

January 31, 2012

Select Board
Finance Committee
Town of Hadley
100 Middle Street
Hadley, MA 01035

Re: Budget FY 2013: ○²

Dear Members of the Select Board and Finance Committee:

Greetings. I am pleased to present the budget information for Fiscal Year 2013 for the Town of Hadley.

Let me begin by pointing out that this budget is not in balance and requires significant work to bring to closure. Most notably, the School Department's budget request has seriously put the overall budget askew.

The budget was prepared and presented using our automated accounting program, VADAR. The layout of budget information, therefore, is substantially different than any other budget which I have prepared. Department heads, boards, commissions, and officials have learned this new way of preparing their budgets, and they are to be commended for working successfully with an unfamiliar process. In addition to the hard copy provided here, the budget is available on-line, and at the request of the Finance Committee I have not assembled them a physical copy.

The Select Board announced the first steps in the budget process, and their principals have guided this budget, to a point. First, there shall be no general proposition 2½ override. Second, services shall be maintained at existing levels. Third expenditures from reserves shall be for the purpose of capital needs. Fourth, in all areas within our control, government shall be set on a sustainable course. At a minimum, this means that existing financial management policies will be followed. Unfortunately, strict adherence to these principals is not possible given some of the budget requests submitted, and I have used the Select Board's principals to guide the formulation of the budget as closely as I can. Much work and debate remains to be done, and together we must square the circle.

The Larger Picture

The Town of Hadley has weathered a very difficult couple of years, and just when it appeared that the economy was going to stabilize, we were presented with a series of poor decisions at the national and international level that have plunged us back into uncertain times. All the signs are in place for a gradual recovery out of the worst economic downturn since the 1930s. But just when recovery seemed at hand, our national leaders engaged in an irresponsible game of brinkmanship with the American economy. The result is a lower national credit rating from Standard and Poor's and future automatic budget cuts that will affect funding for education, public safety, community development, and roads and bridges.

Our American crisis was coupled with insolvency in European nations, touching off instability in international monetary markets, trade, and credit. Countries such as Greece, Italy, Spain, Portugal, France, Belgium, Ireland and Iceland all face unmanageable debt, which can only be addressed by austerity programs and international bailouts.

Energy prices also remain volatile, with political instability throughout the Near East making oil exports uncertain. Increasing demand from the growing economies in South America, Africa, and Asia will put pressure on energy prices. Our national oil reserves are nearly depleted, and when they are replenished, there will be pressure to drive prices upward. The futures market for such energy sources as gasoline and heating oil continue their volatility, and the general expectation is that energy prices will slowly rise over the next year until gasoline approaches \$5.00 per gallon before prices either stabilize or fall.

Preparing a budget is never easy, and I am keenly aware of how hard it is for many people in Hadley. Unemployment in our town has risen from 3.9 percent four years ago to 6.2 percent at the end of 2011. For those who are unemployed and underemployed, it does not really matter that our rates are below the state average of 7 percent and the national average of 8.5 percent. I have tried to be sensitive to the needs of the entire community in putting together this budget.

Still, more needs to be done. So my first recommendation is that the Select Board work with its partners on the Planning Board and the Board of Assessors along with the Executive Office for Housing and Economic Development to establish a Tax Increment Financing Zone and offer tax incremental financing to promote job growth and economic development in a targeted and sustainable manner. This program will extend temporary tax credits to small, local businesses to expend and grow at no net loss to the town's tax base and create more jobs and assuring future revenues for municipal services.

Revenue

Our FY 2012 local receipts revenues have performed well to date, and we have collected 62% of the revenues listed on the tax recapitulation sheet by midyear.

Our enterprise fund revenues have performed less well in FY 2012 compared to last year. The prior year was hot and dry, and water consumption was boosted because of increased water consumption. During wet years, water consumption declines, and we have collected about \$50,000 less for both water and wastewater by midyear. In each enterprise fund, revenues have exceeded expenses, so both enterprise funds are in good shape for the first two quarters. We will monitor the next water and wastewater commitments to gauge where our final revenue amounts will be at the end of the fiscal year. Fortunately, both water and wastewater have sufficient reserves to make up for a shortfall, if any.

