

# TOWN OF SHREWSBURY

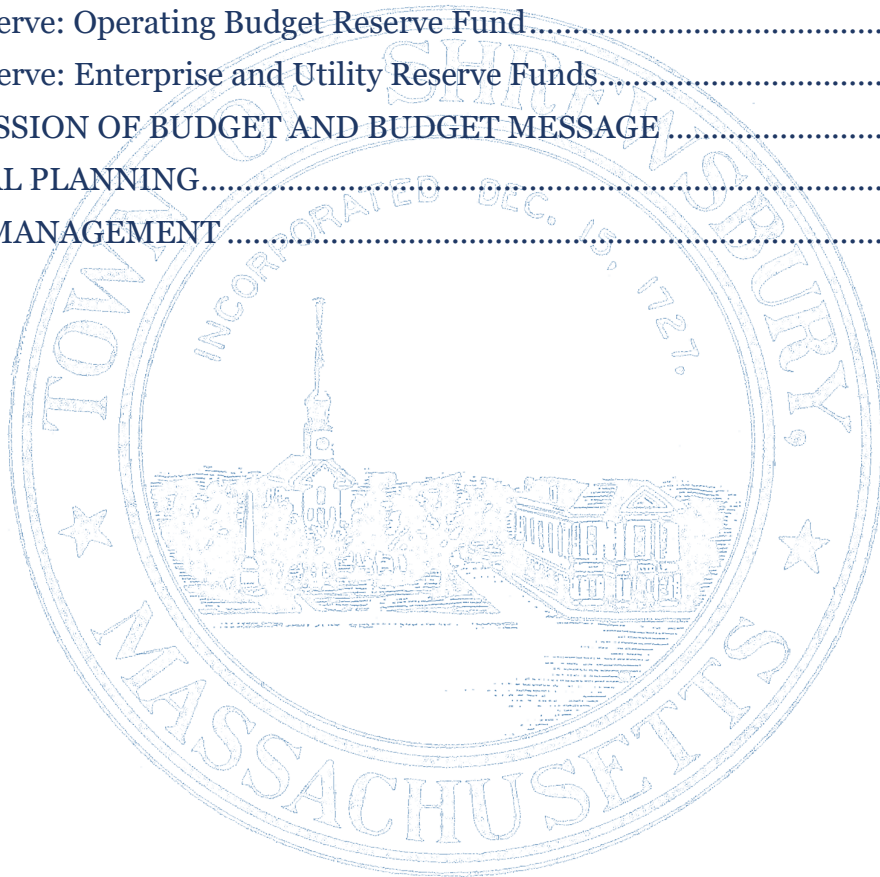
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## FINANCIAL POLICIES

November 13, 2018

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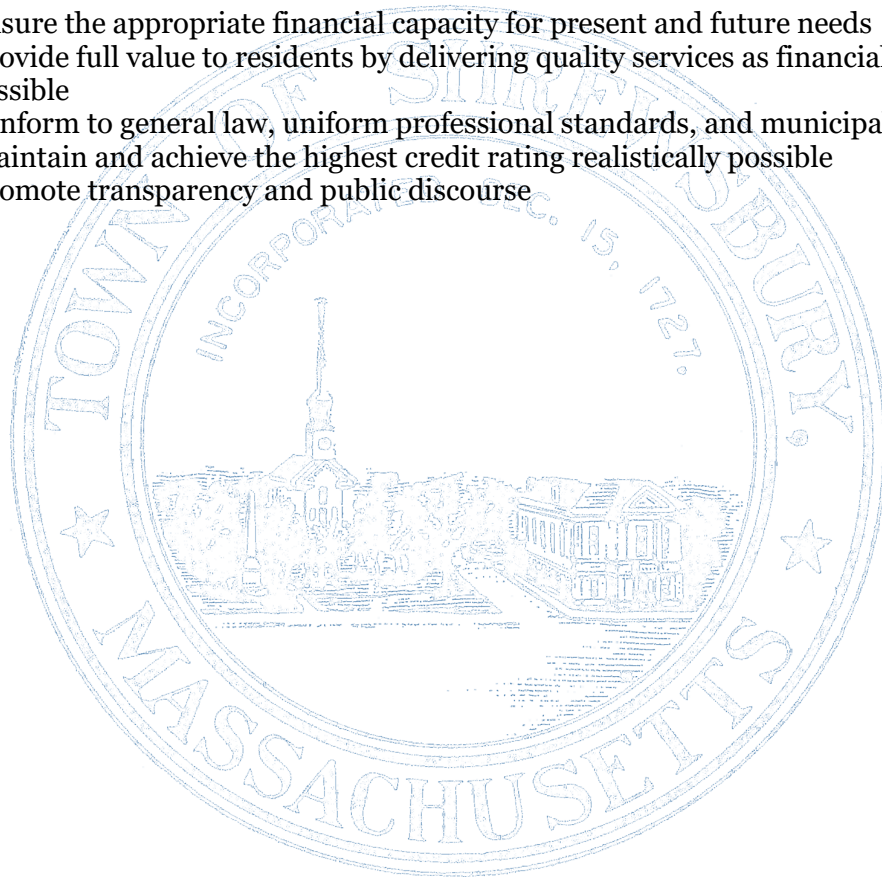
## INTRODUCTION

