees generally receive more comprehensive health benefits than the private sector workers and, because most public-

Figure 1



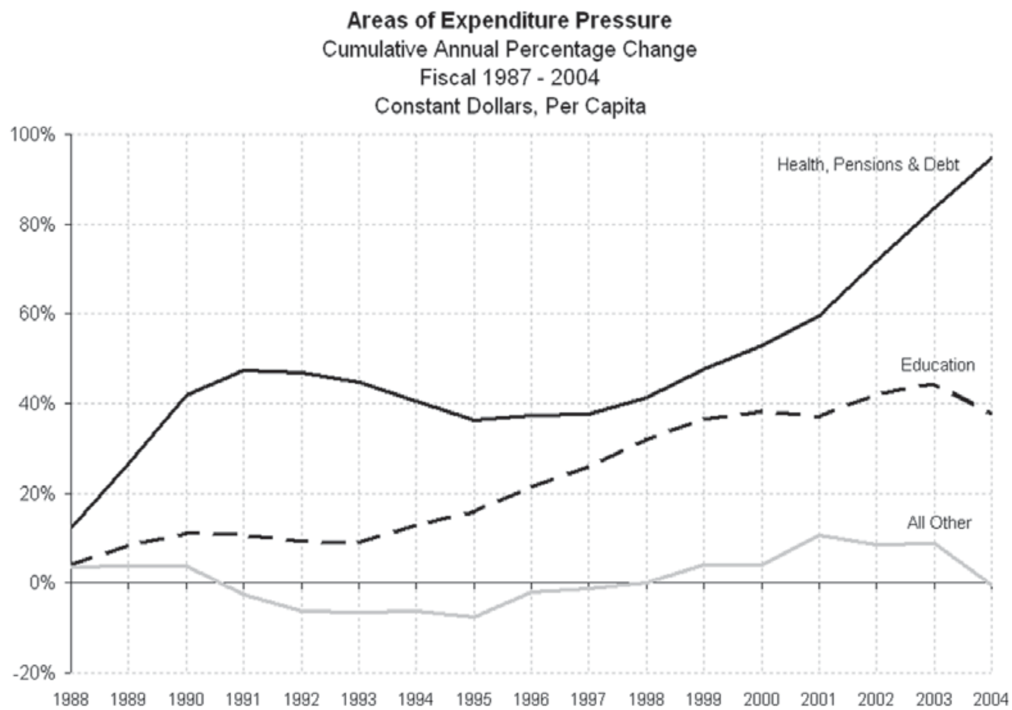
Municipal Finance Task Force report, 2005, pg. 48

sector workers are unionized, many localities cannot unilaterally force workers to pay an increasing share of health insurance costs. As a result, municipal spending for health insurance increased 63 percent between 2001 and 2005, according to a recent survey of a sample of municipalities conducted by the Massachusetts Taxpayers Foundation (MTF). The increase in health insurance costs, moreover, consumed approximately 80 percent of the 2.5 percent annual growth in taxes on existing properties allowed by under Proposition 2½. Examining separate cost data from the Department of Revenue on all 351 cities and towns in the Commonwealth, the Massachusetts Taxpayers Foundation report found an even more dire situation: increases in municipal health insurance costs on average exceeded this allowable revenue growth by an average of 8 percent a year during the same period.

In response to such pressures, many municipalities focused on new development which was exempt from Proposition 2½'s requirement that local property tax revenues not grow faster than 2.5 percent a year. Most localities that were not already at one of the limits imposed by Proposition 2½ raised property taxes and many others asked voters to approve overrides to Proposition 2½ (though voters often turned down those requests).

As a result, between fiscal years 2000 and 2005 the average yearly residential tax bill for families increased 36 percent or $910 before adjusting for inflation, according to the state Department of Revenue.[4] Moreover, in 2004 property taxes provided 53 percent of localities' total revenues, up from 46 percent in 1988, and user fees provided another 17.6 percent of revenue, up from 16.5 percent in 1988. In contrast, local aid provided only 24 percent of

Figure 2



Municipal Finance Task Force report, 2005, pg. vi.

local revenues in 2004, down from 31 percent in 1988.

Higher health insurance costs and required local spending on education have also forced localities to constrain spending on non-educational public services such as police, fire, public works, parks, public health, fire, community development, and libraries. Between 1987 and 2004 real per-capita expenditures by local governments for debt service increased by an average of 3.1 percent annually and per capita spending on other fixed costs – health insurance, pensions, unemployment, workers compensation, and other employee benefits – grew by an annual average of 2.2 percent. Similarly, per capita school spending, the largest spending item for most municipalities, increased an average of 2.1 percent per capita annually after adjusting for inflation. (See Figure 2)

In contrast, municipal expenditures for non-educational services declined 0.3 percent a year in real per capita terms. This drop, however, was far from uniform. Police and fire expenditures increased in real terms at rates that averaged 1.5 percent and 0.7 percent per capita between 1987 and 2004. Spending on public works, which includes such items as roads, waste collection, water distribution and snow removal, declined in constant-dollar, per capita terms by an average of 1.2 percent per year during this period. And per capita, constant-dollar spending on local health and welfare, which includes public health, clinics, and veterans' services, fell even more sharply, dropping by an average of 2.7 percent a year.

The underlying constraints on local budgets were particularly severe when the state cut local aid during the recent recession. Cities and towns cut their workforces by 5.2 percent between February 2002 and August 2004, eliminating 14,200 jobs, according to a report by the Massachusetts Taxpayers Foundation. Likewise, Economy.com, a Pennsylvania research firm, estimates that municipalities in Massachusetts reduced their workforces more steeply than in any other state in the nation between 2001 and 2005.

Labor Costs

Some officials contend that Massachusetts's localities create their own budget woes by hiring excessive personnel or paying workers too much. The Boston Municipal Research Bureau, a privately funded watchdog group, for example, recently warned that city revenues are highly unlikely to increase fast enough to pay the cost of the city's recent contracts with firefighters, police officers, and others, particularly because those contracts did not give city officials significant new powers to better manage Boston's workforce.

Similarly, in 2004, Eric Kriss, who stepped down as Massachusetts Secretary for Administration and Finance the following September, observed that according to the federal Bureau of Labor Statistics "public employees earn 12 percent more than private-sector employees for comparable jobs in eastern Massachusetts." He attributed the disparity to the power of public-sector unions and warned, "The hidden tax of union monopoly is so heavy that many municipalities crack under the strain."[5]

The Massachusetts Taxpayers Foundation, however, reached a different conclusion in its recent report which contended, "although some observers occasionally suggest that some municipal employment contracts have been overly generous in recent years, it seems that most have been conservative enough to produce annual average growth per employee of only 0.7 percent, in inflation-adjusted terms between 1994 and 2003, compared to 1.8 percent for private sector and 1.0 percent for state employees over the same period."[6]

Several recent studies also suggest that local government in Massachusetts generally is neither overstaffed nor overpaid—at least when compared to other governments around the country. Nick Turner and E. Matthew Quigley, two researchers at the Federal Reserve Bank of Boston, for example, recently found that in 2003 local governments in Massachusetts employed only 356 people per 100,000 residents, less than the national average of 398 employees per 10,000 residents. Combined,

Several recent studies also suggest that local government in Massachusetts generally is neither overstaffed nor overpaid—at least when compared to other governments around the country.

moreover, state and local government in Massachusetts employ 498 people for every 10,000 residents, well below the national average of 542 employees and less than any other state in New England.

Turner and Quigley also found that while salaries for state and local government workers in Massachusetts were 12 percent higher than the national average—$46,535 compared to $41,508—these generally higher wages reflect the higher living costs and private-sector salaries in New England and also mask considerable differences across groups. Correctional officers in Massachusetts, for instance, earn 30 percent more than the national average, but local public welfare employees earn 11 percent less. Turner and Quigley also found that for every $1,000 in personal income earned by Massachusetts' residents, $4.96 went to state and local payroll, compared to an average of $6.08 per $1,000 nationally. By this measure, the only category of public employees for which payroll exceeded the national average were not municipal employees but non-educational state employees – a category that also garnered the highest average salaries of any subgroup at $50,328.

Structural Reform for Structural Problems

The Municipal Finance Task Force made several recommendations designed to ensure that localities have enough money to pay for basic local services and also have the power to control costs. The task force, for example, called on the state to adopt a formal revenue-sharing policy that allocates a fixed percentage of state receipts to local aid and it urged the state to allow local governments new revenue options such as taxes on restaurant meals, parking, and car rentals. Among other recommendations, it asked the state to give localities some of the same powers the state uses to control health insurance costs, such as more flexible rules for collective bargaining and Medicare enrollment.

Each of these proposals is likely to spark intense debates and taken individually each of these debates has the potential to obscure a growing consensus on the critical larger point: serious structural problems are making it increasingly difficult for localities in Massachusetts to provide basic public services

Endnotes

1. John Hamill, Chair of Municipal Finance Task Force, quoted in Metropolitan Area Planning Council press release, September 7, 2005. Available at http://www.mapc.org/Municipal_Finance_Task_Force/Press%20Release%209.7.05.pdf.

2. John Hamill, "How state policies put communities at risk," *MetroWest Daily News*, October 30, 2005, available at http://www.metrowestdailynews.com/columnists/view.bg?articleid=112977

3. Unless otherwise indicated, all figures are from the task force's report.

4. This figure excludes eleven communities with residential tax exemptions. In such communities, the distribution of tax increases are skewed toward residents with higher property values.

Less Flexibility than in Other States

Cities and towns in Massachusetts face similar problems as municipalities in other states, but often with less ability to adapt to change. Massachusetts' localities may be particularly vulnerable to fluctuations in local aid because of their limited revenue-raising options and strict responsibility for schools. Examining 53 American cities in 2003-2004 (including Boston, Fall River and Worchester), Bruce Wallin, a professor of political science at Northeastern University, found that chief financial officers in those cities tend to report greater financial strain when – as in Massachusetts – they lack powers to levy local income or sales taxes.

Similarly, municipalities in Massachusetts wield less flexibility when courts declare existing financing arrangements unconstitutional and mandate reductions in school finance disparities. Katherine Baicker and Nora Gordon, professors of economics at Dartmouth College and the University of California, San Diego, find that "Each dollar of increased educational funding a locality received from the state resulted in an average decline in funds from the state for other purposes of about 20 cents."[7] They also found that localities tend to respond to increased education aid by reducing their own-source spending on both education and other programs. While the local aid story in Massachusetts is consistent with the patterns described by Baicker and Gordon, state laws since 1994 have made it virtually impossible for localities to reduce their own-source spending on schools.

5. Eric Kriss, "No more public-sector monopoly," *Commonwealth Magazine*, Summer 2004, available at http://www.massinc.org/fileadmin/CommonWealth/Summer_2004/cw_summer_2004.pdf

6. Massachusetts Taxpayers Foundation, 2005, p. 13.

7. Baicker and Gordon, 2004, p. 26. More precisely, for each dollar of increased state education aid, total state aid to localities rises by only 78 cents.

Further Reading

"The Effect of Mandated State Education Spending on Total Local Resources,"
by Katherine Baicker and Nora Gordon, *National Bureau of Economic Research Working Paper 10701*, August 2004, available at http://www.nber.org/papers/w10701

"Mounting Personnel Costs Threaten Boston's Competitive Edge,"
by the Boston Municipal Research Bureau, October 2005, available at http://www.bmrb.org/content/upload/Trends2005A.pdf

"Revenue Sharing and the Future of our Massachusetts Economy,"
by Barry Bluestone, Alan Clayton-Matthews, and David Soule, PowerPoint presented on October 18, 2005 at the Massachusetts Municipal Association Statewide Economic Forum and available at http://www.mma.org/news/news_files/local_finance_news/revenue_sharing_rpt.pdf . The full report will be released in January, 2006.

"Local Communities at Risk: Revisiting the Fiscal Partnership Between the Commonwealth and Cities and Towns,"
by the Municipal Finance Task Force, September 2005, available at http://www.mapc.org/

"A Mounting Crisis for Local Budgets: The Crippling Effects of Soaring Municipal Health Costs,"
by the Massachusetts Taxpayers Foundation, July 2005, available at http://www.mma.org/policies_positions/press_releases/MTFhealthfinal.pdf

"The Comparative Cost of Labor in Massachusetts and the Boston Metropolitan Area: Another Look at the Empirical Evidence,"
by Andrew Sum, Ishwar Khatiwada, Joseph McLaughlin, et. al., Center for Labor Market Studies, Northeastern University, prepared for The Commonwealth Corporation (May 2005).

"Do New England State and Local Governments Have Too Many Employees, and Are They Overpaid?"
by Nick Turner and E. Matt Quigley, *Fiscal Facts*, New England Public Policy Institute at the Federal Reserve Bank of Boston, Summer 2005, available at http://www.bos.frb.org/economic/neff/neff34/neff34.pdf

"Budgeting for Basics: The Changing Landscape of City Finances,"
by Bruce A. Wallin, Brookings Institution Metropolitan Policy Program Discussion Paper, August 2005, available at http://www.brookings.edu/metro/pubs/20050823_budgetingbasics.htm

PREVIOUS RAPPAPORT INSTITUTE POLICY BRIEFS

PB-2004-1, October 2004
"Can Social Capital Last: Lessons from Boston's Villa Victoria Housing Complex,"
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by Phineas Baxandall (Rappaport Institute for Greater Boston) and Bruce Sacerdote (Dartmouth College)

PB-2005-2, February 2005
"Needed Corrections: Promising Strategies for Improving Massachusetts' Prisons and Jails,"
by Anne Morrison Piehl (Kennedy School of Government)

PB-2005-3, March 2005
"Standards-Based Education Reform in the Computer Age: Lessons from Boston's Murphy School,"
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"Smart Growth: Education, Skilled Workers, and the Future of Cold-Weather Cities,"
by Edward L. Glaeser (Harvard University)

PB-2005-5, September 2005
"Creating an Effective Foundation to Prevent Youth Violence: Lessons Learned from Boston in the 1990s,"
by Anthony A. Braga (Kennedy School of Government) and Christopher Winship (Faculty of Arts and Sciences and Kennedy School of Government, Harvard University)

PB-2005-6, October 2005
"Local Services, Local Aid and Common Challenges: Can American Police Get a Grip on Their New, 'Less Lethal' Weapons Before They Kill Again?"
by Christopher Stone (Kennedy School of Government), Brian Buchner and Scott Dash (Police Assessment Resource Center)

PB-2005-7, November 2005
"Local Services, Local Aid and Common Challenges"
by Phineas Baxandall (Rappaport Institute for Greater Boston)

UPCOMING EVENTS IN THE BOSTON 101 SPEAKER SERIES

Funding Local Government: Revisiting the Fiscal Partnership
Wednesday, November 2, 5:00 p.m.
Bell Hall, 5th floor Belfer Building

John Hamill, Chairman and CEO, Sovereign Bank of New England and chair of the Municipal Finance Task Force
Representative Rachel Kaprielian, Massachusetts House of Representatives and Co-chair of the Joint Committee on Municipalities and Regional Government
Linda Bilmes, Lecturer in Public Policy, Kennedy School of Government; former Chief Financial Officer and Assistant Secretary for Management and Budget at the U.S, Department of Commerce

Sprawl in Overdrive: Hurdles to Smart Growth
Wednesday, November 9, Noon
Room 301, 3rd floor of the Taubman Building

Anthony Flint, Smart Growth Education Director at the Office for Commonwealth Development, former reporter for *The Boston Globe*
Alan Altshuler, Dean of Harvard's Graduate School of Design

Racial and Ethnic Disparities in Violence
Monday, November 21, 5:00 p.m.
Bell Hall, 5th floor Belfer Building

Robert J. Sampson, Harvard University
Larry Mayes, Chief of Human Services, City of Boston

The Effects of New Rail Transit: Lessons from Boston
Wednesday, December 7, 12:00 noon
Malkin Penthouse, 4th floor Littauer Building

Matthew Kahn, Tufts University
Nate Baum Snow, Brown University
James Kostaras, City of Somerville and Harvard's Graduate School of Design

More information on events can be found at the Rappaport Institute website at http://www.rappaportinstitute.org.

The Long-Term Mismatch Between Available Resources and Important State Priorities

A Five-Year Fiscal Analysis

SEPTEMBER 2006

The Massachusetts Taxpayers Foundation is a nationally recognized, nonprofit research organization working to promote the most effective use of tax dollars, improve the operations of state and local governments, and foster positive economic policies. Our credibility is based on independent, objective, and accurate analysis of state and local spending, taxes and the economy. The quality and impact of the Foundation's work is reflected in ten prestigious national awards earned over the past decade for research on business costs, capital spending, state finances, MBTA restructuring, state government reform, and health care.

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The Long-Term Mismatch Between Available Resources and Important State Priorities: A Five-Year Fiscal Analysis

Table of Contents

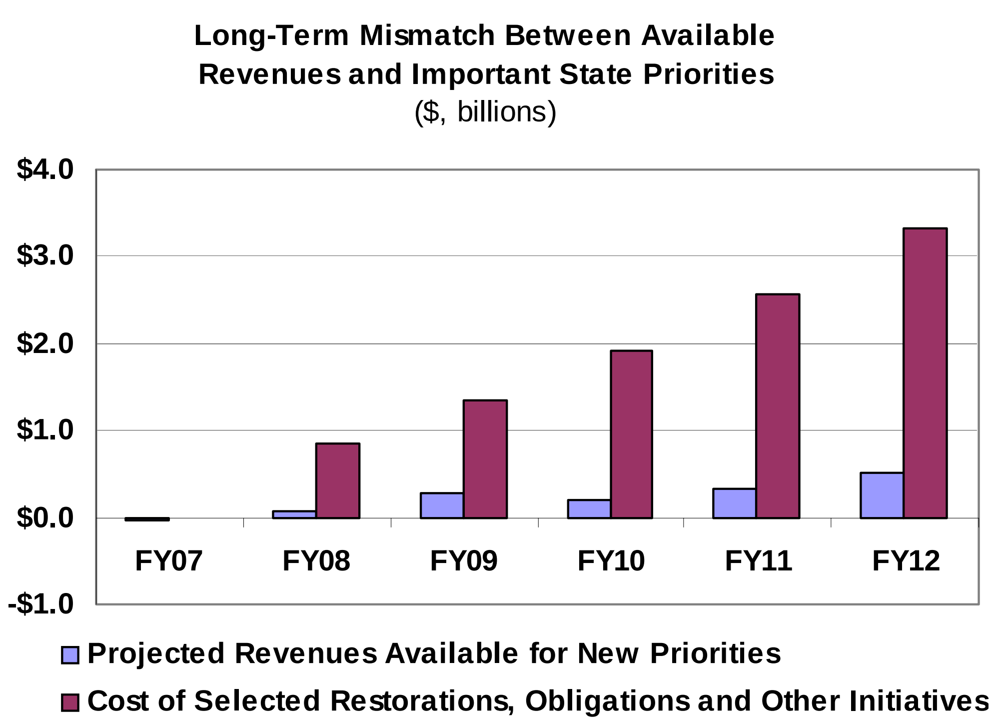
Introduction

Despite the better-than-expected revenue performance in fiscal 2006, the state's leaders will soon have to grapple with a large and rapidly growing disparity between available resources and the costs of a broad array of important priorities. Dealing with this challenge is likely to dominate the financial decision making of the next Governor and Legislature for the foreseeable future.

