Town of Hawley, MA

Financial Policy Guidelines

Principles

Live within our means.

Don’t put off til tomorrow what we can afford to do today.

Do not overstate revenues or understate expenses.

Do not use Free Cash for Operating Expenses.

5ave for a rainy day.

Plan for tomorrow.

Use Balance Forward accounts where appropriate and allowed.

Clean up Balance Forward/Fund accounts with “no longer needed” residuals.

Introduction

A well developed and practiced financial plan can provide guidance to Town Officials to ensure the best use of funds as well as provide stability both short and long term. Financial policies can improve a Town’s credit rating and reduce interest cost on debt issued by the Town.

The Treasurer and the Administrative Assistant should review these financial guidelines with the Finance Committee and the Board of Selectmen annually.

- Funds needed to provide the necessary balances must be appropriated prior to any appropriations for operations.
- If recommended balances cannot be attained in any given year, a plan to meet the balance guidelines must be established and affirmed by both committees.
- The Treasurer and Administrative Assistant will provide annual projections and suggested levels for additions to the Reserve Fund, Stabilization Fund, Capital Projects, Debt Service and use of current year certified free cash.

Financial Guidelines

The following recommended guidelines for the management of Free Cash, Reserve Fund, Stabilization Funds, Capital Projects and Debt Management should serve as a platform for the annual town meeting warrant. The principles contained in these guidelines must be incorporated in the recommendations by the treasurer and

Administrative Assistant in each year's budget and used as the basis for any projections of the Town's future financial condition.

The following sections outline the longer-term financial goals of the Town. In some cases, the attainment of certain levels of funds or percentages may not be attainable in the short-term. Specific short-term goals are outlined in the Financial Planning section of this document.

<u>Free Cash</u>

The accumulation and use of Free Cash, is an important component of the Town's overall financial management policies. The available amount is calculated and certified each year by the Massachusetts Department of Revenue using data submitted by the Town. Free cash is made up of *revenues in excess of projections* and *expenditures less than appropriations* at fiscal year end. Free Cash is also used in order to cover any deficits (all funds) at year-end. Free Cash should never be used as a mechanism for funding the Town's operating budget since it is not "recurring" revenue.

Therefore the following policy for the use of Free Cash must be applied in each budget cycle:

> a. Reserve Fund - Appropriate at least 0.2% of the Operating Budget for a Reserve Fund for Unforeseen and Unexpected Financial Crises that may occur during the fiscal year. More may be required in years of difficult economic conditions.
>
> b. Stabilization - Appropriate amounts at least 5% of Free Cash after Reserve Fund appropriation or until the balance in the Stabilization Funds meets the limit set by Massachusetts General Law (MGL) as detailed in the section below.
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> c. Capital Projects (No Long Term Debt Issued) - Appropriate amount not to exceed remaining balance of Free Cash after above appropriations. Capital Projects should have a value of $2,000 or more and having a useful life of at least 3 years
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> **<u>Reserve Fund</u>**
>
> It is imperative that the Town set aside a minimum balance of 0.2% of the operating budget each year in order to provide a Reserve Fund for unforeseen and unexpected financial crises that may occur during the year.
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> **<u>Stabilization Funds</u>**
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> Stabilization Funds are special reserve accounts allowed by Massachusetts General Laws to fund any lawful purpose, including approved school projects

under Chapter 70B and any other purpose for which the town may lawfully borrow money. Any appropriations into or out of these funds shall require a two-thirds vote at Town Meeting, except as provided in paragraph (g) of section 21C of MGL Ch. 59 for a majority referendum vote. Bond rating agencies rate municipalities more favorably if they maintain a healthy balance in this and other reserve type accounts. Since this is not a recurring source of revenue, the Town should avoid the use of stabilization funds to fund operating expenses, with the exception of an established payment plan to pay down debt. The aggregate amount in all Stabilization Funds may not exceed (10%) ten percent of the equalized valuation of the Town (EQV) and all interest shall be added to and become part of the funds. The Treasurer may invest the proceeds in keeping with the regulations as set in MGL Ch. 40, s. SB.

Therefore, the following policy is recommended regarding Stabilization Funds:

1. A minimum balance of 5% (approx. $50,000) of the current operating budget should be maintained in the Stabilization Funds.

2. Withdrawals from Stabilization Funds should only be used to mitigate a catastrophic or emergency event(s) that cannot be supported by current general fund appropriations or for the pay down of planned debt incurred in stabilization accounts specified for that purpose (fire dept and highway dept equipment).

    a. Withdrawals of funds should be limited when possible to the amount available above the 5% minimum reserve previously referenced.

    b. Withdrawals from stabilization that drive the balance below the minimum level should be avoided. If, however this was deemed necessary, the Treasurer and Administrative Assistant, together with the Finance Committee should develop a detailed plan that will replenish the fund until it reaches at least 5%.

Capital Projects (No Long Term Debt Issue)

Capital purchases are an important part of the overall fiscal and physical health of the town. Operating budgets must not displace the purchase of capital items. Capital Projects should have a value of $2,000 or more and having a useful life of at least 3 years. Using a five year plan the Treasurer and Selectboard can best plan for the capital needs of all departments and make those needs known to the Finance Committee for approval.

