

COMPREHENSIVE FINANCIAL ADVISORY COMMITTEE (CFAC)

CFAC Report: Fiscal Policy Reevaluation

For

FY 2022

Committee Members

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CFAC provides financial advice to the Town Council on the yearly operating and capital budgets for all town agencies, including the school department budget adopted by the School Committee. The advisory responsibilities of CFAC are found in The Administrative Code of the Town of Barnstable, Chapter 241, Section 18 and Section III, Paragraphs A-C.

INTRODUCTION

In accordance with the Town of Barnstable Charter, Part VI, Section 6-2 and Chapter 241-18 of the Administrative Code, the Comprehensive Financial Advisory Committee (CFAC) submits its review, comments, and recommendations for the proposed FY 2021 Operating Budget to the Town Manager and Town Council.

CFAC's advisory responsibilities do not include evaluation of fiscal policy. Fiscal policy is the responsibility of the Town Council and Town Administration. However, both Town Council President Paul Hebert and Town Manager Mark Ells approved CFAC's request to discuss and forward its comments and recommendations on the Town of Barnstable's re-evaluation of its fiscal policy for FY 2022.

CFAC extends its appreciation to Council President Paul Hebert, Town Manager Mark Ells, and Finance Director Mark Milne for the confidence they have in our committee's experience and familiarity with the budget process to submit comments and ideas on fiscal policy.

METHODOLOGY

CFAC Councilor Liaison Paula Schnepf informed CFAC that the Council would hold its strategic planning meeting in September 2020. She outlined the Council's expectations of CFAC's analysis and recommendations that will serve as part of the Council's resources. In this report, CFAC addresses those expectations.

The proposed strategic planning for FY 2022 includes a re-evaluation of a number of fiscal policies:

- Resources dedicated to capital program and operations
- Review of designation of specific revenues
- Review of allocations within General Fund operations
- Review Enterprise Fund subsidy policy
- Review indirect cost model for Enterprise Funds
- Review cost of service recovery policy
- Implement new or revised fees
- Review tax levy policy
- Review Comprehensive Wastewater Management Plan (CWMP) financing

Town Finance Director Mark Milne provided financial updates, background information, and the post COVID-19 budget process to assist CFAC's discussion of each of the fiscal policies designated for review.

As in its past reviews of the Town Capital Improvement Budget and the Town Operating Budget, CFAC submits this report to provide the Council and Administration with an independent assessment and recommendations. CFAC's report represents thorough discussion and input from all its members and approved for transmittal to the Town Manager and Town Council.

OVERVIEW

The serious economic effect of COVID-19 on Town finances and the rapid and successful response of Town administration and Council leadership to revise revenue projections and resource allocations for FY 2021 produced both a revised budget that addressed immediate fiscal challenges and an opportunity to evaluate new approaches and modifications to existing fiscal policy and the processes to guide budget formation.

While the response to the economic shutdown has been timely, appropriate, and effective, it may not be the final chapter. Recovery is highly uncertain and may be subject to a sustained low level of economic activity. The Federal Reserve has predicted that the economy may take years to rebound, despite near zero interest rates and the Fed's quantitative easing bond buying and Main Street programs. In addition, the prognosis about COVID-19's resurgence remains unknown.

By re-evaluating its fiscal policy, the Town of Barnstable is taking steps to ensure that Town finances are not permanently scarred by the economy. An objective review of its economic and financial framework underscores the Town's commitment to a fiscal policy that strengthens the stability of its revenue and expenditures and its ability to respond to economic downturns.

FISCAL POLICY

Fiscal policy is directly governed by the Town Council. It is influenced by the goals and priorities established by Town Council to improve the quality of life in the Town of Barnstable. Toward that end, the Council has set a fiscal policy, which includes revenue, expenditures, and debt, to stabilize its financial framework to achieve its long-term objectives of budget sustainability, capacity to meet future needs and increase the potential for growth through investments in infrastructure and education.

The current Barnstable policy of fiscal accountability is based on sound financial management through balanced budgets, adequate reserves, stability of the tax base, and minimum government debt. The strengths of the current fiscal policy have provided sufficient revenue to fund both essential needs and expansion of programs and services. The re-evaluation of fiscal policy for FY 2022 seeks solutions to speed budget recovery without sacrificing support for the essential services and programs that define Barnstable's quality of life.