The mismatch between expected revenues – and the costs of widely held goals such as greater local aid, additional spending for higher education, and increased capital investment – is staggering. Even with careful targeting on only those priorities of greatest importance for the long-term health of the Massachusetts economy, their costs are likely to exceed available resources by billions of dollars, according to a detailed analysis of the state's financial outlook over the next five years (see Figure 1). And contrary to the common belief that the Commonwealth can finance its unmet needs through economic growth, addressing any substantial portion of these spending ambitions would push the state budget deeply into deficit under any reasonable set of assumptions about future tax receipts and spending growth.

The situation is further complicated by proposals to cut the income tax rate from 5.3 to 5.0 percent, with an annual revenue impact of almost $700 million. The more accelerated the tax cut, the greater the impact on funding for various spending priorities, including providing relief to hard-pressed local property taxpayers via the

Figure 1



Foundation's recommendation to dedicate 40 percent of tax revenues to cities and towns.[1]

The Foundation's comprehensive new analysis examines the potential impact on the state budget through fiscal 2012 of a tightly focused list of initiatives that MTF believes are crucial to the state's long-term economic competitiveness.

The initiatives – a selected set of restorations, obligations and priorities – include rebuilding the financial capacity of cities and towns through the Foundation's proposal to dedicate 40 percent of tax revenues to local aid, restoring and increasing the state's investment in public higher education, maintaining and expanding the capital infrastructure, and preserving the Commonwealth's credit-worthiness by addressing the looming unfunded liability for the medical costs of state retirees (see Table 1).

Table 1

Selected Restorations, Obligations and Priorities Considered in the Analysis

Restorations Highlighted by MTF

- "40%" local aid proposal
- Additional funding for higher education
- Raising the capital spending cap

Other Spending Priorities

- Pay-as-you-go capital spending
- Routine infrastructure maintenance and repair
- Partial restoration of prior agency spending cuts

Looming Obligations

- Unfunded liability for medical costs of state retirees

In estimating the budgetary resources that are likely to be available to address these priorities, the Foundation prepared a baseline projection for fiscal 2008-2012 that uses reasonable assumptions about future revenue growth and the expectation of very tight annual budgeting. The analysis is predicated on annual tax growth of just over six percent, reflecting the long-term average rate of real growth of the Massachusetts economy and inflation of three percent a year. It assumes spending growth that is limited to largely unavoidable increases in areas such as Medicaid, pensions, and debt service, the costs of existing commitments such as school construction, and inflation in other state programs.[2]

Using these assumptions, the analysis projects a tiny budgetary surplus of only $62 million, or 0.2 percent of total revenues, in 2008; that figure would rise to about $500 million, or 1.4 percent of revenues, in 2012. However, achieving these surpluses would be possible only by adhering to strict maintenance budgeting, with no expansion in areas such as local aid, higher education, and human services beyond the rate of inflation, and no further restorations of the deep spending cuts during the fiscal crisis. Although those cuts undoubtedly eliminated some unnecessary spending, their magnitude – 2007 spending in these areas remains 15 percent below 2001 after adjusting for inflation – required significant reductions in services across state government.

Even under the favorable assumptions of the baseline projection – healthy revenue growth and sustained budgetary discipline –

[1] Under existing law, the 5.3 percent income tax rate will decline to 5.0 percent over an eight-year period if revenues remain strong.

[2] The analysis assumes an annual inflation rate of 3.0 percent for both revenues and spending.

the costs of the new priorities considered in the analysis would still far exceed available revenues. Taken in combination, the selected initiatives would require additional annual spending of $840 million in 2008 and rising to $3.3 billion in 2012, or more than six times the projected $500 million surplus in 2012.

While the new Governor and Legislature could well choose a different list of priorities than the ones considered here – including, for example, other large-scale initiatives such as greatly expanding early childhood education at a cost of up to $1 billion annually – they would still confront the same problem: a lack of sufficient resources to finance the additional spending.

And although the set of priorities to be considered could be trimmed, the major finding of the analysis – a huge disparity between the costs of new initiatives that could be undertaken and the state's ability to manage those costs – would remain essentially unchanged. Even if the priorities to be pursued, and their costs, were reduced by half, the state budget would still be unable to accommodate the required new spending.

The Foundation's analysis, if anything, overstates the state's capacity to take on new priorities. Far from a worst-case scenario, the baseline projection assumes that revenues will grow at the healthy rate of 6.2 percent a year over the next five years, without an evaporation of the capital gains and other volatile tax receipts that have supported the recent rapid growth in revenues, and without a recession. It also assumes that spending for current services and commitments will be held tightly in check, with the kind of fiscal discipline the state has rarely been able to sustain.

At the same time, the analysis makes no provision for cuts in the income tax beyond those that are already authorized in law, which include a restoration of personal exemptions to their 2002 levels and the gradual reduction of the income tax to 5.0 percent if revenue performance remains healthy. Nor does it add to the state's stabilization fund beyond the 0.5 percent of tax revenues that is required to be contributed annually under current law.

Although it is conceivable that the state's revenues could perform better for the next year or two than the roughly six percent rate of growth assumed in the analysis, the additional revenues would make only a small dent in the gap identified in the

Table 2
Fiscal 2006 and 2007 Finances
($, millions)

	FY06	FY07
Revenues		
Taxes (using consensus forecast for FY07)	$17,286	$17,604
Other revenues	9,052	9,555
Total	26,338	27,159
Estimated spending	25,951	27,722
Revenue minus estimated spending	387	-563
FY07 spending financed from prior year surplus revenues (not included in the 2007 spending total shown above)		805
End-of-year stabilization reserves, including impact of projected FY07 operating deficit	1,939	1,500

Note: The figures presented here are based upon administration estimates published in the August 17, 2006 Official Statement of the Commonwealth, adjusted to include certain off-budget spending, primarily for Medicaid costs, and the revenues supporting that spending. Tax revenues exclude sales taxes dedicated to the MBTA and School Building Authority, which total $1.2 billion in fiscal 2006 and $1.29 billion in fiscal 2007. FY07 spending does not include $200 million of bond-funded expenditures that were authorized at the end of fiscal 2006 for use in FY07 and future years. Fiscal 2006 stabilization reserves include $305 million of balances in the Transitional Escrow Fund which are reported separately in the Official Statement. The FY07 stabilization balance of $1.5 billion assumes a transfer from the stabilization fund to the General Fund to offset the projected $563 million operating deficit; this withdrawal would require legislative authorization.

analysis. However, that performance is unlikely, with employment that remains almost 150,000 below the pre-recession peak, a national economy that is starting to slow, and the heavy reliance on volatile capital gains and corporate receipts to achieve the well-above-average rate of revenue growth in 2006.

It is possible as well that a portion of the spending growth for some existing state programs that has been assumed in the analysis will not be necessary, but any such savings are almost certain to be offset by unforeseen requirements in other programs.

Dealing with this challenging fiscal outlook will be even more difficult given the buoyant atmosphere that marked the close of fiscal 2006. With baseline revenue growth topping nine percent[3] and an estimated surplus approaching $400 million, fiscal 2006 ended in a wave of last-minute authorizations that added almost $1 billion to the budget, almost all of which will carry forward for expenditure in 2007, including $200 million that will be financed through long-term borrowing (see Table 2).[4] These additional appropriations completely used up the 2006 surplus and required dipping into 2006 reserves as well. Despite public claims, there was no $1 billion surplus in 2006, and the much smaller actual surplus has already been spent.

Both those who are pressing for major expansions in spending and those who are advocating for a more rapid reduction in the income tax rate will have to come to grips with the far less positive fiscal reality that lies ahead.

That reality begins with a fiscal 2007 budget that is not even in structural balance. Using the consensus revenue forecast (which appears conservative given the 2006 performance), the 2007 budget is more than $500 million out of balance.[5] Attaining balance will require revenue growth slightly greater than the 6.2 percent assumed in our analysis, and almost two percentage points greater than the underlying rate of growth assumed in the consensus forecast on which the 2007 budget was built. While the 6.2 percent rate of growth may be achievable, it is by no means certain.

The detailed results of the Foundation's analysis are presented in the following sections of the report, including the assumptions on which it is built, the year-by-year projections of revenues and spending used in the baseline analysis, and the annual costs of the selected restorations, obligations and initiatives considered in the analysis.

[3] The growth in baseline tax revenues (before law changes) was 9.1 percent in 2006, according to the Department of Revenue; actual collections rose by 8.2 percent.

[4] Approximately two-thirds of the additional authorizations are for one-time purposes.

[5] In the absence of stronger revenue growth, the 2007 authorized spending (excluding prior appropriations carried forward from 2006) that is in excess of the consensus revenue forecast will have to be financed from reserves.

Five-Year Analysis

The Foundation built its analysis on three elements that are critical to assessing the fiscal capacity of the Commonwealth over the next five years:

1. The revenues that will be available to meet future needs.
2. The costs of maintaining the state's current budgetary commitments and obligations.
3. The future financial impact of addressing new priorities and initiatives that already command widespread support.

Revenues

The Foundation's baseline analysis assumes that over the next five years state tax revenues will grow by 6.2 percent a year, before adjusting for already authorized tax cuts (see Table 3). While this rate of growth is substantially less than the 9.1 percent baseline increase in fiscal 2006, it reflects the historical performance of the state's economy, as measured by the average annual growth in total personal income.

In several respects, the 6.2 percent growth assumption is optimistic, at least over the five-year time horizon of the analysis. It does not take into account the potential evaporation of the recent surge in volatile revenue sources such as capital gains and corporate profits, or the possibility of an economic recession. As the Commissioner of Revenue noted in announcing final tax receipts for fiscal 2006, these two sources

Table 3
Five-Year Baseline Budget Analysis
(Before Selected Spending Restorations, Obligations and Priorities)
($, millions)

	FY07	FY08	FY09	FY10	FY11	FY12
Revenues						
Taxes						
Baseline taxes at 6.2% growth*	$19,633	$20,850	$22,143	$23,516	$24,974	$26,522
Increase personal exemption	-60	-120	-120	-120	-120	-120
Triggered income tax cut to 5%	0	0	-51	-191	-331	-494
Other authorized tax cuts	-46	-77	-57	-57	-57	-57
Total taxes	19,528	20,653	21,915	23,148	24,466	25,851
Non-tax revenues						
Lottery at 3% growth	920	948	976	1,005	1,035	1,067
All other excluding Medicaid (0%-1%)	4,194	4,214	4,234	4,254	4,275	4,295
Total revenues	$24,642	$25,815	$27,125	$28,407	$29,776	$31,213

* Tax revenues shown include income taxes dedicated to pension costs and sales taxes dedicated to the MBTA and School Building Authority.

Table 3 - Continued
Five-Year Baseline Budget Analysis
(Before Selected Spending Restorations, Obligations and Priorities)
($, millions)

	FY07	FY08	FY09	FY10	FY11	FY12
Spending						
Health care at 7% growth						
Medicaid net of federal reimbursements	$3,750	$4,013	$4,293	$4,594	$4,915	$5,260
Employee health costs	1,064	1,138	1,218	1,303	1,394	1,492
Senior pharmacy (not incl. in Medicaid)	64	68	73	78	83	89
Health reform (7% growth beyond FY10)	200	200	200	400	428	458
Uncompensated care	290	200	200	200	200	200
Total health care	5,367	5,618	5,984	6,575	7,021	7,498
Local aid						
Chapter 70 at 3% growth	3,506	3,611	3,719	3,831	3,945	4,064
Lottery at 3% growth	920	948	976	1,005	1,035	1,067
Additional assistance	380	380	380	380	380	380
Other local aid at 3% growth	789	812	837	862	888	914
Total local aid	5,594	5,750	5,911	6,077	6,248	6,424
Other major commitments						
Pensions	1,358	1,419	1,483	1,550	1,619	1,692
Debt service - $1.25 billion spending cap	1,987	2,066	2,149	2,235	2,325	2,417
MBTA sales tax at 6.2% growth	734	780	828	879	934	992
School Building Authority phase-in	557	770	866	971	1,086	1,153
Total other major commitments	4,636	5,036	5,326	5,635	5,963	6,254
All other programs at 3% growth	8,975	9,245	9,522	9,808	10,102	10,405
Required stabilization fund deposit	98	103	110	116	122	129
Total spending and stabilization deposit	24,670	25,752	26,853	28,211	29,457	30,711
Revenue minus spending and stabilization deposit	-$29	$62	$272	$197	$319	$502

Note: Totals may not add exactly due to rounding.

led the growth in revenues in 2006.[6]

Revenue collections from these sources are notoriously volatile, responding in the case of corporate profits to national trends that are closely tied to the business cycle, and in the case of capital gains and other investment-related income to the often sharp fluctuations in national and worldwide capital markets. In 2002, the headlong plunge in tax collections was attributable in large part to the collapse of the stock market. And while economists cannot predict with any certainty when the next downturn will come, the possibility of a recession, perhaps a severe one, is very real over the next five years.

Fiscal 2007 revenue performance further highlights the risks in the 6.2 percent growth assumption. Tax receipts in July and August fell short of the benchmark for the consensus forecast (which is approximately $600 million lower than the 2007 revenues assumed in the baseline analysis). Although

[6] The 6.2 percent rate of growth is also assumed for fiscal 2007, producing a revenue figure that is $598 million higher than the conservative consensus forecast upon which the 2007 budget was built.

collections in these two months account for a relatively small share of the annual total, the weak performance so far is an inauspicious start for a year in which the consensus forecast must be exceeded by more than one-half billion dollars in order to achieve structural balance in the budget.

Current Budgetary Commitments

In calculating the costs of the state's existing programs and commitments over the next five years, the Foundation assumed a "bare bones" approach to budgeting that provides only the minimum amounts needed to sustain current services and obligations and to honor commitments that have already been made. This approach makes no provision for the costs of restoring prior spending cuts in local aid, higher education, and other areas or taking on new initiatives and obligations. The analysis includes the following major assumptions about future spending requirements (see Table 3 on page 6):

- Growth in health care spending of 7.0 percent a year, including the costs of Medicaid (net of federal reimbursements), employee health benefits, and the senior pharmacy program.

- Carrying forward the $200 million funding of health care reform in 2007 to 2008 and 2009, with an additional $200 million in 2010.

- Growth in Chapter 70 aid of 3.0 percent a year – the rate of inflation assumed in the analysis – in order to meet the state's obligation to assure an adequate level of school spending in poorer school districts. This rate of increase assumes the foundation budget as currently defined, with no legislative adjustments or expansions.

- Annual lottery aid growth of 3.0 percent a year; and level-funding of additional assistance.

- Increases in annual pension contributions that are consistent with the most recently approved pension funding schedule, which provides for growth of about 4.5 percent a year.

- Projected increases of about 4.0 percent a year in the costs of debt service, assuming that annual bond-funded capital spending is held within the current $1.25 billion cap.

- Growth in sales-tax-funded contributions to the MBTA at the assumed rate of overall tax growth.

- Phasing in of sales-tax-funded contributions to the School Building Authority over seven years ending in fiscal 2011, as provided in the Authority's enabling legislation.

- Spending growth for all other state programs at the assumed inflation rate of 3.0 percent a year, resulting in level funding of these programs in inflation-adjusted dollars.

- Annual contributions to the stabilization fund at the statutorily required amount of 0.5 percent of total tax revenues.

As previously noted, the overall spending totals in the analysis make no accommodation for reversing prior spending cuts beyond the restorations already implemented in recent budgets, or for any initiatives beyond those already enacted. Under the analysis, total spending[7] would grow by an average of 4.5 percent a year over the next five years, well below the

[7] Excluding federally reimbursed Medicaid spending.

Table 4
Selected Restorations, Obligations and Priorities
(Increase over 2006 in millions of dollars)

	FY07	FY08	FY09	FY10	FY11	FY12
Priorities highlighted by the Foundation						
"40%" local aid proposal (10-yr. phase-in)	$0	$159	$369	$632	$956	$1,340
Additional higher education funding	0	59	120	184	251	325
Increase in capital spending cap to $1.5 billion	0	13	42	75	113	157
Other spending priorities						
Restoration of 50% of prior cuts over 5 years	0	131	270	417	573	738
Pay-as-you-go capital spending (5-yr. phase-in)	0	50	103	159	219	281
Routine capital maintenance and repair	0	50	52	53	55	56
Looming obligations						
Unfunded medical costs of state retirees	0	378	391	401	408	415
Total	$0	$841	$1,347	$1,921	$2,575	$3,313

roughly seven percent growth in the 2007 budget and also less than the approximately five percent rate of annual increase that the administration has set as an informal guideline for prudent budgeting.

Even with this tight budgeting, the state would have very little room for program restorations or new priorities. Based on the bottom-line results of the analysis, in 2012 the revenues available for new initiatives would total $500 million, a modest amount in the context of the overall budget and in relation to the potential new funding needs.

Selected Restorations, Obligations and Priorities

The third element of the analysis is the broad array of new priorities, commitments and obligations that are now being considered or that address long-recognized needs. We have not attempted to identify a comprehensive roster of potential future initiatives, but instead have concentrated the analysis on a short list of priorities that the Foundation considers crucial to the long-term health of the state economy and on obligations that are so pressing that they cannot be ignored.

The initiatives included in the analysis fall into three broad categories (see Table 4):

- Major priorities that the Foundation has highlighted over the last 12 months.
- Other expansions that would help strengthen the state's competitiveness.
- Looming obligations that will be difficult, if not impossible, to avoid.

Table 5
Mismatch Between Projected Surplus Revenues and Selected Restorations, Obligations and Priorities
($, millions)

	FY07	FY08	FY09	FY10	FY11	FY12
Projected surplus revenues	-$29	$62	$272	$197	$319	$502
Selected restorations, obligations and priorities						
Priorities highlighted by the Foundation	0	232	531	891	1,320	1,822
Other spending priorities	0	231	425	629	846	1,076
Looming obligations	0	378	391	401	408	415
Total	0	841	1,347	1,921	2,575	3,313
Projected surplus revenues minus priorities and obligations	-$29	-$779	-$1,075	-$1,724	-$2,256	-$2,811

Priorities Previously Highlighted by the Foundation Three proposals supported by the Foundation have been considered in the analysis.