The adoption of formal financial policies provides instructive guidance and promotes consistency as local official's plan, direct, monitor, and protect municipal assets and resources. These policies form the foundation of all financial decision making processes and are expounded upon through short term goals and objectives.

If you have any questions, please contact Town Manager Kevin J. Mizikar at 508-841-8508 or [kmizikar@shrewsburyma.gov](mailto:kmizikar@shrewsburyma.gov).

### Key Policy Objectives

1. To ensure the appropriate financial capacity for present and future needs
2. To provide full value to residents by delivering quality services as financially efficiently as possible
3. To conform to general law, uniform professional standards, and municipal best practices
4. To maintain and achieve the highest credit rating realistically possible
5. To promote transparency and public discourse



## A – RESERVE POLICY

### **Background:**

Formal written policies that establish guidelines for funding and maintaining reserves can help a community sustain operations during difficult economic periods. Reserves can be used to finance unforeseen or emergency needs, to hold money for specific future purposes, or in limited instances, to serve as a revenue source for the annual budget. Reserve balances and policies can also positively impact a community's credit rating and as a consequence, the long-term cost to fund major projects. The discussion of reserves, and the attention of credit rating agencies, is generally focused on free cash, and stabilization funds. A review of the public finance literature generally reveals five reasons local governments create and maintain reserves:

- A. **Operational Needs** – These are contingency reserves which are typically appropriated as part of the annual budget. The purpose is to meet unexpected increases in department operational costs such as legal fees, major equipment repairs and other extraordinary costs.
- B. **Catastrophic or Emergency Expenditures** – These are contingency reserves which provide emergency funds for use in a major calamity such as a hurricane, blizzard, uninsured loss or damage to a capital asset.
- C. **Maintenance of Assets** – These are restricted reserves used to replenish the continuing depreciation or replacement of buildings and equipment. The Town is required to show the depreciation of certain fixed assets.
- D. **Liquidity or Cash Flow** – These are unrestricted reserves used to reduce the need for short-term borrowing, generate investment income and to maintain a strong credit rating.
- E. **Unfunded Liabilities** – These are restricted reserves used to fund an unfunded liability that has been incurred during the current or prior years, but which does not have to be paid until a future year, and for which adequate reserves have not been set aside. These liabilities may not be apparent in typical financial records in a way that makes their impact easy to assess. This type of liability accumulates gradually over time and may go unnoticed until it has created severe financial problems. Unfunded liabilities are predominantly pension obligations and postemployment benefits.

The Town of Shrewsbury's reserves include: A Stabilization Fund, Free Cash, and an operating budget Reserve Fund, Solid Waste Enterprise retained earnings, Water System Improvements Account, Sewer Enterprise Fund Surplus account, Other Post-Employment Benefits (OPEB) and Pension Trust Funds.