Debt Management (Long Term Borrowing)

Debt Management is essential to the overall financial planning of the town. Borrowing funds and repaying over a number of years allows the Town to finance projects it could not afford to pay from its operating budget. The objective of debt management is to borrow at the least cost over the term of the repayment of debt. The town should only borrow when doing so reduces the impact of capital purchases on the taxpayer.

Recommended Guidelines for Debt

a. Minimize amount of debt funded within the operating budget of the Town.

b. Principal, Long Term Interest, Short Term Interest, and borrowing costs should be approximately 5% of the total budget.

c. The total of Non Dedicated Revenue Supported Debt should not exceed 10% of the operating budget.

d. Repayment schedules should be in accordance with published requirements and be set as aggressive as possible.

Following the above guidelines will ensure:

1. Capital Projects are not displaced by the fiscal demands of current operations.
2. Borrowing is controlled.
3. Interest Costs are minimized.
4. Capability to borrow is quickly restored.

Financial Planning

Proper financial planning is essential for the Town in order to continue the services necessary for its residents in the most cost effective method possible. Decisions made to alleviate issues in one budget cycle may carry impacts for several years down the road. The Town will maintain a budget forecast at a minimum of 3 years to assist in the planning of future projects, and quantify the impacts of today’s decisions on future years.

Increases to the budget on the expenditure side cannot be allowed to increase greater than the recurring revenues available. This is essential for proper fiscal management. Inflating revenue projections and under budgeting expenses to balance an operating budget cannot be allowed to occur. Using other non-recurring revenue items and moving dollars from older warrant articles should only be used for like non-recurring expenses.

The Town must take care to fund its obligations relating to health insurance, retirement benefits and snow and ice expenditures at the appropriate amount.

- At a minimum, the Snow and Ice budgets should be crafted using a five year rolling average expenditure total.

Underfunding these obligations will mandate the use of the following year's revenue stream to meet the expense, thus perpetuating the shortfall.

Planning for capital purchases as well as the ongoing maintenance of facilities and equipment is an essential part of the financial plan for the Town. The following guidelines should be adhered to:

- A detailed fìve-year capital plan, including projected funding sources, should be maintained by department..
- Capital purchases will be accomplished either as a capital exclusion item, raised by taxation when funds within the levy are available, an appropriation from Free Cash, or an appropriation from an available fund.
- Debt exclusions shall be required to authorize the funding of capital projects, as previously defined, if such projects cannot be paid for completely within the current fiscal year.
- Infrastructure maintenance budgets, such as General Highways and Machinery Maintenance, or facility maintenance budgets built into the operating budget should not be reduced to fund other department budgets.

It is the intention of the Town to minimize the amount of debt and capital exclusions since this amount has a direct impact on the taxpayer. As a general guideline, the tax impact of excluded items should be held to less than 10% of the single tax rate. In some instances, such as periods where multiple projects may be in process or recently bonded, this guideline may be exceeded. In those instances, the Treasurer with, the Finance Committee, should develop a plan to reduce this ratio by either reducing or eliminating capital exclusions or delaying future projects, if circumstances allow.

Financial Terms:

Bond Anticipation Note (BAN): Short term debt instrument used to generate cash for initial project costs with the expectation that the debt will be replaced later by permanent borrowing. Typically issued for less than one-year, BANs may be reissued for up to seven years, provided that principal repayment begins after two years (MGL ch 44, s 17).

Bond Rating: A credit rating assigned to a municipality by a credit rating agency to help investors assess the future ability, legal obligation, and willingness of the municipality t0 make timely debt service payments. The rating helps prospective investors to determine the level of risk associated with a given income investment.

Capital Outlay Expenditure Exclusion (MGL ch 59 s 2Ic ss I 1/2*):* A temporary increase in the tax rate, approved via referendum vote to fund a capital project or make a capital acquisition. The exclusion is added to the tax levy only during the year in which the project is being funded and may increase the tax levy above the levy ceiling for that year only.

Debt Exclusion (MGL ch 59 s21C ss K): An action taken by a community through a referendum vote to raise the funds necessary to pay for debt service costs for a particular project from the property tax levy, but outside the limits of Proposition 2 ½. The amount is raised above the tax levy for the life of the debt only.

Department of Revenue (DOR): State department responsible for collecting a wide variety of taxes, providing taxpayer support, and administering programs related to municipal finance through the Division of Local Services.

Excise Tax (MGL ch 60A, s 1 et seq.): A locally imposed annual tax to owners of motor vehicles registered to an address within the community

Enterprise Fund (MGL ch 44, s53 1/2*):* A separate accounting and financial reporting mechanism for municipal service for which a fee is charged in exchange for goods and services. It allows a community to demonstrate to the public the portion of total costs of a service that is recovered by user charges and the portion that is subsidized by the tax levy, if any.

EQV: an estimate of fair cash value of all taxable property in each city and town as of January 1 of each year.

Fees: Costs charged for services provided as allowed per MGL.