- *Dedicating 40 percent of income, sales, and corporate taxes to the state's major local aid accounts*. This MTF proposal would restore the deep cuts in aid during the state's fiscal crisis and expand future aid for our cash-strapped municipalities. Cities and towns face a long-term financial crunch due to dependence on uncertain state aid, rapidly rising costs, particularly for employee health care, and limited ability to raise revenues. The proposal would give local taxpayers much needed relief, while providing local officials with a degree of certainty about the ongoing share of state resources on which they can rely.

  The analysis assumes that the 40 percent goal would be phased in over ten years, with the first five years of the phase-in during 2008-2012.[8] At this pace of implementation, the plan would require an additional $160 million in 2008.[9] Due to the combined effect of the phase-in schedule and the assumed growth in annual tax revenues, this figure would rise to $1.3 billion in 2012.

- *Restoring the state's financial commitment to public higher education* along the lines proposed by the Joint Committee on Higher Education. In the Foundation's view, reversing the deep cuts in state support for higher education during the fiscal crisis is crucial to preparing our future workforce. Despite recent increases, 2007 funding for UMass and the state and community colleges remains almost one-third below 2001 levels after adjusting for inflation.

  The Committee's plan combines the additional funding with affordability safeguards for students and parents, a system to ensure that the new dollars are

[8] Under the Foundation's proposal, an amount equal to 40 percent of the actual income, corporate, and sales taxes in the calendar year preceding the beginning of the fiscal year would be made available to fund that year's Chapter 70 school aid, lottery, and additional assistance. The comparable figure for fiscal 2007 is 32 percent (2007 aid divided by calendar year 2005 tax collections).

[9] The additional dollars would come on top of the inflationary increases in the three main local aid accounts that have been assumed in the baseline projection (approximately $130 million in 2008).

distributed among campuses based on educational need, and governance reforms.

Based on MTF's estimates, this proposal would require approximately $60 million of additional appropriations in 2008, increasing gradually to about $325 million in 2012.

- *Raising the cap on bond-funded capital spending* from its current level of $1.25 billion to $1.5 billion in 2008, an amount that reflects the inflation in construction costs for state and local government since 2002, with additional annual adjustments in the cap in 2009 and beyond to keep up with inflation. The Foundation estimates that this action would require average increases in debt service of $30-$40 million a year over the next five years.

Other Spending Priorities The priorities emphasized by the Foundation represent only a small portion of the numerous initiatives and expansions which been identified since the state emerged from the recent fiscal crisis. We have not attempted to determine the potential fiscal impacts of a comprehensive list of these other spending priorities, but instead focused on a small number of potential program restorations and expansions, including additional capital investments.

- *Restoring a portion of the prior cuts in human service, environmental, and other programs.* The analysis assumes that half of these cuts would be restored over the next five years, requiring $130 million of additional spending in 2008 (beyond the three percent inflationary increase that is built into the analysis), rising to roughly $750 million in 2012.

- *Pay-as-you-go capital spending* Given the Commonwealth's enormous capital needs, it makes sense to use operating revenues as well as to raise the bond cap to help meet those needs. The analysis assumes that the additional pay-as-you-go capital expenditures would be phased in over five years beginning in fiscal 2008, reaching a total of $250 million a year (before adjusting for inflation) in 2012.

  Over the next ten years, the measure would support $2.4 billion of additional investments outside the capital spending cap. Although a substantial sum, this amount falls woefully short of the many billions of dollars more that are needed to proceed with capital projects that cannot be accommodated within the cap or that are not yet authorized.

- *Capital maintenance.* Providing $50 million a year for annual upkeep and repair would make at least a small dent in the large accumulation of deferred maintenance needs for state bridges, parks, campuses and other facilities.

Looming Obligations While the baseline analysis includes contractually or legally required costs, such as debt service payments to buyers of state bonds and refunds to taxpayers under the *Peterson* case, the state faces another major obligation that will soon have to be addressed:

- *The large unfunded liability for the future medical costs of state retirees*. These costs are now funded on a pay-as-you-go basis. In the recent actuarial valuation prepared for the state comptroller, the unfunded liability for these medical benefits was estimated at $7.6 billion (assuming that the state pays down the liability using the approach that was adopted for erasing the unfunded pension liability).

> According to the valuation, if the state immediately adopted a funding schedule to eliminate the liability over 30 years, an additional $378 million would need to be appropriated in 2008. By 2012, the necessary funding would rise to $415 million, a figure that would continue to grow in subsequent years.
>
> Although the Commonwealth may be able to put off addressing this obligation for a year or two, it will eventually have to be dealt with in order to protect the state's credit rating. However, the longer the delay, the larger the accumulated liability that will have to be funded.
>
> Cities and towns will likewise face major unfunded liabilities for the medical costs of municipal retirees – the costs of which are not included in this analysis. In the absence of additional state assistance, such as that provided by MTF's "40 percent" aid proposal, these costs will inevitably have to be borne by local residents in the form of higher property taxes, reduced services, or both.

In combination, these three sets of initiatives – Foundation recommendations, other spending priorities, and the looming retiree medical obligation – would require an estimated $840 million of additional resources in 2008, increasing to $3.3 billion in 2012. These costs dwarf the surpluses projected in the baseline analysis, which range from $62 million in 2008 to $500 million in 2012.

This enormous mismatch does not take into account proposals to cut the income tax rate to 5.0 percent more rapidly than authorized in current law. While accelerating the tax cut would have only a modest impact in the final years of the analysis, over the short term it would even further limit the state's ability to take on new initiatives.

Far from exaggerating the disparity between resources and need, the Foundation's analysis, if anything, understates the financial challenges that lie ahead. On the revenue side, our assumption of 6.2 percent annual revenue growth does not account for an economic recession or for the loss of capital gains receipts that would result from a substantial downturn in the stock market. According to the analysis, the evaporation of the capital gains "bonus" that has pushed up receipts over the last two years would wipe out the projected surpluses under the "bare-bones" budgeting assumed in the analysis, throwing the state's finances into the red before addressing any of the priorities we have identified (see Table 6).[10] A recession would result in even larger deficits, requiring cuts in existing programs and precluding any consideration of restorations or expansions.

At the same time, a more optimistic revenue outlook would do little to change the overall picture. As Table 6 shows, even under the highly unrealistic assumption that baseline tax revenues continue to grow for another two years at the rapid 9.1 percent pace of 2006, the resulting strong surpluses – ranging from $1.2 billion in 2008 to $1.9 billion in 2012 – would still be insufficient to accommodate the initiatives we have considered.

Each of these alternative revenue scenarios assumes that the tight rein on spending growth built into the analysis can actually be achieved. The baseline projection – a rate of spending growth of 4.5 percent a year on

[10] The use of a more conservative revenue assumption along the lines considered prudent by the administration would result in greater deficits still. Assuming 5.0 percent, rather than 6.2 percent, annual growth in tax revenues over the next five years would produce deficits ranging from more than $300 million in fiscal 2008 to almost $600 million in 2012 – before accounting for the costs of initiatives.

Table 6
Analysis Using Alternative Revenue Assumptions
($, millions)

	FY07	FY08	FY09	FY10	FY11	FY12
Revenue growth at long-term average						
Assumed rate of tax revenue growth	6.2%	6.2%	6.2%	6.2%	6.2%	6.2%
Revenue minus Table 3 spending	-29	62	272	197	319	502
Revenue minus Table 3 spending minus Table 4 restorations, obligations, and priorities	-29	-779	-1,075	-1,724	-2,256	-2,811
Strong revenue performance through FY08						
Assumed rate of tax revenue growth	9.1%	9.1%	6.2%	6.2%	6.2%	6.2%
Revenue minus Table 3 spending	505	1,168	1,443	1,431	1,621	1,877
Revenue minus Table 3 spending minus Table 4 restorations, obligations, and priorities	505	327	96	-490	-954	-1,436
Evaporation of capital gains "surprise"						
Assumed rate of tax revenue growth	3.1%	6.2%	6.2%	6.2%	6.2%	6.2%
Revenue minus Table 3 spending	-599	-484	-370	-481	-397	-254
Revenue minus Table 3 spending minus Table 4 restorations, obligations, and priorities	-599	-1,325	-1,717	-2,402	-2,972	-3,567

average – would require that much of state government be level-funded (after taking inflation into account) for the next five years, while making no provision for further restoration of previous spending cuts or for any significant expansions. This kind of spending discipline has rarely been sustained over any significant period of time – and then only in response to fiscal crisis, not in years of healthy revenue growth.

Although it is certainly possible to scale back the selected priorities and initiatives – by setting less ambitious goals or by implementing the initiatives at an even slower pace than we have assumed – the basic conclusions of the analysis again would remain essentially unchanged.

For example, if the pace of implementation of the Foundation's 40 percent local aid plan were stretched out from the ten years assumed in the analysis to an untenably long twenty years, the costs of that initiative in 2012 would still consume essentially all of the projected available revenues for that year, before addressing any of the other priorities. Even if the scope of all of the priorities were reduced by half, the amounts needed to finance them would exceed available resources by more than $1 billion.

Conclusion

Considering the Foundation's analysis as a whole, it is clear that the state's fiscal leaders, both current and future, will face enormous challenges through the end of the decade. On the one hand, the analysis demonstrates that the Commonwealth will have sufficient resources to meet its current obligations and commitments – but *only* if it maintains the kind of fiscal discipline that enabled the state to weather successfully the recent fiscal crisis. It is equally clear that the state budget can accommodate only a small fraction of the long list of expensive initiatives that are now under consideration – which include further significant restorations of the severe spending cuts during the fiscal crisis – *and* that it will not be possible for the state to grow its way out of the mismatch between available resources and spending ambitions.

As the Foundation underscored in a recent *Bulletin*,[11] the 2007 budget process provides an example of the kind of decision making that must be avoided if the state is to maintain fiscal stability. In both its rate of spending growth and in its reliance on the stabilization reserve to support that growth, the 2007 budget reflects a worrisome lapse of fiscal discipline. It creates expectations for annual spending growth that cannot be sustained, and it risks the reserves that will be needed in the event of an economic downturn.

There is no question that the Commonwealth has sufficient cash on hand to pay for the spending that has been authorized in the budget, as well as in the economic stimulus and supplemental spending bills that were adopted at the end of fiscal 2006. Although the recent weak performance raises some concerns, we continue to believe that 2007 tax revenues will be sufficient to avoid a draw on the rainy day fund in order to support ongoing operating costs.

However, the Foundation's analysis paints a picture that is starkly at odds with the expansionary mood that has driven the budgetary choices for 2007. The financial proposals and decisions of the last six months have taken place in what can only be described as a misguidedly festive atmosphere. In light of the Foundation's new findings, the party will soon be over.

Methodology

The five-year financial analysis is intended to provide a framework for identifying longer-term trends in the state's finances, not to forecast specific financial results. For the purposes of presenting a fuller picture of the Commonwealth's tax-supported finances, the analysis includes spending for pensions, the MBTA, and school building construction, as well as the dedicated income and sales tax receipts which support that spending, and excludes the portion of Medicaid spending that is financed from federal reimbursements. Non-tax revenues other than Medicaid federal reimbursements are included in the analysis, with annual growth rates that average a modest three percent or less, reflecting historical performance that is much less robust than tax revenues.

Because of these and other accounting differences, the total revenue and expenditure amounts calculated in the analysis would differ from those reported in the Comptroller's official financial statements and those appearing in the General Appropriation Act ("the budget").

The analysis makes use of several simplifying assumptions in calculating the future impacts of initiatives, both currently authorized and proposed. These modeling simplifications in some instances may affect the timing of the initiatives' impacts in individual fiscal years, but should not materially change their cumulative effects.

Although the analysis of spending growth builds in annual inflationary increases in the costs of existing programs, it does not assume any "efficiency" gains that would reduce spending for those programs below inflation. Approximately two-thirds of the state budget is dedicated to fixed costs such as debt service and pensions, pass-through payments such as local aid to cities and towns and revenues set aside for the MBTA, and difficult-to-control Medicaid and other health care costs. A significant portion of the remaining one-third supports the direct delivery of human and other services.

[11] *State Budget 2007: Fanning the Expansionary Flames*, June 22, 2006.

Massachusetts Department of Revenue *Division of Local Services*
Alan LeBovidge, Commissioner *Gerard D. Perry, Deputy Commissioner*

Levy Limits: A Primer on Proposition 2½

Introduction

The Division of Local Services has developed this primer to guide local officials through the mechanics of Proposition 2½. Proposition 2½ revolutionized property tax administration and is a fundamental feature of the Massachusetts municipal fiscal landscape. Yet there is still some confusion about its meaning for cities and towns, particularly because the law is complex and has undergone a number of changes since Proposition 2½ was enacted in 1980.

The purpose of this primer is to explain, as simply as possible, the basic provisions of Proposition 2½. We focus in particular on those aspects of the law that we have found to cause the most confusion, for example: the ways in which Proposition 2½ limits the property tax, how the levy limit is calculated, how an override differs from a debt exclusion or capital outlay expenditure exclusion, and how new growth works.

With the help of this primer, a local official should be able to understand the fundamentals of Proposition 2½. However, this primer is not intended as a substitute for legal guidance on a community's options and obligations under the law. If you have any questions, please refer to the Resources section included in this primer and contact the Division of Local Services for assistance and information.

We hope this primer will help you grasp the basic concepts of Proposition 2½ and act on behalf of your community with a better understanding of the law. We welcome questions and comments on this publication.

What is a Levy?

The property tax levy is the revenue a community can raise through real and personal property taxes. We will refer to the property tax levy simply as the **levy**. In Massachusetts, municipal revenues to support local spending for schools, public safety and other public services are raised through the property tax levy, state aid, local receipts and other sources. The property tax levy is the largest source of revenue for most cities and towns.

What is a Levy Ceiling? What is a Levy Limit?

Proposition 2½ places constraints on the amount of the levy raised by a city or town and on how much the levy can be increased from year to year.

A levy limit is a restriction on the amount of property taxes a community can levy. Proposition 2½ established two types of levy limits:

First, a community cannot levy more than 2.5 percent of the total full and fair cash value of all taxable real and personal property in the community. In this primer we will refer to the full and fair cash value limit as the **levy ceiling**.

Second, a community's levy is also constrained in that it can only increase by a certain amount from year to year. We will refer to the maximum amount a community can levy in a given year as the **levy limit**. The levy limit will always be below, or at most, equal to the levy ceiling. The levy limit may not exceed the levy ceiling.

Proposition 2½ does provide communities with some flexibility. It is possible for a community to levy above its levy limit or its levy ceiling on a temporary basis, as well as to increase its levy limit on a permanent basis. These options are discussed in more detail in other sections of this primer. The concepts of levy ceiling and levy limit are illustrated in *Figure 1*.

How is a Levy Ceiling Calculated?

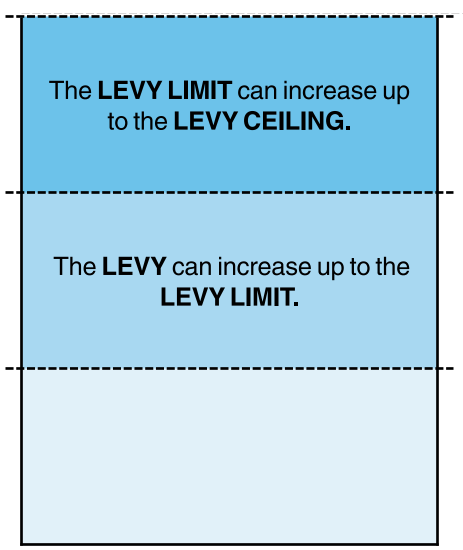
The levy ceiling is determined by calculating 2.5 percent of the total full and fair cash value of taxable real and personal property in the community:

Full and Fair Cash Value x 2.5% = LEVY CEILING

Full and Fair Cash Value = $100,000,000

$100,000,000 x 2.5% = $2,500,000

In this example, the levy ceiling is $2,500,000.



LEVY CEILING: The maximum the levy limit can be. The ceiling equals 2.5 percent of the community's full and fair cash value.

LEVY LIMIT: The maximum the levy can be in a given year. The limit is based on the previous year's limit plus certain allowable increases.

LEVY: The amount the community can raise through the property tax. The levy can be any amount up to the levy limit.

Figure 1

How is a Levy Ceiling Changed?

The total full and fair cash value of taxable real and personal property in a community usually changes each year as properties are added or removed from the tax roll and market values increase or decrease. This also changes the levy ceiling. See *Figure 2.*

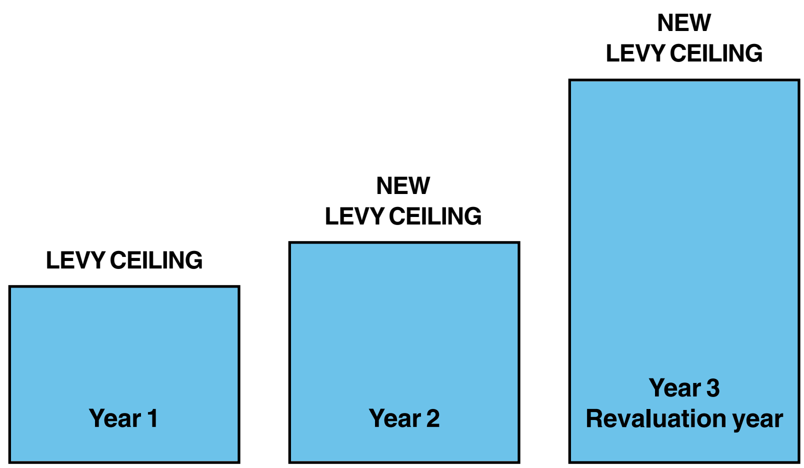


Figure 2

How is a Levy Limit Calculated?

A levy limit for each community is calculated annually by the Department of Revenue. It is important to note that a community's levy limit is based on the previous year's levy limit and not on the previous year's actual levy.

Each step in the example below is detailed in other sections of this primer. A levy limit is calculated by:

Taking the previous year's levy limit and increasing it by 2.5%:

A. FY2000 Levy Limit		**$1,000,000**
B. (A) x 2.5%	**+**	**$25,000**

Adding to the levy limit amounts of certified new growth added to the community's property tax base:

C. FY2001 New Growth	**+**	**$15,000**

Adding to the levy limit amounts authorized by override votes:

D. FY2001 Override	**+**	**$100,000**
E. FY2001 Subtotal (A+B+C+D)	**=**	**$1,140,000**

Comparing the FY2001 levy limit to the FY2001 levy ceiling and applying the lesser number (compare E and F):

F. FY2001 Levy Ceiling		**$2,500,000**

$1,140,000
Applicable FY2001 Levy Limit
(Lesser of E and F)

This community's levy limit, the maximum amount in real and personal property taxes it can levy, is $1,140,000 for FY2001. How much of this amount the community actually wants to use — that is, the amount of the levy — is up to the discretion of local officials. The community can levy up to or at any level below the entire levy limit amount, regardless of what its levy was in the previous year. Levy increases are discussed on page 13.