The overall level of Financial Reserves is critical to maintaining and improving the Town's Bond Rating and ensuring sufficient funds to manage unanticipated needs. Funds shall be appropriated from Reserves only after an analysis has been prepared by the Town Manager and presented to the Finance Committee and Board of Selectmen. The analysis shall provide sufficient evidence to establish that the remaining balance is adequate to offset potential downturns in revenue sources and provide sufficient cash balance for daily financial needs.

## A.1 – Reserve: General Stabilization

### **Background:**

The General Stabilization Fund is the Town's main reserve fund designed to provide financial stability for all aspects of Town operations, while improving the Town's credit worthiness and flexibility. The provisions of this fund are dictated by Massachusetts General Law (MGL), Chapter 40, Section 5B. Under State law, a municipality may establish one or more stabilization funds for different purposes and may appropriate into them in any year an amount not to exceed 10% of the prior year's tax levy. A majority vote of Town Meeting is required to establish, amend the purpose of, or appropriate money into the general stabilization fund, and a two-thirds majority is required to appropriate money from the general stabilization fund. Any interest generated by a fund must be added to and become a part of the fund. The total of all stabilization fund balances shall not exceed 10% of a municipality's equalized values. A stabilization fund is designed to accumulate amounts for emergency, extraordinary or unforeseen events, although it may be appropriated for any lawful purpose.

### **General Stabilization Policy:**

The Town shall maintain a General Stabilization Fund of at least 5% of the annual general fund budget for the purpose of extraordinary or unforeseen expenditures. The Town will endeavor to leave this balance unspent, except in the event of an emergency or extraordinary or unforeseen events. If it is necessary to draw down from the General Stabilization Fund, the Town will ensure that it is restored through the appropriation of revenues such as free cash and/or any other lawful appropriation.

## A.2 – Reserve: Free Cash

### **Background:**

The Massachusetts Division of Local Service's (DLS) Municipal Finance Glossary (May 2008) defines Free Cash as follows:

*Free Cash (Also Budgetary Fund Balance) – Remaining, unrestricted funds from operations of the previous fiscal year including unexpended free cash from the prior year, actual receipts in excess of revenue estimates shown on the tax recapitulation sheet, and unspent amounts in budget line-items. Unpaid property taxes and certain deficits reduce the amount that can be certified as free cash. The calculation of free cash is based on the balance sheet as of June 30, which is submitted by the community's auditor, accountant, or comptroller. Important: free cash is not available for appropriation until certified by the Director of Accounts.*

Free Cash provides a financial cushion against events such as a sudden loss of a revenue source, an economic downturn, an emergency, or other unanticipated expenditure, non-recurring capital expenditures and uneven cash flow. Free cash can serve as a source for funding capital projects or replenish other reserves.

The Government Finance Officers' Association (GFOA) notes it is essential that governments maintain adequate levels of fund balance to mitigate current and future risks (e.g., revenue shortfalls and unanticipated expenditures).

DLS recommends that a municipality strive to generate free cash in an amount equal to 3-to-5% of its annual budget.

***Free Cash Policy:***

Except as approved below, the Town of Shrewsbury will not use Free Cash to fund the operating budget. Free Cash is considered a non-recurring source of funds, and should only be used for non-recurring purposes, including replenishing reserves.

The Town will endeavor to generate Certified Free Cash equivalent to the amount of 3-5% of the annual general fund budget. Amounts in excess of 2.5% of the proposed operating budget will be available for capital or other one-time expenses, while the target amount will be left unspent from year-to-year.

Free cash shall not be depleted in any year, so that the following year's calculation will begin with a positive balance. Conservative revenue projections and departmental expenditures shall be managed to produce excess income and departmental budget turn backs when possible.

Free Cash may be used for certain one-time expenditures, such as capital projects, emergencies, other unanticipated expenditures, or to support other reserves.

The Town has historically used some portion of its Free Cash to subsidize the ensuing year's annual operating budget. However, it is the Town's goal to limit the amount of Free Cash used in the operating budget to a sustainable level and to use these available funds for non-recurring one-time expenses, such as capital items.