Free Cash: Remaining, unrestricted funds from operations, including unexpended free cash from the previous fiscal year, actual receipts in excess of revenue estimates on the tax recapitulation sheet, and unspent amounts in budget line items. Free cash is certified annually by the Division of Local Services, usually in advance of the Fall Annual Town Meeting. Unpaid property taxes and certain deficits reduce the amount that can be certified as free cash.

Gift: A sum of money or item donated to the Town or the public schools to be used either freely or toward a particular purpose.

Generally Accepted Accounting Principles (GAAP): Uniform minimum standards and guidelines for financial reporting that serve to achieve a level of standardization.

Government Accounting Standards Board (GASB): The ultimate authoritative accounting and financial reporting standard-setting body for state and local governments.

Grant: A sum of money awarded by the state or federal government and occasionally by private individuals or companies to be spent for a particular purpose.

Inter-fund Borrowing: An advance between funds in order to fund debt that will either be repaid or externalized through BANs or permanent debt by the close of the fiscal year.

Inter-fund Transfer: An amount that is transferred to general fund revenue from special revenue and enterprise funds to offset costs associated with those funds that are paid for by the general fund.

Levy Ceiling: One of two levy restrictions imposed by proposition 2 ½. Real and personal property taxes imposed in any year may not exceed 2 ½ percent of the full and fair cash value of all taxable property. Property taxes levied may exceed this limit only if the community passes a capital outlay expenditure exclusion, or a debt or special exclusion.

Levy Limit: The other of two levy restrictions imposed by Proposition 2 ½.. Real and personal property taxes imposed by a city or town may only grow by 2 ½ percent over the prior year's tax levy, plus new growth plus any overrides or exclusions.

New Growth: The additional tax revenue generated by new construction, renovations, and other increases to the property tax base during the calendar year.

Non-Dedicated Revenue: Funds received at the state and local levels of government that may be utilized for any purposes. These unallocated funds are acquired through business and property taxation. ***Dedicated revenues*** might include sewer assessments, broadband assessments and utility assessments.

Override (MGL Ch 59 s 21 C ss 0): Process established by Proposition 2 ½ which allows the taxpayers of a community to increase tax revenue by permanently increasing the levy limit through a referendum. The override question on the election ballot must state a purpose for the override and the dollar amount.

Personal Property Tax: The tax on movable items not permanently affixed to, or part of the real estate. It is assessed separately from real estate to certain businesses and public utilities.

Proposition 2 1/2 (MGL Ch 59, s 21C): Statute which limits property tax increases by municipalities to an annual limit of 2.5% of the total levy over the previous year plus new growth. It was passed by initiative petition in 1980, and went into effect in 1982.

Rating Agency: A company that assigns credit ratings for issuers of certain types of debt obligations as well as the debt instruments themselves. The two agencies used by municipalities are Standard and Poor's (S&P) & Moody's.

Reserve Fund (MGL Ch 40, S 6): An amount set aside within the budget of a town to provide a funding source for extraordinary or unforeseen expenditures. Funds are released based on recommendation of the Selectboard, approved by the Finance Committee.

Revenue Anticipation Note (RAN): A short term loan issued to be paid off by revenues, such as tax collections and state aid.

Stabilization Fund: A fund designed to accumulate amounts for capital and other future spending purposes, although it may be appropriated for any lawful purpose (MGL Ch 40, See 5B).

State Aid: Revenue allocated by the Commonwealth to cities, towns, and regional school districts.

Tax Anticipation Note (TAN): A short term note issued to provide cash to cover for operating expenses in anticipation of tax proceeds.

Tax Levy: The amount that a community raises through real and personal property taxation. The tax levy can be any amount up to the levy limit, which is re-established every year through Proposition 2 ½. The annual budget is based on the tax levy, coupled with projected state aid, local receipts and transfers in/out.

Tax Recapitulation Sheet: A worksheet submitted by a city or town to the Department of Revenue to calculate and set the tax rate. It consists of four pages (With numerous supporting documents); the tax rate summary (page 1), the total amounts to be raised (page 2), local receipts (page 3), and certifications and appropriations of funding (page 4). The compilation of data on this worksheet calculates the tax rate, and determines if the rate is under or over the levy limit. The tax rate cannot be set if the city or town exceeds the levy limit.

Tax Title: A collection procedure that secures a community's lien on real property and protects the Town's right to payment of overdue taxes. Otherwise, the lien expires five years after the January 1 assessment date if the property has been transferred to another owner. If the amounts remain outstanding on a property after issuing a demand for overdue property taxes and publishing a notice of tax taking, the treasurer/collector may take the property for the city or town. The Treasurer/Collector may initiate foreclosure proceedings six months after the instrument of taking is recorded.

Trust Fund: A sum of money donated or transferred to a municipality with specific instructions on its use.

Unreserved Fund Balance: The amount by which cash, accounts receivable and other assets exceed liabilities and restricted reserves. It is akin to "stockholder's equity" on a corporate balance sheet. It is not, however, available for appropriation in full, because a portion of the assets listed as "accounts receivable" may be taxes receivable and uncollected.