How is a Levy Limit Increased?

The levy limit is increased from year to year as long as it remains below the levy ceiling. Permanent increases in the levy limit result from the following:

Automatic 2.5 percent increase. Each year, a community's levy limit automatically increases by 2.5 percent over the previous year's levy limit. This does not require any action on the part of local officials; the Department of Revenue calculates this increase automatically.

New Growth. A community is able to increase its levy limit each year to reflect new growth in the tax base. Assessors are required to submit information on growth in the tax base for approval by the Department of Revenue as part of the tax rate setting process. New growth is discussed on page 8.

Overrides. A community can permanently increase its levy limit by successfully voting an override. The amount of the override becomes a permanent part of the levy limit base. Overrides are discussed on page 9.

Please note: Debt exclusions, capital outlay expenditure exclusions and overrides are all often referred to as "overrides" and enable a community either to permanently increase its levy limit or temporarily levy above its levy limit or levy ceiling. This primer makes a distinction between an override and a debt or capital outlay expenditure exclusion, because there is a significant difference in the impact of each on a community's levy limit. An override enables a community to permanently increase its levy limit, while an exclusion only allows for a temporary increase in taxes over a community's levy limit. Overrides, debt exclusions and capital outlay expenditure exclusions are discussed in greater detail in other sections of this primer.

In summary, the levy limit can increase from year to year in these ways: automatic 2.5 percent increase, new growth and overrides. Once the levy limit is increased in any of these ways, the increased levy limit amount becomes the base upon which levy limits are calculated for future years. See *Figure 3*.

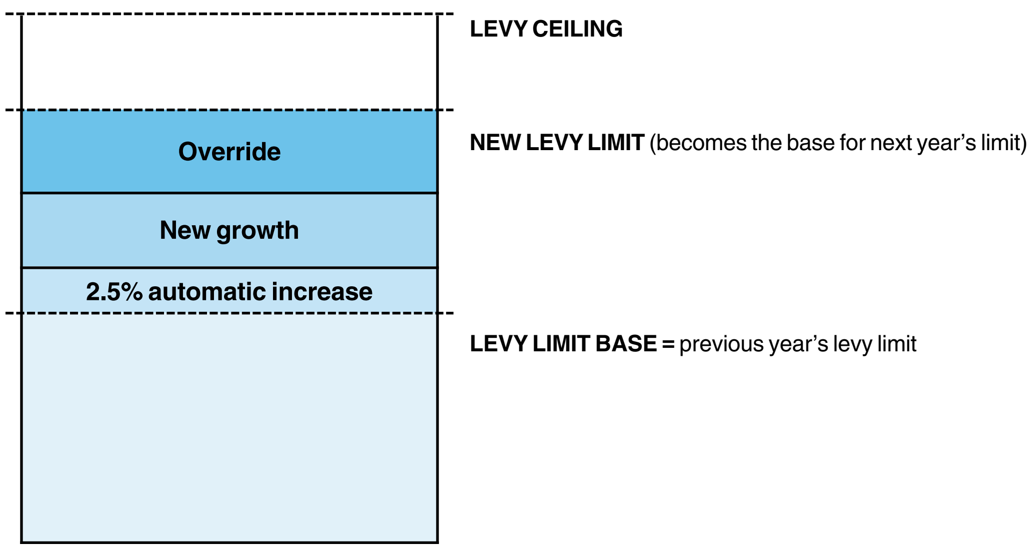


Figure 3

How Can a Community Levy Taxes in Excess of its Levy Limit or Levy Ceiling?

A community can assess taxes in excess of its levy limit or levy ceiling by successfully voting a debt exclusion or capital outlay expenditure exclusion. The amount of the exclusion does not become a permanent part of the levy limit base, but allows a community to assess taxes for a certain period of time in excess of its levy limit or levy ceiling for the payment of certain debt service costs or for the payment of certain capital outlay expenditures. See *Figures 4a and 4b*.

In *Figure 4a* the debt exclusion or capital outlay expenditure exclusion gives the community temporary additional taxing capacity over and above its levy limit, but below its levy ceiling.

In *Figure 4b* the debt exclusion or capital outlay expenditure exclusion gives the community temporary additional taxing capacity that is over and above not only its levy limit, but also its levy ceiling.

For more information on debt exclusions and capital outlay expenditure exclusions, see page 10.

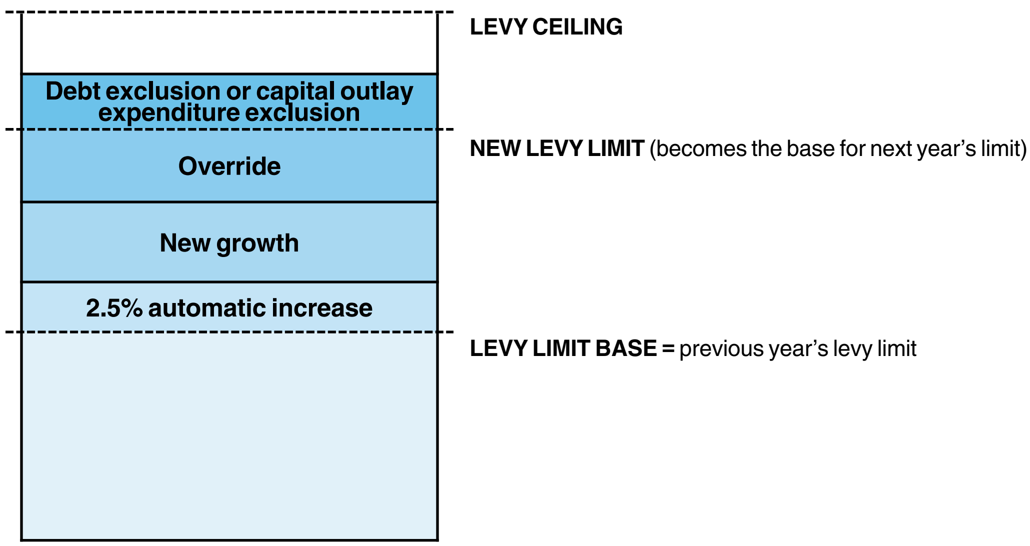


Figure 4a

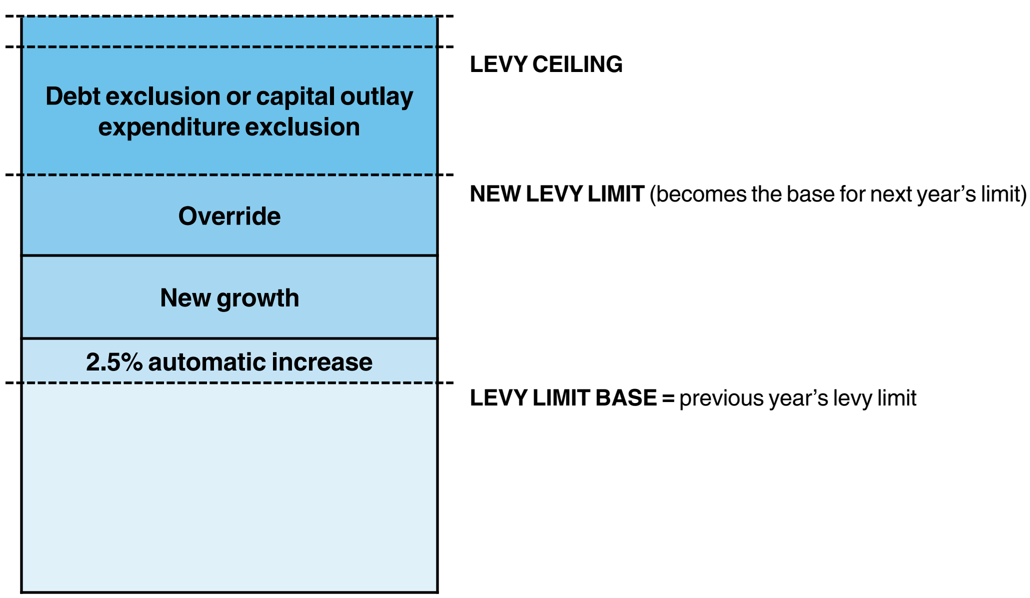


Figure 4b

What is New Growth?

Proposition 2½ allows a community to increase its levy limit annually by an amount based on the increased value of new development and other growth in the tax base that is **not** the result of revaluation. The purpose of this provision is to recognize that new development results in additional municipal costs; for instance, the construction of a new housing development may result in increased school enrollment, public safety costs, and so on. New growth under this provision includes:

- Properties that have increased in assessed valuation since the prior year because of development or other changes.
- Exempt real property returned to the tax roll and new personal property.
- New subdivision parcels and condominium conversions.

New growth is calculated by multiplying the increase in the assessed valuation of qualifying property by the prior year's tax rate for the appropriate class of property. **Any increase in property valuation due to revaluation is not included in the calculation.**

Below we highlight how new growth is calculated:

Increases in Assessed Valuation
x Prior Year's Tax Rate for Particular Class of Property
= New Growth Addition to Levy Limit

For example, for a community that applies the same tax rate to all classes of property:

Increases in Assessed Valuation = $1,000,000
Prior Year's Tax Rate = $15.00/1000
$1,000,000 x ($15.00/1000) = $15,000
New Growth Addition to Levy Limit = $15,000

Below we highlight where the addition of new growth occurs in the calculation of the levy limit:

Taking the previous year's levy limit and increasing it by 2.5%:

A. FY2000 Levy Limit		**$1,000,000**
B. (A) x 2.5%	+	**$25,000**

Adding to the levy limit amounts of certified new growth added to the community's property tax base:

C. FY2001 New Growth	+	**$15,000**

Adding to the levy limit amounts authorized by override votes:

D. FY2001 Override	+	**$100,000**
E. FY2001 Subtotal (A+B+C+D)	=	**$1,140,000**

Comparing the FY2001 levy limit to the FY2001 levy ceiling and applying the lesser number (compare E and F):

F. FY2001 Levy Ceiling	**$2,500,000**

$1,140,000
Applicable FY2001 Levy Limit
(Lesser of E and F)

New growth becomes part of the levy limit base, and thus increases at the rate of 2.5 percent each year as the levy limit increases. Reporting of new growth provides a community with an opportunity to increase its levy limit, which can provide for added budget flexibility in the future. Boards of Assessors are required to report new growth each year as a part of setting the tax rate.

What is an Override?

Proposition 2½ allows a community to assess taxes in excess of the automatic annual 2.5 percent increase and any increase due to new growth by passing an **override**. A community may take this action as long as it is below its levy ceiling, or 2.5 percent of full and fair cash value. An override cannot increase a community's levy limit above the level of the community's levy ceiling.

When an override is passed, the levy limit for the year is calculated by including the amount of the override. The override results in a permanent increase in the levy limit of a community, which as part of the levy limit base, increases at the rate of 2.5 percent each year.

A majority vote of a community's selectmen, or town or city council (with the mayor's approval if required by law) allows an override question to be placed on the ballot. Override questions must be presented in dollar terms and must specify the purpose of the override. Overrides require a majority vote of approval by the electorate.

Below we highlight where the amount of an override is added in the calculation of the levy limit:

Taking the previous year's levy limit and increasing it by 2.5%:		
A. FY2000 Levy Limit		**$1,000,000**
B. (A) x 2.5%	**+**	**$25,000**
Adding to the levy limit amounts of certified new growth added to the community's property tax base:		
C. FY2001 New Growth	**+**	**$15,000**
Adding to the levy limit amounts authorized by override votes:		
D. FY2001 Override	**+**	**$100,000**
E. FY2001 Subtotal (A+B+C+D)	**=**	**$1,140,000**
Comparing the FY2001 levy limit to the FY2001 levy ceiling and applying the lesser number (compare E and F):		
F. FY2001 Levy Ceiling		**$2,500,000**
$1,140,000 Applicable FY2001 Levy Limit (Lesser of E and F)		

The community can levy up to its levy limit of $1,140,000 in FY2001.

What is a Debt Exclusion? What is a Capital Outlay Expenditure Exclusion?

Proposition 2½ allows a community to raise funds for certain purposes above the amount of its levy limit or levy ceiling. A community can assess taxes in excess of its levy limit or levy ceiling for the payment of certain capital projects and for the payment of specified debt service costs. An exclusion for the purpose of raising funds for debt service costs is referred to as a **debt exclusion,** and an exclusion for the purpose of raising funds for capital project costs is referred to as a **capital outlay expenditure exclusion**. Both exclusions require voter approval with very limited exceptions. These exceptions are explained on page 12.

The additional amount for the payment of debt service is added to the levy limit or levy ceiling for the life of the debt only. The additional amount for the payment of the capital project cost is added to the levy limit or levy ceiling only for the year in which the project is being undertaken. Unlike overrides, exclusions do not become part of the base upon which the levy limit is calculated for future years.

Reimbursements such as state reimbursements for school building construction are subtracted from the amount of the exclusion.

A capital outlay expenditure exclusion or debt exclusion is effective even in the rare case when the exclusion would bring the community's levy above its levy ceiling.

Both of these exclusions require a two-thirds vote of the community's selectmen, or town or city council (with the mayor's approval if required by law) in order to be presented to the voters. A majority vote of approval by the electorate is required for both types of exclusion.

Questions presented to exclude a debt obligation must state the purpose or purposes for which the monies from the debt issue will be used. Questions presented to exclude a capital outlay expenditure exclusion must state the amounts and purposes of the expenditures.

Below we highlight how exclusions are added to the levy limit:

Taking the previous year's levy limit and increasing it by 2.5%:

A. FY2000 Levy Limit		**$ 1,000,000**
B. (A) x 2.5%	**+**	**$25,000**

Adding to the levy limit amounts of certified new growth added to the community's property tax base:

C. FY2001 New Growth	**+**	**$15,000**

Adding to the levy limit amounts authorized by override votes:

D. FY2001 Override	**+**	**$100,000**
E. FY2001 Subtotal (A+B+C+D)	**=**	**$1,140,000**

Comparing the FY2001 levy limit to the FY2001 levy ceiling and applying the lesser number (compare E and F):

F. FY2001 Levy Ceiling	**$2,500,000**

$1,140,000
Applicable FY2001 Levy Limit
(Lesser of E and F)

Calculating FY2001 levy limit with debt exclusion or capital outlay expenditure exclusion:

H. FY2001 Levy Limit		**$ 1,140,000**
I. Add FY2001 Debt Exclusion or Capital Outlay Expenditure Exclusion	**+**	**$50,000**

$1,190,000
Applicable FY2001 Levy Limit with Debt Exclusion
or Capital Outlay Expenditure Exclusion

In FY2001, this community can levy up to $1,190,000, its applicable levy limit with this debt exclusion or capital outlay expenditure exclusion.

What is a Special Exclusion?

For a few limited capital purposes, a community may assess taxes above the amount of its levy limit or levy ceiling without voter approval. Otherwise, special debt and capital outlay expenditure exclusions are like voter approved exclusions. The amount of the special exclusion is only added to the levy limit or ceiling for a temporary period of time, and does not become part of the base upon which the levy limit is calculated for future years.

One special debt exclusion allows a community to add water and sewer project debt service costs to its levy limit or levy ceiling for the life of the debt, as long as it reduces water and sewer rates by the same amount. The water and sewer debt exclusion is adopted by a majority vote of the community's selectmen, or town or city council (with the mayor's approval if required by law) and may include all or part of existing and subsequently authorized water and sewer debt or just the residential share of that debt.

Another special debt or capital outlay expenditure exclusion applies if a community has a program to assist homeowners to repair or replace faulty septic systems, remove underground fuel storage tanks or remove dangerous levels of lead paint in order to meet public health and safety code requirements. Under the program, the board of health and the homeowner agree that the board may contract with third parties to perform the work, and the homeowner will repay the community for all project costs. Homeowners may make the repayment by having a portion of the repair costs, with interest, added to their property tax bills for up to 20 years. The community may automatically add to its levy limit or levy ceiling the amount appropriated, or the amount of the debt service costs on any borrowing for the program.

What is an Underride?

Proposition 2½ allows a community to reduce its levy limit by passing an **underride**. When an underride is passed, the levy limit for the year is calculated by subtracting the amount of the underride. The underride results in a permanent decrease in the levy limit of a community because it reduces the base upon which levy limits are calculated for future years.

A majority vote of a community's selectmen, or town or city council (with the mayor's approval if required by law) allows an underride question to be placed on the ballot. An underride question may also be placed on the ballot by the people using a local initiative procedure, if one is provided by law. Underride questions must state a dollar amount and require a majority vote of approval by the electorate.

Below we highlight where the amount of an underride is subtracted in the calculation of the levy limit:

Taking the previous year's levy limit and increasing it by 2.5%:

A. FY2000 Levy Limit		**$1,000,000**
B. (A) x 2.5%	**+**	**$25,000**

Adding to the levy limit amounts of certified new growth added to the community's property tax base:

C. FY2001 New Growth	**+**	**$15,000**

Subtracting from the levy limit amounts authorized by underride votes:

D. FY2001 Underride	**–**	**$ 40,000**
E. FY2001 Subtotal (A+B+C–D)	**=**	**$1,000,000**

$1,000,000
Applicable FY2001 Levy Limit

The community can levy up to its levy limit of $1,000,000 in FY2001.

Levy Increases

Once a community's levy limit is established for a particular year, the community can determine what its levy will be. The community may set its levy at any amount up to the levy limit. (Or, if it has voted a debt exclusion or capital outlay expenditure exclusion, it may levy up to the levy limit plus the additional temporary capacity resulting from the exclusion.)

It is important to note that as long as a community levies no more than its levy limit, there is no restriction on the dollar increase or percentage increase in its levy from year to year. Proposition 2½ restricts increases in the levy limit, not the levy. A community is permitted to tax up to its levy limit, even if it must raise its levy by a large percentage over the previous year's levy.