REVENUE

The revenue sources for the Town of Barnstable are more reliable and constant than those of other jurisdictions that depend on income and general sales taxes, which fluctuate with the economic circumstances. Property and excise taxes form the basis of Barnstable's revenue and provide 78% of the funding for the General Fund. Other sources of General Fund revenue include intergovernmental aid, fines and penalties, fees, licenses, permits, interest, charges for services, special revenue funds, interest, Enterprise Funds, Trust Funds, and reserves.

In addition, Proposition 2 ½, which allows a statutory increase in property tax annually, guarantees an automatic increase in revenue. This revenue stability, along with new property growth, has given Barnstable the ability to fund its ongoing services and programs, expand, and/or initiate new services and programs, undertake capital improvement projects, and generate cash reserves.

This healthy and steady revenue has earned Barnstable a AAA bond rating and enabled the Town to issue bonds at very favorable interest rates.

The complex and unpredictable economy that is emerging from the unprecedented and precipitous lockdown of both citizens and economic activity presents both a challenge and an opportunity to discuss and consider changes to the conventional public revenue paradigm.

CFAC submits the following revenue suggestions for fiscal policy re-evaluation:

Designations of specific revenues - Many taxes and fees have been sources of revenue for specific departments and programs. For example, the beach revenue has traditionally been given to the Community Services Recreation; motor vehicle excise tax goes to Department of Public Works which repairs and maintains roads; and the rooms and meals tax funds the CWMP. On the other hand, CH70 funds become part of the General Fund.

The issue for consideration is should fees continue to be designated to their specific areas of service, or should fees become part of the General Fund and appropriated to specific departments and Enterprise Funds as part of the budget?

Should existing fees remain the same or increased based on increased costs to administer the services and the increase consumer price index? For example, is a small increase in transfer station fees-solid waste and recycling- appropriate to cover the increased costs of this operation? Is an increase in the Marine Enterprise Fund slip waiting fee, which currently is very low, a possibility? While fees and permits are not a major revenue source, their combined impact may increase total revenue and may decrease General Fund support of specific programs.

National reports indicate that the reopening of the economy has been uneven. It appears that tax revenue from food, beverages, and rooms will be hit hard. This will have an impact on Town revenue, but this income represents a relatively small amount overall. The increase in excise taxes and assessments could easily compensate for any shortfalls in the other amounts.

What new taxes or fees might be possible without legislative approval?

For example:

1. An environmental protection fee/ tax per diem at hotels/motels. Many cities have a hotel resort/day tax to pay for environmental protection and city infrastructure. These fees range from \$3.50/day in New York City to 3% /day in Miami to \$25/day in Honolulu. Boston hotels have a convention fee added to their daily room rates. This fee would help pay for CWMP or repair/maintenance of the water system.
2. A tax on non-carbonated beverages, plastic bottles would raise revenue and decrease littering.

Tax levy policy - Property tax levy increases are limited by Proposition 2 ½. Through prudent budget management, Barnstable has consistently had an annual override capacity of more than \$200 million. This capacity demonstrates Barnstable's steady ability to balance its budget without overrides. The override has seldom been used in Barnstable. The last referendum for an override was to fund Barnstable's portion of the newly constructed Regional Technical High School.

In the event that Barnstable's budget for programs and services exceeds its projected revenue, the Town may elect to use either its override or debt exclusion option. Both require voter approval through a referendum. Both the override and debt exclusion options provide mechanisms to finance CWMP, for example. The debt exclusion would allow an increased tax levy for CWMP for a specific period of time to cover the cost of the project and would not become part of the tax base. The override, on the other hand, results in a permanent increase of the levy limit of 2 1/2% each year. The key consideration in overrides and debt exclusions is its impact on property owner tax liability and the effects that an increased tax burden may have on economic development and quality of life.

Revenue to fund CWMP - Because CWMP's projected costs exceed \$1 billion over the next thirty years, Town Council faces the daunting challenge of putting together a combination of funding sources to enable this project to proceed. The existing specified funds include: 100% of the local meals tax generated in town; 33% of the local rooms tax generated in town on traditional lodging (hotels/motels/B&B); 100% of the local rooms tax generated in town on stabilization trust fund – Council created a separate Stabilization Trust Fund (STR) dedicated for wastewater and water; and the new 2.75% tax on traditional lodging and STR's capewide overseen by the Governing Board of Cape Cod & Islands Water Protection Fund.