For purposes of this policy, the following are deemed to be appropriate uses of Free Cash:

1. Appropriated Reserve within Operating Budget– an amount to provide for extraordinary or unforeseen expenditures as authorized by MGL Chapter 40, Sec. 6.
2. Operating Budget – in order to pursue a gradual transition from using Free Cash to fund recurring operational expenses, the Town will reduce its annual appropriation each year until such time that Free Cash is no longer utilized or until such time the provisions of this policy are met.
3. Stabilization Funds – to fund or replenish any Stabilization Fund.
4. Capital Improvement Program – to fund any projects in accordance with the policy defined “Capital Planning”
5. Special Use – to augment the trust funds related to fringe benefits and unfunded liabilities related to employee fringe benefits and retiree benefits.
6. Extraordinary Deficits – to fund any potential deficits that would otherwise be carried over to the following fiscal year.
7. Emergency Appropriations – to allow for fiscal flexibility in any given fiscal year.

## A.3 – Reserve: Operating Budget Reserve Fund

### ***Background:***

Annually, the Town funds a reserve fund within the operating budget, which is managed by the Finance Committee, to cover unforeseen and extraordinary operating expenses for that particular fiscal year. The Town has funded this line item at \$280,000 for at least the last fifteen years. In FY19 the amount was decreased by the Finance Committee to remove a consistently recurring expense that was funded through the reserve fund.

### ***Operating Budget Reserve Fund Policy:***

The Town shall fund operating budget reserve fund within the operating budget which shall be equal to or greater than 5% of the expense line items <4,5,6> of the proposed operating budget.

## A.4 – Reserve: Enterprise and Utility Reserve Funds

### ***Background:***

The Town of Shrewsbury utilizes enterprise fund accounting to manage its utility services. In accordance with financial management best practices, this method of management and accounting is utilized to help ensure equity when charging for these services. Utility user fees cover the costs of the operation of the utilities rather than relying upon the general tax levy.

### ***Enterprise and Utility Reserve Policy:***

The Town shall maintain reserves of at least 5% of the annual recurring operating costs of each utility fund for the purpose of extraordinary or unforeseen expenditures. Reserves may be dedicated for infrastructure replacement and enhancement as needed to ensure the viability of the utility. Special purpose stabilization funds for each utility shall be established and funded so long as the current capital needs of the system are being satisfied. In extraordinary circumstances the Town General Stabilization Account may be used to cover expenses of utilities.

### ***References:***

[M.G.L. c. 40, § 5B](#)

[M.G.L. c. 59, §23](#)

[M.G.L. c. 59, § 25](#)

[M.G.L. c. 44, § 53F<sup>1/2</sup>](#)

DLS Best Practices: [Free Cash](#), [Reserve Policies](#), [Special Purpose Stabilization Funds](#)

DLS Departmental Procedure Manual: [Enterprise Funds](#)

DLS Informational Guideline Releases 17-20: [Stabilization Funds](#)

Government Finance Officers Association Best Practices: [Fund Balance Guidelines for the General Fund](#) and [Working Capital Targets for Enterprise Funds](#)