For example, a community could decide to increase its levy between FY2000 and FY2001 because the people of the community feel that the town should respond to some unmet local needs. Below we highlight the community's FY2000 and FY2001 levy limits and levies:

FY2000 Levy Limit = $1,000,000
FY2000 Levy = $900,000

FY2001 Levy Limit = $1,025,000
FY2001 Levy = $1,025,000

Percentage Change In Levy Limit = 2.5%
Percentage Change In Levy = 13.8%

From FY2000 to FY2001, the community's levy limit only increases by the allowed 2.5 percent. (In this example assume the community has no new growth and has not voted an override.) The community's levy increases from the FY2000 amount of $900,000 up to its FY2001 levy limit of $1,025,000. This is a total dollar increase in the actual levy of $125,000 — and a percentage increase in the actual levy of 13.8 percent. From FY2000 to FY2001, the actual levy increases by 13.8 percent while the levy limit only increases by the allowed 2.5 percent.

It is important to note that the 13.8 percent increase described here is allowable under the provisions of Proposition 2½. As long as the levy limit only increases each year by the amount allowed under Proposition 2½, the actual levy can increase or decrease within the levy limit established each year, as decided by the community. The community may increase its levy up to its new levy limit regardless of the percentage increase in the levy. This concept is illustrated in *Figure 5*.

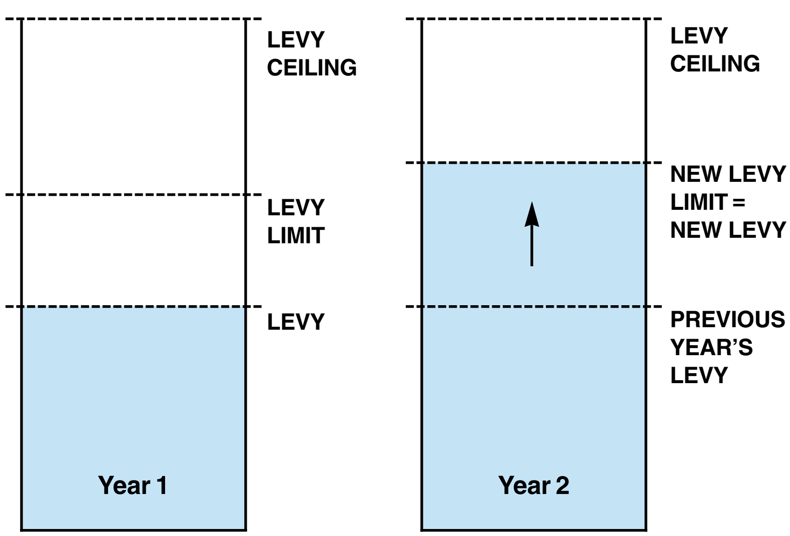


Figure 5

In Year 1, the community levies well below its levy limit.

In Year 2, the community's levy limit increases by the amount permitted under Proposition 2½. The community decides to levy all the way up to its new levy limit. The increase in the levy in Year 2 over Year 1 is indicated by the arrow. This increase is permissible under Proposition 2½.

Excess Levy Capacity

As discussed in the previous section, a community may choose to set its levy at any amount below or equal to its levy limit. When a community sets its levy below the limit, the difference between the levy and the levy limit is commonly referred to as **excess levy capacity**. This is an additional amount the community could, but chose not to, levy.

Levy Limit – Levy = Excess Levy Capacity

The concept of excess levy capacity is not a part of the Proposition 2½ law, as are the levy limit and levy ceiling. However, excess levy capacity is an important factor in municipal finance, and local officials should understand this concept.

There are two common misconceptions about excess levy capacity. The first misconception is that if a community has excess levy capacity in one year, then its ability to levy up to its levy limit in succeeding years is negatively affected. This misconception is based on the fact that Proposition 2½ limits the amount a community can increase its property taxes from year to year. Many think this means that a community cannot raise its levy all the way up to the levy limit to use all its excess capacity in just one year.

This is not true. As we have already seen, Proposition 2½ limits increases from year to year in the levy limit, not the levy. Before the tax rate is set, the full amount of the levy limit is always available to the community, **regardless** of how much of the limit the community has chosen to levy in previous years. It is within the law under Proposition 2½ for a community to have excess levy capacity in one year and, in the following year, to levy right up to the full amount of its new levy limit. This is true no matter what the percentage increase in the levy would be in order to achieve this result.

The second misconception about excess levy capacity is that a community is able to go back and "capture" excess levy capacity from a previous year. This is also not true. Once the community sets its tax rate for a given year, any revenues foregone because of excess levy capacity in that year are lost forever. This is only a one-time loss, however. In the following year, the community may levy up to its new levy limit, regardless of its levy in the previous year. See the example below:

FY2000 Levy Limit = $1,000,000
FY2000 Levy = $900,000
FY2000 Excess Levy Capacity = $100,000

FY2001 Levy Limit = $1,025,000
FY2001 Levy = $1,025,000
FY2001 Excess Levy Capacity = $0

Increase In Levy Limit = $25,000
Increase In Levy = $125,000

In FY2000, the town levies only $900,000 of its levy limit of $1,000,000, foregoing $100,000 of tax revenue it could have collected. In FY2001, the town's levy limit increases by the automatic 2.5 percent allowed by Proposition 2½, or up by $25,000 to $1,025,000. The town decides to levy all the way up to its new levy limit, so it has no excess capacity in FY2001. Its FY2001 levy is $125,000 higher than its FY2000 levy. The town cannot also levy an additional amount to capture the $100,000 foregone in FY2000. In other words, it cannot levy up to $1,125,000 for a total levy increase of $225,000. The $100,000 foregone in FY2000 is lost forever. This is a one-time loss, since the community can, in FY2001, levy all the way up to its new levy limit. This is highlighted in *Figure 6*.

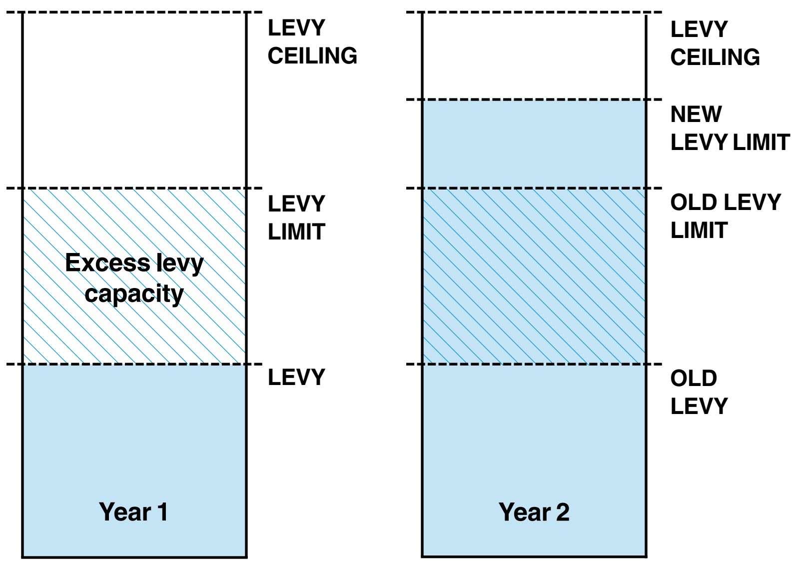


Figure 6

In Year 1, the community levies below its levy limit and as a result has excess levy capacity, represented by the area indicated.

In Year 2, the community may levy all the way up to its new levy limit. By levying up over its "old" levy limit (that is, its levy limit in Year 1), the community "uses" the excess capacity accrued in Year 1, shown by the area indicated. The community may increase its levy up to the new levy limit regardless of the percentage increase in the levy that is required to do so.

However, in Year 2 the community may not go back and recover the actual dollars of excess levy capacity foregone in Year 1 (the area indicated in the Year 1 diagram). That tax revenue is lost forever. It is only a one-time loss since the community can tax up to or above that level in Year 2.

Resources

For information on levy limits, levy ceilings, new growth and ballot questions (overrides, debt exclusions and capital outlay expenditure exclusions), contact DOR's Division of Local Services at:

- (617) 626-2300 by phone;
- (617) 626-2330 by fax; or
- the DLS website at **www.mass.gov/dls**.

Massachusetts Department of Revenue *Division of Local Services*
Alan LeBovidge, Commissioner *Gerard D. Perry, Deputy Commissioner*

Costing Municipal Services

Workbook and Case Study

March 2005

HOW TO USE THIS WORKBOOK

PART ONE A Guide to Costing Municipal Services presents the basic concepts and techniques of costing. It is intended both as an introduction for officials new to costing and as a refresher for officials who have used costing before.

PART TWO Masstown Ambulance Service, illustrates the concepts and techniques discussed in Part One. As you work through the case study, you may wish to refer to specific aspects of costing presented in Part One.

In previous editions, there was a Part Three, a set of blank worksheets for local officials to use when collecting cost information. Because of computerization, we recommend that local officials design their own worksheets, using the formats, or similar ones, displayed in the Case Study.

If you have any questions or would like assistance in costing your municipal services, we urge you to contact us:

MUNICIPAL DATA MANAGEMENT AND
TECHNICAL ASSISTANCE BUREAU
DIVISION OF LOCAL SERVICES
P. O. BOX 9569
BOSTON, MASSACHUSETTS 02114-9569

TEL: (617) 626-2300
FAX: (617) 626-2330
WEB SITE: HTTP://WWW.DLS.STATE.MA.US

COSTING MUNICIPAL SERVICES PAGE

Revised 3/2005

A Guide to Costing Municipal Services

What is the full cost of collecting and disposing of trash in your community? How much does it cost to provide fire protection?

What would it cost to increase service levels? How much could be saved by reducing services?

If you charge fees for municipal services, what percentage of the cost of service do they cover? Under what circumstances should fees be increased?

Could some municipal services be provided more efficiently by private firms?

As a local official – whether you are a mayor or selectman, manager or executive secretary, auditor or accountant, department head, member of the finance committee or any other member of municipal government – you may have asked these or other questions related to the cost of municipal services. Costing is a management and policymaking tool that helps to answer these questions. It differs from traditional municipal budgeting and accounting in three ways:

1. Costing looks at the **cost of all resources** used to provide services rather than expenditures made to operate municipal departments;
2. Costing includes **all** costs of providing a service, not just those found in the budget or financial reports of the department responsible for the service;
3. Costing focuses on the **cost** of the resources used to provide a service **during a given period of time,** regardless of when cash disbursements are made to purchase these resources.

The purpose of costing is not simply to collect cost data, but to provide municipal managers and officials with information they can use to make better management decisions in several areas:

- Analyzing the efficiency of municipal services
- Making budget decisions
- Setting fees for services and determining intergovernmental charges
- Choosing among alternative methods of providing services, such as contracting or regionalization

Costing is as much an art as a science. There are relatively few established rules to follow, and there is considerable leeway for judgment. In this **Guide*,*** we introduce the basic concepts and techniques of costing, which we feel meet the needs of most local officials. More complex approaches to costing, which provide greater accuracy but also require greater effort, are discussed in the books listed in the Bibliography at the end of this **Workbook**.

The costing process presented in this **Guide** has four major steps, each of which is explained by a series of questions and answers. The four steps and the questions addressed under each are listed below.

STEPS IN THE COSTING PROCESS

Step 1	Deciding What to Study	Pages 3-5
Questions:	What service do I want to cost? What is the purpose of costing this service? What information do I need to collect? How can the service be measured?	

Step 2	Getting Organized	Pages 6-9
Questions:	How do I organize a cost study? What time period should a cost study cover? Where will I find cost figures? Do I need to distinguish between expenses and expenditures? How should I treat pension costs? When is productive time important in costing?	

Step 3	Collect Cost Information	Pages 10-15
Questions:	What resources are used in providing a service? What are direct and indirect costs? How are indirect costs allocated to services? When should I make a distinction between variable and fixed costs?	

Step 4	Using Cost Information	Pages 16-19
Questions:	Are services provided efficiently? Are correct budget decisions being made? How should fees and intergovernmental charges be set? Should alternative methods of providing services be considered? What are the limits to costing?	

STEP 1: DECIDING WHAT TO STUDY

Q. What services do I want to cost?

The first step in costing is to specify which service or services are to be costed.

Example: All services performed by the highway department.

Example: A service provided internally to various town departments, such as centralized purchasing.

Q. What is the purpose of costing this service? What information do I need to collect?

It is important at the beginning of a cost study to specify the purposes of the study, the information to be collected, and how the information will be used. How the information is to be used will determine the cost data to be collected; different uses require analyzing different types of costs. **Table I** lists types of cost analyses, the questions they answer, and an example of each.

Example: The recreation department wants to know at what level program fees would have to be set in order to recover one-half of the cost of providing a particular program to 1000 users. In order to calculate the program's cost per participant (average unit cost), the department needs to calculate the full cost of the program and divide this amount by the number of participants.

TABLE I: TYPES OF COST ANALYSES, THEIR USES, AND EXAMPLES

	Questions to be Answered	**Example**
Full Costs	What is the cost of all resources used to provide the service?	Landfill -- the cost of all resources, from all departments, needed to provide landfill service.
Average Unit Costs	What cost should be the basis for setting fees?	Town Clerk -- the cost processing one marriage license.
Job Costs	What is the cost of performing one job?	Vehicle Repair -- the cost of repairing a vehicle.
Incremental Costs	What would it cost to expand the service?	Libraries -- the additional costs of opening a branch library two evenings per week?
Avoidable Costs	What costs would be avoided if some or all of the service were dropped, or if a different service delivery method (e.g., contracting) were used?	Fire -- costs that would be saved if an existing fire station were closed. Ambulance -- costs that would be saved by contracting for the service.

Q. How can the service be measured?

Once the service being costed and purpose of the study have been identified, it is important to consider how the **output** and cost of the service can be measured. We use the term **output** to describe the amount of a service provided by a local government. Measures of output and cost vary with the nature of the service being costed.

For services whose output is reasonably standard from case to case, output can be measured as the total of all units of service provided. A **unit of output** is simply one instance of the service, and **unit cost** is the average cost of providing one unit of service.

Cost of Services	÷	Number of units of output	=	Unit Cost

Example:

$1,900 (total cost of voter registration)	÷	250 (number of voters registered)	=	$7.60 (cost of registering one voter)

For municipal services which are one-time jobs or for which the effort required varies greatly from job to job, units of output are not standard and average unit cost is not a useful measure; a more meaningful calculation is the cost of each job or a range of costs per job.

Example: Installation of a new data processing system.

Example: The time required for criminal investigation by the police department varies from 4 hours to 30 hours per case. The Department estimates that one hour of investigation costs $17.50. Therefore, the cost per case ranges from $70 (4 x $17.50) to $525 (30 x $17.50).

The key to defining output and unit costs is to choose measures, which provide useful information for the particular study being conducted. **Table II** on the following page lists possible measures of output and unit cost for different types of services.

Example: In analyzing the cost of road plowing, we are likely to be more interested in the cost per lane-mile than the cost per road paved. The cost per road paved varies greatly with the length and width of the road. In contrast, calculating the cost per lane-mile allows us to estimate average plowing costs for the town as a whole.

TABLE II: EXAMPLES OF SERVICES, MEASURES OF OUTPUT, AND UNIT COSTS

Service	Output	Unit Cost
Road Paving	Lane-miles paved	$ per lane-mile
Street Repair	Square yards of street repaired	$ per square yard
Water	Gallons of water delivered	$ per gallon
Fire Protection	Protection of property & lives	$ per hour of protection provided
Police Protection	Police patrols	$ per hour of patrol
Accident Reports to Insurance Companies	Number of reports completed	$ per report
Recreation Programs	Number of people served or programs offered	$ per participant or $ per program
Immunization	Number of immunizations	$ per immunization
Payroll Processing	Number checks	$ per check
Tax Billing	Number of bills	$ per bill

STEP 2: GETTING ORGANIZED

Q. How do I organize a cost study?

Successful costing requires a team effort by department heads, employees, and town officials. Before any data is gathered, all people involved in the study need to understand the purpose of the study and their role in it.

Study guidelines should be put in writing. These guidelines specify what information is to be collected, who is to collect it, sources of information to be used, and the assumptions underlying the study. Standard forms for collecting cost data also need to be prepared.

Q. What time period should a cost study cover?

The answer to this question depends on the purpose of the study. If its goal is to determine the annual cost of providing a service, cost information will be needed for an entire fiscal year. However, the study need not be carried out over the whole year. Data from the most recent fiscal year can be collected and estimates made of subsequent changes in costs, or figures on current service levels and costs can be collected over a short time period and an estimate of yearly costs derived from them.

Example: A community wants to determine the full cost of its library services. Costs are found in the expenditure reports for the fiscal year just completed, and likely changes in current year costs are estimated.

To find the cost of its road repair program, the public works department sets up a special cost study. Department employees keep track of the labor, material, and equipment used for road repairs over a two-week period. Since the level of activity during these two weeks is typical of activity for the year as a whole, the annual cost of the program can be derived from the costs incurred during the time of the special study.

If the purpose of the study is to look at cost trends over a number of years, past and current costs need to be collected, and estimates made of future costs. When the purpose of the study is to find the cost of a single project, information is collected for the time period over which the project is carried out.

Example: The public works department wants to know the cost of plowing and cleanup after a recent snowstorm. Records for the two weeks in which the work was done are examined to find costs related to this project.

Q. Where will I find cost figures?

The primary source of cost data is expenditure records: general and subsidiary ledgers, warrants for payments, debt service records, and expenditure reports. Information is also contained in budgets and non-financial records such as equipment purchase and maintenance records, building records, mileage reports, and payroll and personnel records.

The ease with which cost information can be collected will depend on the level of detail in municipal expenditure records and budgets.

Example: The police department wants to know the cost of its routine patrols. If department records report separately the costs that go into providing this service (personnel, equipment usage, and vehicle mileage), then calculating its cost is relatively easy. However, it is likely that patrol costs are not reported separately; in this case, officials will need to estimate costs based on existing records or conduct a study of current costs over a short period of time.

Q. Do I need to distinguish between expenses and expenditures?

Expenses: The costs of resources used to provide a service over given period of time.

Expenditures: The cash transactions made when purchasing these resources.

Costing requires that the **expenses** incurred to provide a service be calculated for the time period in which the service is provided, regardless of when the **expenditures** necessary to purchase these resources take place. Thus, the financial analysis used in costing differs from the cash accounting system used by most municipalities, in which expenses are recognized only when expenditures are made.

For costing purposes, the relationship between expenses and expenditures is one of the three types:

1. Expenditures made in the same time period in which expenses are incurred.

Example: Municipal employees are usually paid on a weekly or biweekly basis for hours worked in the previous one or two weeks. Over the course of a fiscal year, there is no significant difference between the amount paid to employees (expenditure) and the cost of personnel resources used (expense).

2. Expenses incurred before expenditures are made.

Example: A sidewalk repair bill submitted by a contractor in August 1998 for work done in June of that year should be considered an **expense** for the 1998 fiscal year, even though the **expenditure** is made in the 1999 fiscal year.