Discussions and analysis of the viability of some other revenue sources include the Capital Trust Fund, property tax contributions, and assessments. The Proposition 2 ½ override and debt exclusion are also options.

Revenue to fund private road maintenance - The cost of installing new sewers and possibly new drinking water pipes and utility lines along private roads raises the issue of management of the estimated 1,100 private roads in the Town of Barnstable. If a private road, meets certain criteria, its maintenance can be financed through Sewer Construction and Private Way Maintenance funds. However, as sewer infrastructure and installation progress, funds may not be sufficient. CFAC suggests that Town Council develop a new funding plan for construction and subsequent maintenance of private roads.

Capital Trust Fund (CTF) - Long-term projects like CWMP, wastewater management treatment, and private roads are important for health and safety in Barnstable. CFAC suggests the addition of revenue from all new growth from taxes on properties over \$1 million to the Capital Trust Fund. This will increase the capacity of the CTF to fund these projects as well as others. CFAC recommends increasing the CTF by 1-2% annually.

EXPENSES

The financial upheaval and revenue disruption caused by the pandemic required revision of the FY 2021 budget that freezes hiring, reduces discretionary spending, and defers capital projects. The revised budget is a remarkable achievement that reflects the experience and commitment of Town Administration and Town Council to ensure that health, safety, education, and other critical needs and programs have appropriate funding to continue operations.

Capital Improvement and Operations - Evaluation of proposed capital improvement projects through the two-step process created in 2018 has streamlined the method of evaluating proposed capital improvement projects. Ranking projects in descending order from “must do” to “nice to do” has

resulted in sending a list of highest-ranking projects to the Town Manager for his evaluation and approval.

CFAC reviews the CIP budget each year and has recommended shifting certain recurring projects from the capital budget to the operating budget. It has been the view of CFAC that capital outlays that are used to maintain current capacities or town assets should be included in the operating costs of the Town. For example, painting, replacement parts or replacement equipment, repaving of parking lots, and floor repairs are recurring costs that are often included in the capital budget each year. CFAC has often recommended a deferred maintenance plan for Town properties and equipment.

CFAC suggests that Town Council discuss the issue of these recurring maintenance and replacements that are proposed as capital expenditures. Should there be a separate category of expense in the operating budget rather than repeated requests for capital outlay?

With tight budget constraints for the next few years, how much and what kind of capital expenditures would be the most prudent use of Town funds? Should more Town funds be used for the operating budget to ensure that the services and departments have the capability to meet the needs of residents? The re-evaluation of fiscal policy for FY 2022 should include consideration of the municipal operations and the allocation of resources. Perhaps the General Fund budget process could adopt the capital improvement process of priority ranking from “must have” in descending order to “nice to have”.

The revised FY 2021 budget shows clearly that proposed categories that were not “must have” were halted or deferred, and only top priority expenditures were included in the budget. Perhaps the success of this process can be helpful as Barnstable deals with its recovery strategy. Budget recovery strategy proposals include reduction of personnel costs, reduction of material, utility and contractor costs, and reduction of capital spending.

Five Year Plan additions to the Capital Plan - The FY 2021-2025 Five Year Plan for capital projects include \$100 million for approximately 121 sewer projects. This plan represents a 40% increase over the FY 2020-2024 Plan and reflects the Town's commitment to implementation of its Comprehensive Waste Management Plan (CWMP).

As a result of the COVID-19 economic impact, CFAC suggests that the fiscal re-evaluation process for FY 2022 include a review of all assumptions of the FY 2021 Five Year Plan to determine if any changes need to be made.

Comprehensive Wastewater Management Plan - At the request of the Town Manager, several CFAC members served as liaisons to the Water Resources Advisory Committee (WRAC) from the spring of 2016 to the summer of 2017. The thorough studies of water quality in the groundwater, ponds, rivers, failing septic systems, new flood zones, and watersheds and embayment impairments resulted in a revised CWMP plan that was submitted to MassDEP for review and approval.

CFAC's involvement with the WRAC deliberations and WRAC's finance subcommittee provided CFAC with the perspective of the scope, cost, and, most importantly, the critical need to proceed as expeditiously as possible with CWMP projects. In its review of Capital Improvement Projects during the last few years, CFAC has expressed its willingness and interest to provide input on the financing of CWMP. CFAC remains available to provide input while the updated CWMP is being developed, if Town Administration and Town Council feel we can be helpful.