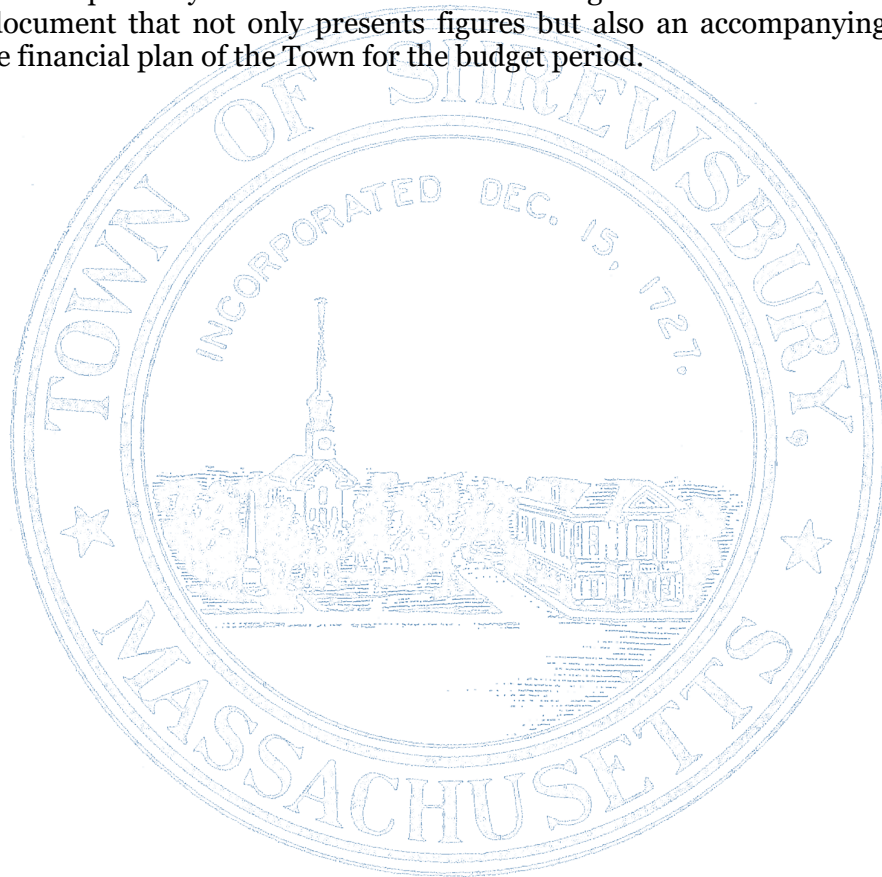
## B – SUBMISSION OF BUDGET AND BUDGET MESSAGE

### **Background:**

The Town defines a balanced budget as a budget in which receipts are greater than (or equal to) expenditures. The Commonwealth of Massachusetts requires all municipalities to present a balanced budget each year as a basic budgetary constraint intended to ensure that a government does not spend beyond its means and its use of resources for operating purposes does not exceed available resources over a defined period of time.

### **Budget Policy:**

The Town Manager is required to present a balanced budget in accordance with the timing and other provisions required by Section 16 of the Town Manager Act as amended. The budget shall be a living document that not only presents figures but also an accompanying narrative that illustrates the financial plan of the Town for the budget period.





## C – CAPITAL PLANNING

### ***Background:***

To effectively maintain the Town's infrastructure and protect the value of its capital assets, this policy outlines guidance for planning, reviewing, and coordinating capital improvements. Adherence to this policy will help the Town meet its capital needs despite limited resources. This policy establishes a framework for long-term capital improvements, sets guidelines and expectations for all Town departments in planning for and requesting capital projects, and outlines consensus budgetary goals for the Board of Selectmen and Finance Committee.

### ***Capital Planning Policy:***

The Town will maintain its physical assets by providing funding in the operating budget or through separate appropriations to protect its capital investments and minimize future maintenance and replacement costs. To provide and preserve the infrastructure needed for achieving the highest levels of public services and quality of life possible within available financial resources, the Town will maintain an annually updated, five year plan for capital improvements. The Town will emphasize preventive maintenance as a cost effective approach to capital reinvestment and replace exhausted goods as necessary.

#### 1. Definition of a Capital Improvement

A capital improvement is a tangible asset or project estimated to cost over \$25,000 and to have or to extend five (5) or more years of useful life. These include:

1. Real property acquisitions, construction, and long-life capital equipment
2. Major improvements to physical infrastructure, including streets, sidewalks, storm-water drains, water distribution systems, and sanitary sewer systems
3. Major renovations of existing capital items that extend their useful lifespans, as distinguished from normal operating expenditures
4. Acquisition of equipment, certain classes of motor vehicles and items related thereto
5. Planning, feasibility studies, and designs for potential capital projects
6. Items obtained under a long-term capital lease
7. Bulk purchases of similar items, like software or furniture, with expected useful life spans of five or more years that, when aggregated, have total costs exceeding the capital threshold

#### B. Inventory

To support a systematic acquisition and replacement schedule, the Town Manager will annually update and maintain a detailed inventory of all capital assets, which shall include dates built, acquired or last improved, original cost, current condition, expected and remaining useful life spans, depreciated value, extent of use, and any scheduled replacement or expansion dates.