3. Expenses incurred after expenditures are made.

This situation occurs when an asset is used after its purchase has been completed. The general principle to be followed in costing the asset is to distribute its cost over its expected useful life.

Example: A police car is purchased for $15,000 at the beginning of fiscal year 1999, and is expected to be used for three years. The annual cost of the vehicle is $5,000 ($15,000 ÷ 3).

Long-term assets financed through debt service, typically buildings, roads, and very expensive pieces of equipment, are also costs for which the expense occurs after the expenditure. According to the principle of distributing costs over the life of an asset, the construction or purchase cost of this type of asset should be considered an expense over its expected useful life. However, it is often difficult to predict accurately a long-term asset's expected useful life.

We recommend that municipalities spread the construction or purchase cost of a long-term asset over its useful life. The useful life of the asset may be determined by using the Internal Revenue Service regulations for depreciation. Otherwise, the cost can be spread over the life of the debt service, by using principal payments as the yearly cost.

Interest payments are also a cost of funding the purchase of long-term assets. Generally, they are recorded as an expense in the year in which they are paid, although for debt service with larger interest payments in initial years than in later years (as occurs in Massachusetts), this method results in an uneven distribution of costs over the useful life of the asset.

Example: A fire station built at a cost of $5,000,000 (excluding interest) has a useful life of 30 years. $5,000,000 divided by 30 is $166,666, which for costing purposes is the yearly expense of the building. Interest payments, which are declining over the debt payment period, are recorded as an expense in the year they are paid.

Q. How should I treat pension costs?

The full cost of services provided in any year ought to include employees’ pension costs. Each community annually contributes to its retirement system. The community’s annual contribution is based on an actuarial study approved by the Public Employees Retirement Administration (PERA). Generally, the annual contribution provides for the current retirees’ pension costs and the active employees’ accumulated pension benefits. As conditions change (e.g., layoffs, new hires, changes in the salaries of the community’s current employees), a community revises its actuarial study, adjusting the contributions to its retirement system. Once the community’s annual contribution is established, the pension costs of any one department can be allocated based on the ratio of active employees’ salaries in that department as a percent of total salaries of all employees contributing to the retirement system.

Example: To determine the full cost of providing ambulance service, a community needs to include an estimate of pension costs for ambulance service. The pension cost for ambulance service is apportioned based on the proportion of ambulance-related salaries to the salaries of all community employees participating in the retirement system. Current salaries of ambulance personnel total $45,400 while the salaries of all employees participating in the retirement system total $1,680,047; therefore the ratio is calculated to be 2.7 percent ($45,400 ÷ $1,680,047). This ratio is then applied to the current pension assessment of $210,000, yielding an estimate of $5,675 (2.7% of $210,000).

Q. When is productive time important in costing?

Productive time is the number of hours actually worked by a municipal employee, rather than the number of hours for which the employee is paid. The cost of productive time is calculated by dividing the employee's annual cost by the number of productive hours. What figure should be used for productive hours? Although a full year's work might be considered 2080 hours (8 hours/day x 5 days/week x 52 weeks/year), employees do not work many of these hours. Vacation days, paid holidays, lunch and coffee breaks, and sick leave used all reduce the number of productive hours worked during a year.

Example: A municipality wants to determine the hourly cost of the town engineer's productive time. His annual cost is $45,000 (salary, benefits, and pension cost), or $21.63/hour, based on a year with 2080 hours. However, with two weeks of paid vacation, ten paid holidays, five days of sick leave used, and 30 minutes/day of paid breaks, productive hours worked are 1,762.5/year. The hourly cost of the employee's productive time is $25.53 ($45,000/1,762.5 hours), which is 18 percent higher than the full yearly rate.

Precise calculation of the cost of productive time can be difficult, particularly when accounting for accrued sick leave and vacation time. For costing studies in which average unit costs or job costs must be determined, officials need only be aware that there is a difference between paid and productive time and account for the major factors which affect productive time.

STEP 3: COLLECTING COST INFORMATION

After the cost study has been defined and organized, the third step in the costing process is to collect the costs of the resources used to provide the service.

Q. What resources are used in providing a service?

Before the costs of a service can be collected, the resources needed to provide the service must be identified. These resources are labor, supplies, equipment, facilities, and purchased services. Most resources are provided by the department responsible for the service.

Example: The police department is responsible for the personnel, equipment, and supplies needed to provide police services.

Some resources, however, may be provided by other departments.

Example: Purchasing by a centralized purchasing department, or building maintenance by a central building department.

Example: Townwide administration by the mayor or board of selectmen.

To identify all resources used to provide a service, all areas of local government activity must be examined to determine which are used in some way to provide the service. Once these resources have been identified, their costs can be collected.

Q. What are direct and indirect costs?

The total cost of resources used to provide a service is made up of two elements -- direct costs and indirect costs. **Table III** on the next page illustrates the types of direct and indirect costs, and the following pages describe each type of cost.

DIRECT COSTS: Costs clearly identifiable and readily attributable to the service being costed.

Most direct costs are found in the relevant department's operating budgets as salaries and wages, capital outlay, purchase of services, and other expenses. Sometimes, however, direct costs of one department are found in the budgets of other operating departments.

Example: The Public Works Department cleans and mows parks used by the Recreation Department for its outdoor programs. Part of this cleaning and mowing cost is a direct cost attributable to the services provided by the Recreation Department.

INDIRECT COSTS: Costs **not** readily attributable to a service or department, because they are shared with other services or departments.

TABLE III: TYPES OF DIRECT AND INDIRECT COSTS[1]

Direct Cost: Clearly identifiable and attributable to specific service or department.	**Own Department** E.g., salaries of personnel running the youth program; supplies used in the program. **Other Departments** E.g., mowing of recreation department fields by the public works department.
Indirect Cost: Not readily attributable to a specific service or budget.	**Indirect Operating Costs** E.g., cost of recreation department offices in town hall. Because the town hall is used by many departments, the share of its cost attributable to the recreation department is not found separately in any budget or accounting data. Therefore, it is calculated as an indirect cost. **Indirect Administrative Costs** Government-wide **--** E.g., costs of townwide administration by town manager, which benefits all town departments. Departmental **--** E.g., administrative costs of the recreation department which cannot be readily attributed to individual recreation department programs.

There are two types of indirect costs:

Indirect Operating Costs: Costs of services which are not provided to the public, but which support other municipal departments. These are centrally budgeted costs of operating municipal government.

Example: Buildings shared by more than one department
Central motor pool
Townwide liability insurance

Indirect Administrative Costs: Shared costs of management and policymaking that cannot be assigned to individual services of departments.

Government-wide administrative costs are those shared by all municipal departments.

Example: board of selectmen or city council
town manager or mayor
town accountant or city auditor
town counsel or legal department
treasurer/collector
assessors

[1] The examples used here refer to a youth program run by a municipal recreation department.

Individual departments may also have indirect administrative costs that they cannot trace clearly to the services they provide. An example is the cost of a police chief's time spent in general management of the police department. Because departmental indirect costs are not large in most cases, and because they increase the complexity of the costing process, we do not discuss them further in this **Guide.**

The reason for distinguishing between direct and indirect costs is to help identify all costs of providing services. Each local government that does costing will categorize its direct and indirect costs differently, depending on how services are organized and how easily costs can be traced to them.

Example: If the police department is located in its own building, the building cost is direct. It is readily attributable to the services provided by the police department. On the other hand, if the police department shares space in the town hall with other departments and it is not possible to measure directly each department's share of the cost of the facility, building costs are an indirect cost of police services. Although the cost of office space cannot be traced directly to the police department, it is still a necessary cost of providing police services.

REMEMBER: There is no single correct way to categorize a cost as direct or indirect. What is important is to:

- Set reasonable guidelines to decide if a cost is direct or indirect
- Be consistent in categorizing costs as direct or indirect
- Count every cost, but only count it once

Q. How are indirect costs allocated to services?

Although indirect costs are not easily attributable to individual services they are still an essential part of the cost of municipal government, and it is important to include them in the full cost of providing municipal services. For this reason, indirect costs are allocated to departments and services according to the amount of the indirect costs for which they are responsible.

Indirect costs are distinguished from direct costs by the fact that they cannot be assigned precisely to various municipal activities. As a result, the indirect costs allocated to a particular department or service are approximate rather than exact costs. Sometimes, this fact bothers officials who like to have precise cost figures. It is important to remember that even though indirect costs are approximations, including them in the full cost of municipal services results in more accurate cost information than if they are not included at all.

This **Guide** discusses allocation methods which are relatively easy to use and which meet the costing needs of most municipalities. Local officials who feel that more precise allocation of indirect costs will result in significantly better cost information should consider using the more complex allocation methods discussed in the books cited in our **Bibliography**.

Allocating indirect costs is a two-step process:

First, indirect costs are calculated and combined into one or more **cost pools**. We use the term “cost pool” to describe a collection of indirect costs to be allocated.

Second, the **basis for allocating cost pools** is determined, and dollar amounts are calculated and assigned to individual services.

These steps are explained in more detail below.

First Step: Forming Cost Pools

Officials doing a cost study must decide which of the indirect operating and administrative costs are to be pooled. A useful guideline for this decision is to pool all costs which are relevant to the costing issues being considered. Remember to specify in the study which costs are included, and why.

Example: If a cost study is being done to find out the additional cost of keeping recreational facilities open for several extra hours per week, indirect **administrative costs** are not likely to be affected, and need not be included. On the other hand, indirect **operating costs** (e.g., facility maintenance and fee collection) might well increase, and therefore should be considered.

Second Step: Allocating Cost Pools

Once direct costs are pooled, they are allocated to individual departments or services according to the department's or service's percentage of the following.

- The municipality's direct personnel costs; or
- The municipality's number of employees; or
- The municipality's total direct costs.

The allocation base used should be the one which most accurately allocates indirect costs to the services or departments. Since personnel represent the largest single portion of municipal costs, personnel costs or numbers are logical choices for an allocation base. If equipment and building cost are a substantial percentage of costs, it is also reasonable to use total direct costs as the basis for allocating indirect costs.

Example: The landfill is responsible for 8 percent of the town's direct personnel costs; therefore, it is allocated 8 percent of townwide indirect costs.

A somewhat more accurate, but also more complex, method of allocation uses several different indirect cost pools, depending on the type of cost.

Example: Indirect building construction and maintenance costs, indirect personnel administration costs, and indirect costs of vehicles are collected into separate cost pools. Costs in each pool are then allocated according to a different base:

building costs according to the percentage of space occupied; personnel costs according to the percentage of personnel numbers or costs; and vehicle costs according to the number of vehicles used by each department or service.

Sometimes, an indirect cost pool must be formed for an indirect cost shared by only a few departments.

Example: The fire and police departments occupy one building; costs of operating this building, which are indirect costs to the fire and police departments, are allocated only to these two departments.

Q. When should I make a distinction between variable and fixed costs?

So far, we have looked at costs as either direct or indirect, depending on our ability to link them to the service being costed. It is useful also to remember that different costs change differently with increases or decreases in service levels. Using this distinction, we can classify costs as follows.

- Variable Costs
- Fixed Costs
- Stepped Costs

Variable Costs: Change directly and proportionally with the amount of service being provided.

Example: The cost of asphalt used by the Highway Department, which changes with the miles of road being paved.

Fixed Costs: Do not vary with a change in service levels.

Example: The cost of operating and maintaining the Highway Department building generally does not change with increases or decreases in miles of road paved.

Stepped Costs: Within a given level of service, they do not change, but with large increases or decreases in service, they change in relatively large amounts.

Example: The cost of equipment used in road paving does not change with small increases in miles of road paved. However, if a large number of additional miles of road are to be paved, additional equipment will have to be purchased; equipment costs will thus increase in a large single step and be fixed at a new, higher level.

Many direct costs are variable costs**,** primarily materials, supplies, and hourly labor costs. They are attributable to the service being provided and they vary directly with the level of service.

Example: Fuel, oil, and maintenance costs of police department vehicles are direct, variable costs. The purchase cost of the vehicles is also a direct cost, but it is fixed, because it does not change with changes in the level of service provided.

Indirect costs are often fixed or stepped. They do not change when services are expanded or contracted, unless large expansions or contractions take place.

Example: The cost of centralized payroll accounting for a library is the same whether the library is open five or seven days per week. However, if library hours are extended enough that new personnel must be hired, payroll accounting costs will rise and be fixed at a higher level.

The differences between variable, fixed, and stepped costs are important when we look at incremental and avoidable costs -- costs which change with increases or decreases in service levels.

Example: The highway department plans to pave 10 more miles of road this year than last. Variable costs will be the additional cost of hourly labor, paving materials, fuel, and equipment maintenance. If no new equipment is needed, equipment costs will be fixed; if new equipment must be purchased, this cost will be a stepped cost.

Similarly, if the highway department reduces its road paving by a small amount, only the variable costs will be avoidable. Unless the equipment used for road paving can be sold or used on other projects, its cost is fixed; that is, it will not change regardless of decreases in road paving activity.

STEP 4: USING COST INFORMATION

As stated earlier in this **Guide**, the purpose of costing is not simply to collect cost information, but to use this information to make better management and policy decisions in several areas.

- Analyzing the efficiency of municipal services
- Making budget decisions
- Setting fees for services and determining intergovernmental charges
- Choosing among alternative methods of providing services

In the following pages, we discuss how different types of costs can be used for these purposes. Remember that each costing situation is unique, and must be analyzed individually to determine which types of costs are relevant to it. The guidelines presented here are general ones designed to help local officials use their own judgment in determining which costs are applicable to their costing needs.

Analyzing the efficiency of municipal services

Service efficiency means providing a service for the lowest possible cost. Cost information is used to answer a variety of questions about service efficiency.

What factors make the cost of a service unusually high?

Example: The head of the recreation department feels that the cost of materials used in recreation programs is high relative to other program costs. Costing helps to identify and explain these costs, so that the program manager can take corrective steps, if necessary.

Why has a cost changed?

Example: The board of selectmen notices a large increase in the public works department's labor costs, and is concerned that labor productivity has dropped. A costing study reveals that the department is now doing maintenance work at schools which used to be done by school department employees. As a result, labor costs in the public works department have risen and those in the school department have dropped. The amount of work being performed has not changed.

Have unit costs changed?

Example: A town's treasurer/collector feels that the cost of issuing tax bills has risen. After collecting information on the number of bills issued and the costs of issuing them, he finds that unit cost (the cost of issuing one bill) has actually dropped, because of streamlined procedures adopted recently. Total costs have risen because of a large increase in the number of taxpayers, due to new commercial and residential development.

In analyzing service efficiency, it is important to distinguish between the efficiency and effectiveness of services. Efficiency means providing a service at the lowest possible cost, while effectiveness refers to the quality of the service and how well it is meeting its objectives.

Example: The cost of municipal water service rises dramatically in one year, raising questions about its efficiency. However, further investigation reveals that a new purification system was installed during the year which provides cleaner water. Thus, the water department is delivering a more expensive service, but one which better meets the need of citizens for pure water.

Making budget decisions

In making budget decisions, officials are interested in many of the issues of efficiency discussed above. In particular, year-to-year cost comparisons reveal changes in costs, while the breakdown between direct and indirect costs indicates which costs and departments relate directly to the service, and which are needed to support it indirectly. When changes in service levels are being considered, incremental and avoidable costs are important.

Officials may be asking a variety of costing questions when making budget decisions.

- Why has the cost of service changed from last year?
- How can I justify to voters an increase in next year's budget for a particular service?
- How much money can be saved if a particular service is reduced? How much will it cost to increase a service?

Setting fees for services and determining intergovernmental charges

In order to determine fees for municipal services, officials need to know the amount of service provided and the cost of one instance of service.

Example: The charge for one immunization by the health department is based on average unit cost, since the output and cost of this service is relatively uniform from case to case.

In contrast, the cost of building inspections varies greatly with the size and complexity of the building project. As a result, inspection fees are based on the actual cost of inspecting each project or on the dollar value of the project.

Pricing municipal services is a complex task, and we urge officials who use costing for this purpose to consult one of the books on pricing and user fees listed in the **Bibliography**. Some of the issues to be considered in setting prices are the following.

1. Statutory restrictions

State laws or local ordinances may specify the fee to be charged, place a ceiling on it, or establish a range within which the fee must be set.

Example: State law prohibits libraries from setting general user charges for library services, although fees may be set for specific services.

2. **Costs to be recovered**

Example: Should fees for recreation programs be set to recover all direct and indirect costs associated with them, or only the direct costs of operating the programs? Officials should keep in mind the guideline "just and equitable" when setting fees.

3. **Equity**

Example: Will an increase in health department fees mean that low-income and elderly citizens, who most need the department's services, will not be able to afford them? If so, a reduced fee to these citizens may be worth consideration.

4. **Collection costs**

Example: A decision is made to charge a landfill fee each time citizens use it. As a result, another employee must be hired to collect fees and issue receipts. The additional cost of collecting the fees may be more than the fee revenue collected.

5. **Negative effects of charging for municipal services**

Example: When user fees at the landfill are increased sharply, officials may notice an increase in illegal dumping.

When two or more units of governments share costs, costing helps to determine full costs and identify formulas by which costs can be divided.

Example: Four towns share a swimming pool. A cost study is conducted to determine both the direct costs of the pool and the cost of resources provided indirectly by each town. Data collected on use of the facility by residents of the four towns is used to determine the portion of costs to be paid by each local government.

Choosing among alternative methods of providing services

Avoidable and new costs are important factors in choosing among alternative methods of providing services.

Example: In considering a change from trash collection by municipal employees to collection by a private contractor, officials need to determine which costs the town will avoid and what new costs will be incurred if the contract is accepted. If avoidable costs are greater than new costs, then the contract offers financial savings to the town. If, on the other hand, avoidable costs are less than new costs, the change in service delivery does not offer financial savings.

When comparing avoidable and new costs, make sure that the costs being compared are for comparable services.

Example: A contract for trash collection may not include collection of furniture and other large items, as the existing municipal service does. If not, the contract contains a hidden cost, since the town or private citizens will have to pay separately for collection of these items.

Conclusion -- The limits to costing

Although costing is a very useful tool for municipal managers and policymakers, it is important to remember that it represents only one aspect of decision-making. Other factors also must be considered in any decision.

- Local traditions: How have services been provided in the past?
- Political acceptability: Will a change be acceptable to both providers and users of the service?
- Legal constraints: Is the change permissible under the laws of the Commonwealth?
- Employee relations: Does the municipal labor contract allow the change?