Taxation continues to be a significant source of revenue for the Town. A stable, competitive tax strategy has given confidence to residents and businesses alike and has contributed to economic growth that the Town has enjoyed for years.

Our commercial base contributes almost 34% of the total tax value, whereas residential properties make up about 66% of the total. The Town has been fortunate to see its property values remain stable throughout the recession. Several years ago, commercial properties declined in value, whereas residential property values rose, and the tax burden shifted from commercial to residential properties. I am pleased to report that commercial property values have stabilized, as has residential properties. We can expect a stable and predictable valuation for the foreseeable future. For those businesses and residents who need help with their tax payments, Town Hall staff is willing to make payment arrangements. This is a service that we have always offered and will continue to do so.

I recommend that for FY 2013, the Select Board and the Finance Committee meet with the Board of Assessors to help integrate the budget planning process conducted in the spring with the budget reporting process that the Assessors do in the fall to set the tax rate. Since the Select Board, Finance Committee, and Assessors each have their statutory roles to perform, it is important to establish good communication early and often within the budget planning process.

Capital Program

A capital plan is vital to promote stability for businesses and for economic development.

A companion piece to this budget is the Capital Plan for FY 2013 through FY 2017. The Town of Hadley adopted a capital planning bylaw in 2007. In FY 2011, the Town adopted enhanced

meals taxes and by Select Board policy, dedicated that revenue stream to fund capital expenses. We are fortunate to have a vibrant restaurant corridor that sells over \$3 million of product monthly. We can expect a sustainable amount of \$240,000 each year to address capital needs, with the exception of water and wastewater capital expenditures. (These enterprise fund capital expenditures will be funded by wastewater and water funds.) The Town has identified its buildings as a priority for capital improvements, repairs, and modifications. The capital budget contains information about the most pressing repairs that need to happen for most of its older buildings. At the last town meeting, we transferred a significant amount into the Capital Stabilization Fund, and are now in the position where we can use that money to advance our capital program in time for the summer construction season. In the fall, we will replenish the Capital Stabilization Account with an equal, or better, amount of Free Cash in order to sustain a viable capital program for future years.

Most of a local government's wealth is invested in its capital facilities (e.g., streets, bridges, roads, buildings, utilities, and equipment). Local governments often find it easy in the short term to defer maintenance or upgrades to capital facilities, as that can be a relatively painless way to balance budgets during times of fiscal or economic constriction. Continued deferred investment in capital facilities, however, inevitably has a major long-term impact on a town's financial health. Failure to maintain capital assets properly often leads to (a) decreased usefulness of the assets, (b) increased maintenance or replacement costs, (c) increased risk for injury or liability from using deteriorating capital assets, (d) loss of efficiency in equipment, (e) increased the risk of building a huge future obligation created by a maintenance and replacement backlog, and (f) decreasing attractiveness of the town as a place to work, live, and do business.

Reserves

The Town of Hadley is very fortunate to have grown its reserves throughout the global recession. Healthy reserves provide a cushion for emergency spending, save toward planned capital upgrades, and help mitigate the worst effects of fiscal constriction.

In this budget, I propose to add to several stabilization accounts. First, the Town should continue adding \$10,000 annually to the Water Filtration Replacement Stabilization Fund. This would be the fifth year of saving to replace the 57 water filters, each with a replacement cost of about \$1,000, including labor. This installment advances to Town closer to funding 100% of this planned expense, and that goal should be achieved in FY 2014.

Second, in the fall town meeting, we should set aside meals revenues in a capital stabilization account to forward-fund capital plans for summer 2014. In addition, one-time revenues can be added to underwrite capital improvements.

Third, we should add to the Other Post-Employment Benefits (OPEB) irrevocable trust. The unfunded liability is a relatively new reporting requirement under GASB45 and shows the total future costs for retirees' health insurance and life insurance. Addressing the unfunded liability, however inadequately, places the Town of Hadley in the top 5% of Massachusetts cities and towns that have even begun to pay attention to this issue.