Progress of CWMP could be hindered by the COVID-19 economic shutdown and the uncertainty of projected 1% revenue growth from the rooms and meals taxes, which are specifically designated to fund the sewer construction.

CWMP is an enormously expensive project and should remain a top priority for funding in the budget. It is impossible to raise parking fees, greens fees, transfer station fees, ice skating fees, water rates, or the price of any other permit/sticker/stamp to significantly impact revenue growth. CFAC urges Town Council to take a hard look at all Town expenses and consider restructuring everything – including getting rid of the sacred cow of Fire Districts

Everyone agrees that Barnstable's environment affects not only the quality of life for residents but also its attraction for visitors. Updates of infrastructure and maintenance of drinking water, sewers, roads, and pristine beaches are imperative, if Barnstable hopes to maintain its level of vacationers who currently provide 40% of the Cape Cod economy.

Enterprise Funds - Enterprise Funds are intended to be financially self-supporting at the same time that they enhance the quality of life for both residents and visitors.

Temporary subsidies of some Enterprise Funds have been used occasionally, when they were needed. Based on its quality of life strategy plan, Town Council should determine the level and frequency of subsidizing specific Enterprise Funds as well as their level of indirect costs.

School Funds - The school/General Fund allocation for operations ratio has traditionally been 60:40. CFAC recommends consideration of options that would change the present ratio:

- Ratio of Operating Budget to Schools based on enrollment: The ratio could be based on the increase or decrease in enrollment of students.
- Ratio of Operating Budget to Schools based on the size of the General Fund budget: As the percentage of Town revenue increases through tax levies and new growth, expected school expenses may not increase at the same rate. As a result, the school/ GF budget ratio would decrease accordingly. This decrease in education appropriation as a percentage of an increased operating budget has a long history across the United States. For example, when state annual budgets were in the \$4-8 billion range in the 1980's, education (K-12, community colleges, and higher ed) received an average of 50% of total appropriations. In the recent past, when most state annual budgets are in the \$40-80 billion range, total education appropriations are now 30%. The FY 2019 MA state budget appropriated 22.9% (\$15.6 billion) to education; CT appropriated 24%, or \$18.96 billion. NH appropriated 27.9%, or \$15.34 billion. The national average was 29.9%.
- CFAC also suggests consideration of the establishment of a second school budget fund with the CH70 revenue, which currently goes into the General Fund.

Department Funds - To build a rainy day fund for department operations, CFAC suggests a 2% budget decrease in each department to be placed in a reserve fund for use during slowdowns in the economy and decreases in Town revenue.

SUMMARY

While Town Council's re-evaluation its fiscal policy focuses on FY 2022, CFAC recommends regular re-evaluations going forward. Two important factors influence this recommendation: NIH and CDC warnings that the virus caseload and infection rate are far from over and may have resurgence; the Federal Reserve prediction that it may take years for the economy to recover.

CFAC urges the Town to remain flexible and fluid as it responds to the needs of residents and businesses. Prudent use of the emergency funds and grants, like Mass Ideas, will allow the Town to adapt to new situations with innovative approaches and solutions.

Most recently, the Town has demonstrated its ability to solve problems with new solutions. One example of the Town's nimble response is the closing of one lane of Main Street in Hyannis to help businesses and restaurants to operate while social distancing advisories remain in place. Another example is the presence of a special police presence at the beaches to ensure that social distancing and crowd size are observed. These decisions and actions indicate Barnstable's adaptive responses that protect safety and health and help businesses to survive.

CFAC encourages the Town to continue its innovative approach to both fiscal policy and responses to unprecedented situations.

CFAC appreciates the opportunity to provide Town Administration and Town Council with its independent assessment of Town fiscal policy. CFAC hopes that its review of the scope of both revenue and expenses and suggested areas for consideration will be helpful when Town fiscal policy is re-evaluated for FY 2022. We extend our willingness to help in this process, if Town Administration and Town Council feel it would be beneficial.

As always, CFAC extends its appreciation to Mark Milne, Town Finance director, and Nathan Empey, Budget Analyst, for providing information, insights, and assistance with this review.