Example: A costing study shows that trash collection services could be more efficiently provided by a private contractor. However, the service has always been provided by municipal employees, and workers, taxpayers, and the head of the public works department prefer the current system of collection. Furthermore, the townwide labor contract makes layoffs very difficult. In this situation, cost information is one of several considerations to be weighed in choosing the most effective method of trash collection. The value of the cost information is that it sheds the light of objective financial analysis on a situation complicated by many political and subjective factors.

PART TWO: MASSTOWN AMBULANCE SERVICE, A CASE STUDY

STEP 1: DECIDING WHAT TO STUDY[2]

Assume that you are a town official in Masstown, a community of 30,000 people. The board of selectmen has asked you for answers to three questions about the town's ambulance service.

1. What is the full cost of providing ambulance service in Masstown?
2. How much of the full cost of the service is covered by revenue from fees being charged?
3. A private ambulance service has offered to take over Masstown's emergency ambulance service for $150,000 per year. Would Masstown save money if it accepted this offer?

STEP 2: GETTING ORGANIZED

The board of selectmen has organized a group of local officials to conduct the study, including the town manager, Accountant, treasurer/collector, and fire chief. This group has decided to look at cost figures for FY1, the latest year for which complete data are available; where necessary, FY1 figures will be adjusted for estimated changes in current or future costs.

The following facts about the current ambulance service have been collected:

- Service Provided: 24-hour emergency ambulance service;655 runs made in FY1
- Organization: part of the fire department.
- Location: Masstown's fire Station; service provided to local hospital only.
- Personnel: eight EMTs who are also trained as firefighters.
- Fee: $120 per run (fee was set to match the base rate determined by Medicare and Blue Cross). The policy of the board of selectmen has been that ambulance fees should cover 25 percent of total costs of the service.

STEP 3: COLLECTING COST INFORMATION

Most resources used to provide this service are provided by the fire department, where the service is located. A few other town departments also provide resources:

- Treasurer/collector: bills and collects fees. On average, 70 percent of fees billed are collected.
- Town accountant: handles payroll, benefits, and insurance.
- Building Department: cleans and maintains fire station.

A number of different **Worksheets** have been used to collect cost information on the ambulance service. They show each cost, the account where the cost is found, and how it is calculated.

[2] For the sake of brevity, a number of simplifying assumptions about ambulance service in Masstown have been made. The importance of the Case Study is not the facts presented about Masstown and it ambulance service, but the concepts and techniques of costing, which it illustrates.

Masstown Ambulance Service

WORKSHEET I: DIRECT AND INDIRECT SERVICE INPUTS

	Direct Inputs	Indirect Inputs
Personnel	Salaries and Wages Holiday, Overtime Pay Fringe Benefits Supervision by fire chief	Pensions
Equipment & supplies	Ambulance Maintenance Vehicle Supplies Ambulance Insurance Communication Equipment Service-Related Supplies	
Facilities		Capital Plant & Outlay Utilities Building Insurance Maintenance
Other	Training	Treasurer/collector: Billing & Fee Collection, Salaries & Wages Town accountant: Administration of Payroll, Benefits, & Insurance

Masstown Ambulance Service

WORKSHEET IIA: FY1 PERSONNEL COSTS

Type of Cost Name of account where cost is found	Direct Cost Calculation	Direct Cost FY1 Cost	Indirect Cost Calculation	Indirect Cost FY1 Cost
1. Salaries & Wages • Permanent positions • Temporary positions	Each EMT has a different salary; total is $162,752	$162,752 (1a)		$ 0 (1b)
2. Additional pay • Overtime • Other	Sum of payments is $3,820	3,820 (2a)		0 (2b)
3. Fringe Benefits	Benefits for 8 EMTs total $29,295	29,295 (3a)		0 (3b)
4. Supervision • Salaries & Wages • Fringe benefits	Fire chief estimates 15% of his time is spent supervising ambulance personnel. Chief's yearly salary and fringe benefits total $42,900. 15% of $42,900 = $6,435.	6,435 (4a)		0 (4b)
5. Pensions		0 (5a)	Pension costs for ambulance service are apportioned based on the proportion of ambulance-related salaries ($162,752, Line a) to the salaries of all town employees participating in the retirement system ($4,285,800). This ratio, 3.8%, is then applied to the FY1 pension appropriation of $600,000. 3.8% of $600,000	22,785 (5b)
6. Other Personnel Costs		0 (6a)		0 (6b)
7. Total Personnel		$ 202,302 (7a)		$ 22,785 (7b)
8. Grand Total, Personnel Costs (Line 7a + Line 7b)				$ 225,087 (8)

Masstown Ambulance Service

WORKSHEET IIB: FY1 EQUIPMENT & SUPPLY COSTS

Type of Cost Name of account where cost is found	Direct Cost Calculation	 FY1 Cost	Indirect Cost Calculation	 FY1 Cost
1. Equipment capital cost • Capital Items • Principal & interest payments	Ambulance was bought 2 years ago for $40,000, and is expected to last 5 years. $40,000 ÷ 5 = $8,000	$ 8,000 (1a)		$ 0 (1b)
2. Equipment & Maintenance • Repairs & maintenance	4 repairs in FY1: $252, $635, $228, and $430. Total of 4 bills =$1,545	1,545 (2a)		0 (2b)
3. Equipment Supplies	1,883 gallons of gasoline used at average price of $1.08/gallon. 26 quarts of oil used at $1.00/quart. 1,883 x $1.08 = $ 2,034 and 26 x $1.00 = $ 26. Sum is $2,060	2,060 (3a)		0 (3b)
4. Equipment Insurance • Insurance premiums	Town accountant maintains policy; $1,100 premium.	1,100 (4a)		0 (4b)
5. Service-related Supplies	Blankets $95, oxygen $900, medical supplies $250. Total of 3 items is 1,245	1,245 (5a)		0 (5b)
6. Other equipment & supply costs	Fire department has $750 yearly contract to maintain communication equipment for ambulance service.	750 (6a)		0 (6b)
Total Equipment & Supplies		$ 14,700 (7a)		$ 0 (7b)
7. Grand Total, Equipment & Supply Costs (Line 7a + Line 7b)				$ 14,700 (8)

Masstown Ambulance Service

WORKSHEET IIC: FY1 FACILITY COSTS

Type of Cost Name of account where cost is found	Direct Cost Calculation	 FY1 Cost	Indirect Cost Calculation	 FY1 Cost
1. Capital Plant & Outlay[3] • Land • Buildings • Improvements		$0 (1a)	Masstown makes $100,000 principal payments on the fire station; FY1 interest costs are $20,000. Building has 90,000 square feet, of which ambulance service uses 25%. $100,000 + $20,000 = $120,000 x 25% = $30,000	$ 30,000 (1b)
2. Utilities • Energy (heat & electricity • Non-energy (telephone and water)		0 (2a)	Utility charges for fire Station total $1,740: $502 electricity, $926 heat, $312 telephone, no water costs are charged to ambulance service because fire department is responsible for essentially all water usage in the fire Station. Ambulance service is allocated 25% of the utility charges. $1,740 x 25% = 435.	435 (2b)
3. Building Insurance • Insurance premiums		0 (3a)	Cost of 2-year policy is $11,290; 25% of annual cost is allocated to ambulance service. $11,290 ÷ 2 = $5,645 x 25% =1,411	1,411 (3b)
4. Building Maintenance • Building repairs and maintenance • Custodial & housekeeping • Groundskeeping		0 (4a)	Central building Department estimates 210 hours spent on fire station, at hourly cost of $6.90. $235 spent on cleaning supplies. 25% of costs are allocated to ambulance service. 210 x $6.90 = $1,449; $1,449 + $235 = $1,684 (total maintenance cost) x 25% = $421	421 (4b)
5. Other Facility Costs		0 (5a)		0 (5b)
6. Total Facility		$ 0 (6a)		$ 32,267 (6b)
7. Grand Total, Facility Costs (Line 6a + Line 6b)				$ 32,267 (7)

[3] Capital plant includes assets (building, streets, and major equipment) used and paid for over a number of years. Capital outlay includes assets used longer than one year, but purchased in one year.

Masstown Ambulance Service

WORKSHEET IID: FY1 OTHER COSTS

Type of Cost Name of account where cost is found	Direct Cost Calculation	 FY1 Cost	Indirect Cost Calculation	 FY1 Cost
1. Assessments • County • State • Other		$0 (1a)		$ 0 (1b)
2. Education • Training • Tuition reimbursement • Dues & subscriptions	EMT refresher course; trainer was paid $1,150	1,150 (2a)		0 (2b)
3. Travel • Instate • Out of state		0 (3a)		0 (3b)
4. Indirect Operating Costs		0 (4a)	Pool of indirect operating costs includes billing and collection of fees by treasurer/collector and administration of payroll, benefits, and insurance by town accountant. Pooled costs of these departments include all direct costs plus their share of indirect costs. Pooled costs are $112,530 treasurer/collector + $98,760 town accountant = $211,290. Cost pool is allocated to services according to each service's share of the town's total direct personnel cost. Ambulance service's total direct personnel cost of $202,302 (Line 7a, Worksheet IIA) is 2.5% of town's total direct personnel costs. Therefore, ambulance service is allocated 2.5% of indirect operating cost pool. 2.5% of $211,290 = 5,282	5,282 (4b)
5. Indirect Administrative Costs		0 (5a)	Masstown has chosen not to allocate indirect administrative costs	0 (5b)
6. Other Costs		0 (6a)		0 (6b)
7. Total Other		$ 1,150 (7a)		$ 5,282 (7b)
8. Grand Total, Other Costs (Line 7a + Line 7b)				$ 6,432 (8)

Masstown Ambulance Service

WORKSHEET III: SUMMARY OF TOTAL COSTS

	Direct Costs	Indirect Costs	Sum of Direct & Indirect Costs
1. Total Personnel Costs (Line 7a, 7b, 8 Worksheet IIA)	$ 202,302 (1a)	$22,785 (1b)	$ 225,087 (1c)
2. Total Equipment & Supply Costs (Lines 7a, 7b, 8, Worksheet IIB)	14,700 (2a)	0 (2b)	14,700 (2c)
3. Total Facility Costs (Lines 6a, 6b, 7, Worksheet IIC)	0 (3a)	32,267 (3b)	32,267 (3c)
4. Total Other Costs (Lines 7a, 7b,8, Worksheet IID)	1,150 (4a)	5,282 (4b)	6,432 (4c)
5. Total Costs	$ 218,152 (5a)	$ 60,334 (5b)	$ 278,486 (5c)
6. Less Revenues from fees 655 runs x $120 fee/run = $78,600 $78,600 x 70% (average collection rate) = $55,020			$ 55,060 (6)
7. Net Cost Full Cost (Line 5c) – Revenue from fees (Line 6)			$ 223,466 (7)

STEP 4: USING COST INFORMATION

Based on the cost information collected above, we can answer the questions raised by the board of selectmen.

1. What is the full cost of providing ambulance service to Masstown?

For FY1, all direct costs plus a reasonable portion of indirect costs total $278,486 (**Line 5c, Worksheet III**). When fee revenue of $55,020 (**Line 6, Worksheet III**) is deducted, the net cost of service is $223,466 (**Line 7, Worksheet III**).

2. How much of the cost of the service is covered by the fee being charged?

There are a number of ways to analyze this relationship between costs and fees. Here, we want to look at the percentage of total costs covered by fees:

- Fee Revenue: $55,020 (**Line 6, Worksheet III**)
- Full Cost: $278,486 (**Line 5C, Worksheet III**)
- Percentage of Total Costs Covered by Fees: **19.8%** ($55,020 ÷ $278,486)

The policy set by Masstown's board of selectmen has been that ambulance fees should cover 25 percent of total costs of the service. Whether the fee should be raised or the policy changed is a choice the board of selectmen can make based on the information provided by our costing exercise.

3. **Would Masstown save money by contracting out its ambulance service for $150,000 per year, beginning in FY3?** (Masstown would continue to set the fee at $120/run. The private contractor would bill and keep all revenues from fees.)

To answer this question, we need to determine Masstown's avoidable costs, that is, cost savings if Masstown halts provision of ambulance service by town employees. These avoidable costs are then compared with the new costs to Masstown if it accepts the private contract. Three steps are necessary to make this comparison:

First Step: Estimate the FY3 cost of ambulance service if provided by town employees, using the following information about cost and service trends in Masstown:

a. Personnel costs are estimated to rise 5.5 percent per year from FY1 to FY3.

b. Some costs are not expected to change over the FY1-3 period; these include building debt service, equipment capital costs, the guaranteed maintenance contract on ambulance communication equipment, and training.

c. All other costs are estimated to rise by 4 percent per year from FY1 to FY3.

d. The number of ambulance runs is rising by about 30 each year. In FY3, 715 runs are projected, a 9 percent increase over the 655 runs made in FY1. Costs which will rise proportionally with this increase in service are equipment maintenance, equipment supplies, and service-related supplies.

The **Exhibits** on pages 30-34 calculate projected FY3 costs.

Second Step: Determine FY3 costs which are avoidable. These avoidable costs represent the savings Masstown would achieve if it halted provision of ambulance service by town employees.

Third Step: Compare avoidable costs with the new cost to Masstown of accepting the private contract. The new cost of accepting the contract includes both the amount of the contract and the foregone revenues from ambulance fees which Masstown would no longer receive. If the savings to Masstown (its avoidable costs) are **less** than the new cost of accepting the private contract, then the contract **does not** offer net savings to Masstown. On the other hand, if savings (avoidable costs) are **greater** than the cost of accepting the private contract, then the contract **does** save money for Masstown.

This comparison is calculated in **Exhibit V**:

Masstown Ambulance Service

EXHIBIT IA: PROJECTED FY3 PERSONNEL COSTS

FY1	Direct Cost		Indirect Cost	
	Adjusted for FY3	Projected FY3 Cost	Adjusted for FY3	Projected FY3 Cost
1. Salaries & Wages $162,752 (Line 1a, Worksheet IIA)	Up 5.5%/year $162,752 x 1.055 x 1.055	$188,147 (1a)		$ 0 (1b)
2. Additional pay $3,820 (Line 2a, Worksheet IIA)	Up 5.5%/year $3,820 x 1.055 x 1.055	4,252(2a)		0 (2b)
3. Fringe Benefits $29,295 (Line 3a, Worksheet IIA)	Up 5.5%/year $29,295 x 1.055 x 1.055	32,606 (3a)		0 (3b)
4. Supervision $6,435 (Line 4a, Worksheet IIA)	Up 5.5%/year $6,435 x 1.055 x 1.055	7,162 (4a)		0 (4b)
5. Pensions $22,785 (Line 5b, Worksheet IIA)		0 (5a)	Up 5.5%/year $22,785 x 1.055 x 1.055	25,360 (5b)
6. Other Personnel Costs		0 (6a)		0 (6b)
7. Total Personnel		$ 225,167 (7a)		$ 25,360 (7b)
8. Grand Total, Personnel Costs (Line 7a + Line 7b)				$ 250,527 (8)

Masstown Ambulance Service

EXHIBIT IB: PROJECTED FY3 EQUIPMENT & SUPPLY COSTS

FY1	Direct Cost		Indirect Cost	
	Adjusted for FY3	Projected FY3 Cost	Adjusted for FY3	Projected FY3 Cost
1. Equipment capital costs $8,000 (Line 1a, Worksheet IIB)	Unchanged	$8,000 (1a)		$ 0 (1b)
2. Equipment & Maintenance $1,545 (Line 2a, Worksheet IIB)	Up 9% due to increase in service; up 4%/year due to inflation. $1,545 x 1.09 x 1.04 x 1.04	1,821 (2a)		0 (2b)
3. Equipment Supplies $2,060 (Line 3a, Worksheet IIB)	Up 9% due to increase in service; up 4%/year due to inflation. $2,060 x 1.09 x 1.04 x 1.04	2,429 (3a)		0 (3b)
4. Equipment Insurance $1,100 (Line 4a, Worksheet IIB)	Up 4%/year $1,100 x 1.04 x 1.04	1,190 (4a)		0 (4b)
5. Service-related Supplies $1,245 (Line 5a, Worksheet IIB)	Up 9% due to increase in service; up 4%/year due to inflation. $1,245 x 1.09 x 1.04 x 1.04	1,468 (5a)		0 (5b)
6. Other Equipment & Supply Costs $750 (Line 6a, Worksheet IIB)	Unchanged because costs of maintenance contract is guaranteed	750 (6a)		0 (6b)
7. Total Equipment & Supplies		$ 15,658 (7a)		$ 0 (7b)
8. Grand Total, Equipment & Supplies (Line 7a + Line 7b)				$ 15,658 (8)

Masstown Ambulance Service

EXHIBIT IC: PROJECTED FY3 FACILITY COSTS

FY1	Direct Cost		Indirect Cost	
	Adjusted for FY3	Projected FY3 Cost	Adjusted for FY3	Projected FY3 Cost
1. Capital Plant & Outlay $30,000 (Line 1b, Worksheet IIC)		$0 (1a)	Unchanged	$ 30,000 (1b)
2. Utilities $435 (Line 2b, Worksheet IIC)		0 (2a)	Up 4%/year $435 x 1.04 x 1.04	470 (2b)
3. Building Insurance $1,411 (Line 3b, Worksheet IIC)		0 (3a)	Up 4%/year $1,411 x 1.04 x 1.04	1,526 (3b)
4. Building Maintenance $421 (Line 4b, Worksheet IIC)		0 (4a)	Since most of this cost is for personnel, 5.5% yearly increase is estimated $421 x 1.055 x 1.055	469 (4b)
5. Other Facility Costs		0 (5a)		0 (5b)
6. Total Facility Costs		$ 0 (6a)		$ 32,465 (6b)
7. Grand Total, Facility Costs (Line 6a + Line 6b)				$ 32,465 (7)

Masstown Ambulance Service

EXHIBIT ID: PROJECTED FY3 OTHER COSTS

FY1	Direct Cost		Indirect Cost	
	Adjusted for FY3	Projected FY3 Cost	Adjusted for FY3	Projected FY3 Cost
1. Assessments		$0 (1a)		$ 0 (1b)
2. Education $1,150 (Line 2a, Worksheet IID)		1,150 (2a)		0 (2b)
3. Travel		0 (3a)		0 (3b)
4. Indirect Operating Costs $5,282 (Line 4b, Worksheet IID)		0 (4a)	Since most of this cost is for personnel, 5.5% yearly increase is estimated $5,282 x 1.055 x 1.055	5,879 (4b)
5. Indirect Administrative Costs		0 (5a)		0 (5b)
6. Other Costs		0 (6a)		0 (6b)
7. Total Other Costs		$ 1,150 (7a)		$ 5,879 (7b)
8. Grand Total, Other Costs (Line 7a + Line 7b)				$ 7,029 (8)

Masstown Ambulance Service

EXHIBIT II: PROJECTED FY3 TOTAL COSTS

	Direct Costs	Indirect Costs	Sum of Direct & Indirect Costs
1. Total Personnel Costs (Line 7a, 7b, 8 Exhibit IA)	$ 225,167 (1a)	$25,360 (1b)	$ 250,527 (1c)
2. Total Equipment & Supply Costs (Lines 7a, 7b, 8, Exhibit IB)	15,658 (2a)	0 (2b)	15,658 (2c)
3. Total Facility Costs (Lines 6a, 6b, 7, Exhibit IC)	0 (3a)	32,465 (3b)	32,465 (3c)
4. Total Other Costs (Lines 7a, 7b,8, Exhibit ID)	1,150 (4a)	5,879 (4b)	7,029 (4c)
5. Total Costs	$ 241,975 (5a)	$ 63,704 (5b)	$ 305,679 (5c)
6. Less Revenues from fees 715 runs estimated for FY3 x $120 fee/run = $85,800 $85,800 x 70% (average collection rate) = $60,060			$ 60,060 (6)
7. Net Cost Full Cost (Line 5c) – Revenue from fees (Line 6)			$ 245,619 (7)

Masstown Ambulance Service

EXHIBIT IIIA: FY3 AVOIDABLE PERSONNEL COSTS[4]

Projected FY3 Cost	Calculation of Avoidable Cost	Avoidable FY3 Cost
1. Salaries & Wages $181,147 (Line 1a, Exhibit IA)	Termination of 6 EMTs will save $136,900	$ 136,900 (1)
2. Additional pay $4,252 (Line 2a, Exhibit IA)	Termination of 6 EMTs will save $3,196	3,196 (2)
3. Fringe Benefits $32,606 (Line 3a, Exhibit IA)	Termination of 6 EMTs will save $24,470	24,470 (3)
4. Supervision $7,162 (Line 4a, Exhibit IA)	None is avoidable	0 (4)
5. Pensions $25,360 (Line 5b, Exhibit IA)	Termination of personnel will reduce pension costs by $19,166	19,166 (5)
6. Other Personnel Costs	Terminated personnel will be eligible for unemployment compensation; accountant estimates likely payments to be $7,800. Avoidable costs are reduced by this amount.	- 7,800 (6)
7. Total Avoidable Personnel Costs		$ 175,932 (7)

[4] Accepting the contract will result in termination of 6 (or 75 percent) of the 8 EMTs. Because the EMTs are at different levels of the pay scale, savings resulting form the termination will not be precisely 75 percent of the total FY3 personnel costs. Avoidable personnel costs in this Exhibit are estimates by the accountant.