### C. Evaluation of Capital Projects

The Town Manager shall establish a review process through which departments request funding for capital purchases. The Town Manager will evaluate and prioritize the capital requests received from departments and may use the criteria below:

1. Eliminates a hazard to public health and safety
2. Required by state or federal laws or regulations
3. Uses outside financing sources, such as grants
4. Stabilizes or reduces operating costs
5. Replaces a clearly obsolete facility, makes better use of an existing facility, or relieves an overburdened situation
6. Maintains or improves productivity or existing standards of service
7. Supports adopted plans, goals, objectives, and policies of the Town
8. Directly benefits the Town's economic base by protecting and increasing property values
9. Provides new programs having social, cultural, historic, economic, or aesthetic value

### D. Multi-year Capital Improvement Plan (CIP)

The Town Manager will annually update and propose to the Finance Committee and Board of Selectmen a five-year CIP, including the upcoming fiscal year's capital budget and a four-year projection of capital needs and expenditures that details their estimated costs, descriptions, and anticipated funding sources.

Throughout the year, the Town Accountant will monitor active capital projects to ensure they remain properly funded and will report any issues to the Town Manager.

### D. Capital Financing

Long-term debt is an appropriate funding source for certain types of projects, while short-term debt and current revenues should be used for assets with short useful lifespans. Funding shall be derived from a combination of property taxes and the Free Cash and any capital stabilization funds, so established.

The CIP shall be prepared and financed in accordance with the following policies:

1. Special revenue sources (e.g., grants, revolving funds) shall be evaluated as funding options whenever practical.
2. The annual operating costs of each proposed capital project, as well its debt service costs, shall be identified before any long-term, bonded capital project is recommended.
3. Short-term debt may be used to fully finance purchases with useful lifespans of less than 10 years.
4. Major capital projects, such as new construction or major renovations to existing facilities, may be accomplished through capital or debt exclusions.

5. Infrastructure or facility maintenance budgets built into the general operating budget will not be reduced to fund other departmental budgets.
6. To the fullest extent feasible, all capital projects associated with the Town's water, sewer and any other enterprise funds shall be financed from user fees.

F. Capital Project Closeouts

The Town will endeavor to close out all capital projects within six months of completion or discontinuation. As they are closed out, the Town Accountant will do the following:

1. For bonded projects with residual balances less than \$50,000, the Town Accountant and Treasurer will propose the Board of Selectmen approve applying the balances to debt service.
2. For bonded projects with residual balances in excess of \$50,000, the Town Accountant and Treasurer will propose appropriating the balances for other capital projects for which the Town may borrow for an equal or greater term as the original loan was issued.
3. For projects funded with available revenue (tax levy or reserves) having residual balances, the Town Accountant will propose reallocating the balances for other capital projects or will close the balances to the appropriate fund surplus.

*References:*

[M.G.L. c. 44, § 20](#)

[M.G.L. c. 44, § 33B](#)

Division of Local Services Best Practice: [Presenting and Funding Major Capital Projects](#)

DLS Financial Management Guidance: [Capital Improvement Planning Manual](#) and [Capital Improvement Planning Guide – Developing a Comprehensive Community Program](#)

## D – DEBT MANAGEMENT

### ***Background:***

To provide for the appropriate issuance and responsible use of debt, this policy defines the parameters and provisions governing debt management. Policy adherence will help the Town to responsibly address capital needs, provide flexibility in current and future operating budgets, control borrowing, sustain capital investment capacity, and maintain or enhance the Town's bond rating so as to achieve long-term interest savings.

### ***Debt Management Policy:***

Under the requirements of federal and state laws, the Town may periodically issue debt obligations to finance the construction, reconstruction, or acquisition of infrastructure and other assets or to refinance existing debt. The Town will issue and manage debt obligations in such a manner as to obtain the best long-term financial advantage and will limit the amount of debt to minimize the impact on taxpayers. Debt obligations, which include general obligation bonds, revenue bonds, bond anticipation notes, lease/purchase agreements, and any other debt obligations permitted to be issued under Massachusetts law, will only be issued to construct, reconstruct, or purchase capital assets that cannot be acquired with current revenues.

#### A. Debt Financing

In financing with debt, the Town will:

1. Long-term borrowing will take place only for objects or purposes authorized by state law under M.G.L. Ch. 44, sec. 7 and 8, and will be confined to infrastructure and capital projects too expensive to be financed from current revenues. In general, the Town will attempt to finance purchases costing less than \$1,000,000 with operating revenues.
2. Refrain from using debt to fund any recurring purpose, such as current operating and maintenance expenditures.
3. Long-term debt should not be incurred without a clear identification of its financing sources. Because of the debt service costs and annual appropriations necessary to retire this debt, there should be clear knowledge and commitment of revenue sources available to pay these costs without competing with operating budgets for limited resources.
4. Where possible, the town will use special assessment, revenues or other self-supporting revenues to fund general obligation bonds. (ex: light, cable, water)
5. To the extent practicable, user fees will be set to cover the capital costs of Enterprise type services or activities - whether purchased on a pay-as-you-go basis or through debt financing - to avoid imposing a burden on the property tax levy.

#### B. Debt Limits

The Town will adhere to a debt parameter wherein the outstanding debt shall not exceed three (3) percent of the Town of Shrewsbury's Assessed value.

### C. Structure and Term of Debt

The following shall be the Town's guidelines on debt terms and structure:

1. Issue long term debt only for capital projects or assets that have a long useful life. It should be issued to pay for the cost of significant infrastructure and capital projects. Long-term debt should not be issued for recurring, small capital purchases with a useful life of less than five years.
2. The town will maintain good communications with bond rating agencies about its financial condition. The town will follow a policy of full disclosure on every financial report and bond prospectus.

### D. Bond Refunding

To achieve potential debt service savings on long-term, tax-exempt debt through bond refunding the Town will:

1. Bonds will be paid back within a period not to exceed the expected useful life of the capital project or the period defined by state law; whichever is shorter.
2. The Town should attempt rapid debt repayment schedules. This ensures cost savings to the community and seeks to avoid strapping future generations with large debt obligations. This policy recognizes that capital needs continue and that new debt will continue to be identified and issued.

### E. Protection of Bond Rating

To protect its bond rating, the Town will:

1. The town will retire bond anticipation debt within 6 months after completion of the project. Exception- Town may carry BAN(s) longer if market conditions are not favorable.
2. Refunding bonds should be issued only if the present value of debt service saving exceeds 3 percent of the debt service amount of the refunded bonds.
3. The Town will strive to limit annual increases in debt to a level that will not materially jeopardize the Town's AAA credit rating.

#### *References:*

[M.G.L. c. 41, § 59](#)

[M.G.L. c. 41, § 61](#)

[M.G.L. c. 44, § 4](#)

[M.G.L. c. 44, § 6](#)

[M.G.L. c. 44, § 6A](#)

[M.G.L. c. 44, § 7](#)

[M.G.L. c. 44, § 8](#)

[M.G.L. c. 44, § 17](#)

[M.G.L. c. 44, § 19](#)

[M.G.L. c. 44, § 20](#)

[M.G.L. c. 44, § 21A](#)

[26 USC § 148](#)

DLS Borrowing Guidelines: [Asset Useful Life - Borrowing Limits](#)

DLS Best Practice: [Understanding Municipal Debt](#)

DLS Informational Guideline Releases 17-21: [Borrowing](#) and 17-22: [Premiums and Surplus Proceeds for Proposition 2½ Excluded Debt](#)

Government Finance Officers Association Best Practices: [Refunding Municipal Bonds](#)

Internal Revenue Service Guidance: [Arbitrage Guidance for Tax-Exempt Bonds](#)

Adopted this 13th day of November, 2018 by the Board of Selectmen

Reviewed November 12, 2019 by Board of Selectmen during their scheduled meeting.

Reviewed November 24, 2020 by Board of Selectmen during their scheduled meeting.