Masstown Ambulance Service

EXHIBIT IIIB: FY3 AVOIDABLE EQUIPMENT & SUPPLY COSTS

Projected FY3 Cost	Calculation of Avoidable Cost	Avoidable FY3 Cost
1. Equipment capital costs $8,000 (Line 1a, Exhibit IB)	Vehicle can be sold for $6,000; this amount is an average cost.	$ 6,000 (1)
2. Equipment & Maintenance $1,821 (Line 2a, Exhibit IB)	100 percent avoidable	1,821 (2)
3. Equipment Supplies $2,429 (Line 3a, Exhibit IB)	100 percent avoidable	2,429 (3)
4. Equipment Insurance $1,190 (Line 4a, Exhibit IB)	100 percent avoidable	1,190 (4)
5. Service-related Supplies $1,468 (Line 5a, Exhibit IB)	100 percent avoidable	1,468 (5)
6. Other Equipment & Supply Costs $750 (Line 6a, Exhibit IB)	100 percent avoidable	750 (6)
7. Total Avoidable Equipment & Supply Costs		$ 13,658 (7)

Masstown Ambulance Service

EXHIBIT IIIC: FY3 AVOIDABLE FACILITY COSTS

Projected FY3 Cost	Calculation of Avoidable Cost	Avoidable FY3 Cost
1. Capital Plant & Outlay $30,000 (Line 1b, Exhibit IC)	None is avoidable	$ 0 (1)
2. Utilities $470 (Line 2b, Exhibit IC)	Building department estimates that only 50 percent of the ambulance's share of this cost will be avoided. 50% x $470	235 (2)
3. Building Insurance $1,526 (Line 3b, Exhibit IC)	None is avoidable	0 (3)
4. Building Maintenance $469 (Line 4b, Exhibit IC)	Building department estimates that only 50 percent of the ambulance's share of this cost will be avoided. 50% x $469	235 (4)
5. Other Facility Costs		0 (5)
6. Total Avoidable Facility Costs		$ 470 (6)

Masstown Ambulance Service

EXHIBIT IIID: FY3 AVOIDABLE OTHER COSTS

Projected FY3 Cost	Calculation of Avoidable Cost	Avoidable FY3 Cost
1. Assessments		$ 0 (1)
2. Education $1,150 (Line 2a, Exhibit ID)	100 percent is avoidable	1,150 (2)
3. Travel		0 (3)
4. Indirect Operating Costs $5,282 (Line 4b, Exhibit ID)	Because indirect operating costs for ambulance service are a small percentage of the costs in the treasurer/ collector's and accountant's offices, their associated costs will not change. Therefore, none of this cost is avoidable.	0 (4)
5. Indirect Administrative Costs		0 (5)
6. Other Costs		0 (6)
7. Total Avoidable Other Costs		$ 1,150 (7)

Masstown Ambulance Service

EXHIBIT IV: TOTAL FY3 AVOIDABLE COSTS

1. Total Personnel Costs (Line 7, Exhibit IIIA)	$ 175,932 (1)
2. Total Equipment & Supply Costs (Lines 7, Exhibit IIIB)	13,658 (2)
3. Total Facility Costs (Lines 6, Exhibit IIIC)	470 (3)
4. Total Other Costs (Lines 7, Exhibit IIID)	1,150 (4)
5. Total Avoidable Costs	$ 191,210 (5)

EXHIBIT V: NET ADDITIONAL COST TO MASSTOWN IF PRIVATE CONTRACT IS ACCEPTED

1. Cost to Masstown if it halts provision of ambulance service by town employees		
Cost of contract	$150,000	
Revenue foregone by Masstown (Line 6, Exhibit II)	60,060	
Total Cost to Masstown		210,060 (1)
2. Less:		191,210 (2)
Savings to Masstown (Avoidable Costs) if it stops provision of ambulance by town employees (Line 5, Exhibit IV)		
3. Net additional cost to Masstown for contracting out it ambulance service (Line 1- Line 2)		$ 18,850 (3)

Conclusion: It will be approximately $18,850 more expensive to Masstown of it contracts out its ambulance service at $150,000 per year.

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Two publications have been partially helpful in developing this Workbook:

Costing and Pricing Municipal Services, by the Commonwealth of Massachusetts. Boston: Massachusetts Executive Office of Communities and Development, 1982.

Costing Governmental Services: A Guide For Decision Making, by Joseph T. Kelley. Washington, D. C.: Governmental Finance Research Center, 1984.

Local officials who wish to explore costing further may wish to consult these documents or ones listed below.

Paul B. Downing. ***User Charges and Service Fees.*** Tallahassee: Florida State University, 1980.

Eva C. Galambos and Arthur F. Schreiber. ***Making Sense Out of Dollars: Economic Analysis For Local Government***. Washington, D. C.: National League of Cities, 1978.

Anthony J. Gambino. ***The Make-or-Buy Decision***. New York: National Association of Accountants and Society of Management Accountants of Canada, 1980.

John Tepper Marlin, Editor. ***Contracting Municipal Services: A Guide for Purchase from the Private Sector.*** New York: John Wiley & Sons, 1984.

Richard Schramm and Duane Wilcox. ***Cost-Benefit Analysis for Local Governments***. Ithaca: Local Government Program, Cornell University, 1981.

H. Edward Wesemann. ***Contracting City Services***. Pittsburgh: Innovations Press, 1981.

At A Glance Report for Shrewsbury

Socioeconomic

County	Worcester
School Structure	K-12
Form of Government	Town Manager Selectmen Representative Town Meeting
2005 Population	33,174
2006 Labor Force	17,159
2006 Unemployment Rate	4.1
1999 Per Capita Income	31,570
2000 Population Per Square Mile	1,526.3
2000 Housing Units Per Square Mile	612.4
2004 Road Miles	138.59
EQV Per Capita (2006 EQV/2005 Population)	151,986
Number of Registered Vehicles (January 2005)	34,757
Average Age of Vehicles (January 2005)	7.3
2006 Number of Registered Voters	21,004

Revaluation

Most Recent	2004
Next Scheduled	2007

Bond Ratings

Moody's Bond Rating as of June 2006*	Aa3
S & P Bond Rating as of June 2006*	

*Blank indicates the community has not been rated by the bond agency.

Fiscal Year 2007 Estimated Cherry Sheet Aid

Education Aid	16,147,896
General Government	3,787,156
Total Receipts	**19,935,052**
Total Assessments	882,906
Net State Aid	**19,052,146**

At A Glance Report for Shrewsbury

Fiscal Year 2007 Tax Classification

Tax Classification	Assessed Values	Tax Levy	Tax Rate
Residential	4,549,474,405	39,398,448	8.66
Open Space	3,129,400	27,101	8.66
Commercial	366,235,728	3,171,601	8.66
Industrial	194,877,975	1,687,643	8.66
Personal Property	41,561,998	359,927	8.66
Total	**5,155,279,506**	**44,644,720**	

Fiscal Year 2007 Revenues by Source

Revenue Source		Percent of Total
Tax Levy	44,644,721	49.9
State Aid	23,727,465	26.5
Local Receipts	11,400,000	12.7
Other Available	9,677,482	10.8
Total	**89,449,668**	

Fiscal Year 2007 Proposition 2½ Levy Capacity

New Growth	997,304
Override	0
Debt Exclusion	3,566,945
Levy Limit	44,686,208
Excess Capacity	**41,487**
Ceiling	128,881,988
Override Capacity	**87,762,725**

Other Available Funds

7/1/2006 Free Cash	FY2006 Stabilization Fund	FY2007 Overlay Reserve
4,137,833	180,807	484,866

At A Glance Report for Shrewsbury

Fiscal Year 2007 Average Single Family Tax Bill**

Number of Single Family Parcels	8,950
Assessed Value of Single Family	415,501
Average Single Family Tax Bill	3,598

State Average Single Family Tax Bill

Fiscal Year 2004	3,412
Fiscal Year 2005	3,588
Fiscal Year 2006	3,799

Shrewsbury issues property tax bills Quarterly.

**For the thirteen communities granting residential exemptions, DLS does not collect enough information to calculate an average single-family tax bill. Those communities are Barnstable, Boston, Brookline, Cambridge, Chelsea, Everett, Marlborough, Nantucket, Somerville, Somerset, Tisbury, Waltham and Watertown. Therefore, the average single-family tax bill information in this report will be blank.

Fiscal Year 2006 Schedule A – Actual Revenues and Expenditures

	General Fund	Special Revenue	Capital Projects	Enterprise Funds	Trust Revenue	Total All Funds
Revenues	**75,952,409**	**13,506,730**	**654,757**	**37,827,537**	**150,525**	**128,091,958**
Expenditures	**76,701,935**	**11,154,475**	**971,917**	**37,590,004**	**113,100**	**126,531,431**
Police	3,660,062	0	0	0	0	**3,660,062**
Fire	2,551,003	0	0	0	0	**2,551,003**
Education	38,006,529	7,240,838	887,221	0	0	**46,134,588**
Public Works	4,722,198	2,722,212	80,248	29,656,831	0	**37,181,489**
Debt Service	9,245,336	0	0	0	0	**9,245,336**
Health Ins	5,375,635	0	0	0	0	**5,375,635**
Pension	1,883,250	0	0	0	0	**1,883,250**
All Other	11,257,922	1,191,425	4,448	7,933,173	113,100	**20,500,068**

Total Revenues and Expenditures Per Capita

	General Fund	Special Revenue	Capital Projects	Enterprise Funds	Trust Revenue	Total All Funds
Revenues	2,289.5	407.1	19.7	1,140.3	4.5	3,861.2
Expenditures	2,312.1	336.2	29.3	3.4	3.4	3,814.2

If you have questions regarding the data contained in this report, please contact the Municipal Databank/Local Aid Section at (617) 626-2384 or databank@dor.state.ma.us.

SELCO VISION and MISSION

Established 2000 and reaffirmed 2005

VISION

A municipally owned system providing state of the art energy and Cable and telecommunication services to a 100% satisfied residential, commercial and industrial customer base.

MISSION

1. Make cash and other service contributions to the Town of Shrewsbury while providing services including Electric, CATV, and Internet at competitive rates.

2. Rates for all services provided by SELCO shall be at or below rates charged by other companies offering similar services in neighboring communities.

3. The Town, acting through the Light Commission, shall maintain control of energy and cable and telecommunications type services and infrastructure for the benefit of the customers while ensuring that the range of products and services are equal or greater than those provided by other companies.

4. Quality and reliability of services shall be superior when compared to services provided in neighboring communities by private companies. Industry accepted service standards should be used to measure performance.

5. Provide essential cable, telecommunication and energy infrastructure to encourage and support economic development.

6. Work cooperatively with the Town in all matters including help to ensure that an index of cost for all Town services including water, sewer, taxes, electric, CATV, and Internet, is lower than surrounding communities.

Municipal Market Basket
Spring 2006

Market Basket - Tax, Water, Power, CATV and Sewer Bills; Trash and Bus Fees

Rank	Community	Ave Residential Tax Bill (2005)	Water Bill (Annual)	Power Bill (Monthly)	Power Bill (Annual)	CATV (Monthly)	CATV (Annual)	Trash Fee (Annual)		Bus Fee (Annual)	Sewer Bill (Annual)	Total (Annual)
1	Fitchburg	$2,365	$296	$61	$735	$36	$433	$0		$180	$133	$4,142
2	Oxford	$2,519	$397	$81	$974	$49	$592	$0		$0	$0	$4,482
3	Leicester	$2,264	$390	$81	$974	$45	$534	$0		$0	$460	$4,623
4	Auburn	$2,580	$282	$81	$974	$47	$566	$96	F	$0	$152	$4,651
5	Leominster	$2,801	$200	$81	$974	$37	$439	$0		$100	$176	$4,690
6	Northbridge	$2,581	$338	$81	$974	$48	$575	$0		$0	$361	$4,829
7	Clinton	$2,654	$216	$81	$974	$49	$589	$234	B	$0	$162	$4,829
8	Millbury	$2,643	$397	$81	$974	$45	$538	$25	F	$0	$257	$4,834
9	Norwood	$2,961	$316	$41	$490	$37	$440	$0		$200	$509	$4,916
10	Shrewsbury	$3,374	$235	$51	$611	$31	$367	$0		$190	$171	$4,947
11	Worcester	$2,781	$286	$81	$974	$46	$551	$156	B	$0	$251	$4,999
12	Bellingham	$2,684	$248	$81	$974	$38	$456	$286	F	$0	$439	$5,087
13	Hudson	$3,200	$267	$64	$772	$41	$490	$156	B	$0	$293	$5,177
14	Billerica	$3,449	$184	$81	$974	$39	$470	$0		$0	$216	$5,293
15	Milford	$3,424	$290	$81	$974	$35	$425	$0		$0	$318	$5,431
16	Grafton	$3,486	$461	$81	$974	$47	$567	$0		$0	$158	$5,647
17	Sutton	$3,208	$305	$81	$974	$45	$535	$230	F	$180	$278	$5,710
18	Tewksbury	$3,343	$338	$81	$974	$50	$597	$0		$0	$504	$5,756
19	Sterling	$3,885	$301	$59	$708	$49	$589	$0		$275	$0	$5,758
20	Boylston	$4,385	$255	$50	$600	$48	$576	$0		$0	$0	$5,816
21	West Boylston	$3,638	$237	$57	$687	$46	$551	$0		$150	$642	$5,904
22	Marlborough	$3,796	$349	$81	$974	$40	$485	$0		$0	$336	$5,940
23	Paxton	$3,800	$380	$70	$844	$48	$575	$160	F	$275	$0	$6,033
24	Berlin	$4,519	$0	$81	$974	$38	$455	$95	F	$0	$0	$6,043
25	Danvers	$3,751	$361	$81	$974	$38	$458	$0		$100	$516	$6,160
26	Holden	$3,576	$264	$62	$747	$48	$573	$156	F	$275	$584	$6,175
27	Upton	$4,119	$211	$81	$974	$46	$556	$156	B	$0	$305	$6,321
28	Mansfield	$4,533	$382	$50	$595	$36	$437	$0		$150	$245	$6,341
29	Franklin	$3,515	$411	$81	$974	$49	$589	$240	F	$300	$441	$6,470
30	Foxborough	$3,878	$411	$81	$974	$37	$440	$355	B	$0	$448	$6,506
31	Chelmsford	$4,467	$286	$81	$974	$50	$597	$0		$0	$194	$6,518
32	Framingham	$4,129	$326	$107	$1,279	$33	$398	$0		$180	$433	$6,745
33	Canton	$4,147	$314	$107	$1,279	$36	$437	$0		$180	$558	$6,915
34	Millis	$4,083	$392	$107	$1,279	$47	$565	$206	B	$231	$343	$7,099
35	Northborough	$4,891	$258	$81	$974	$47	$566	$312	B	$0	$325	$7,326
36	Medway	$4,961	$264	$107	$1,279	$37	$449	$250	F	$0	$138	$7,341
37	Walpole	$4,499	$420	$107	$1,279	$39	$467	$0		$250	$570	$7,485
38	Natick	$4,303	$246	$107	$1,279	$42	$500	$273	B	$150	$803	$7,554
39	Norfolk	$4,859	$594	$107	$1,279	$39	$464	$378	B	$0	$0	$7,574
40	Holliston	$5,293	$372	$107	$1,279	$39	$467	$512	B	$0	$0	$7,923
41	Ashland	$4,713	$310	$107	$1,279	$37	$443	$215	F	$180	$800	$7,940
42	Westborough	$5,922	$306	$81	$974	$49	$590	$50	F	$0	$292	$8,134
43	Andover	$6,009	$302	$81	$974	$40	$476	$0		$300	$314	$8,375
44	Hopkinton	$6,015	$214	$107	$1,279	$36	$437	$0		$100	$482	$8,527
45	Southborough	$6,667	$301	$81	$974	$46	$554	$100	F	$0	$0	$8,596
46	Acton	$6,900	$342	$107	$1,279	$41	$490	$176	F	$0	$1,080	$10,266

F = Flat Trash Fee Annualized
B = Bag Trash Fee Annualized at (3) Bags/week

Source: Town Manager's office