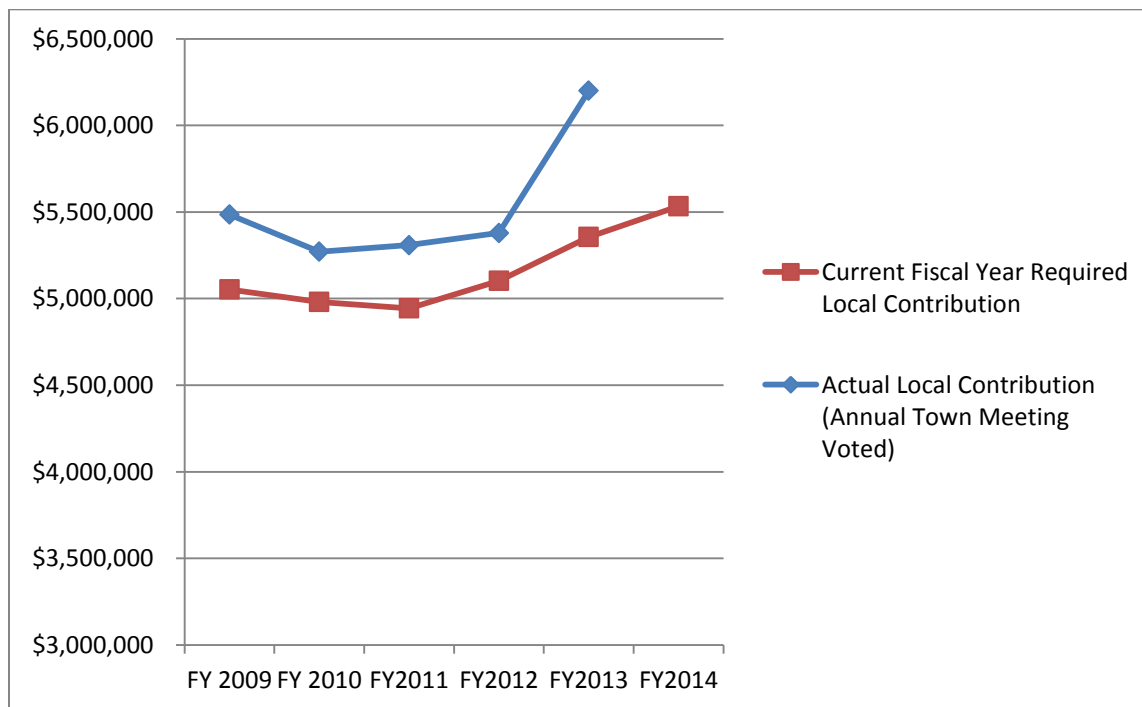
Operations

Schools: Hadley schools remain a source of community pride and are highly important to the Town's future. The Town is fortunate to have two schools that support positive educational experiences for its school children. Our long-time Superintendent, Dr. Nicholas Young, is advancing his career by taking the helm of the South Hadley school system, and we wish him well in his next professional endeavor.

The School Department has opened their budget request discussion with a \$6,200,000 request, albeit they have made it clear that this figure represents a starting point in a discussion. The amount of money that the schools need to close out FY 2012 and to fund fully FY 2013 is still unclear. For FY 2012, the Schools will need to meet contractual obligations, the full financial impact may exceed \$110,000, but the exact amount is still unknown. This uncertainty has implications for the entire Town's cash flow management, and serious discussion needs to happen shortly to avoid any potential problems. For FY 2013, the School Department has increased of their budget request by \$820,728 within one year. The School Department is exploring how such an increase developed, what were its root causes, and what measures are in place to prevent its reoccurrence. In addition, the School Department needs to plan for and adequately fund a new superintendent search and future operations that address the educational needs of school children.

All towns need to balance the need to educate children to allow them to reach their fullest potential yet remain within fiscal boundaries that are affordable and sustainable. The current School Department request of \$6,200,000 may fulfill the former need, but not the latter. The preliminary required local contribution established by the Department of Elementary and Secondary Education is \$5,356,386, whereas the School funding request is \$843,614 higher. The Town of Hadley has a practice of funding more than the minimum state-mandated requirement, as shown in the table and chart below.

	FY 2009	FY 2010	FY2011	FY2012	FY2013	FY2014
Current Fiscal Year Required Local Contribution	\$5,053,095	\$4,980,975	\$4,944,218	\$5,102,966	\$5,356,386	\$5,533,582
Actual Local Contribution (Annual Town Meeting Voted)	\$5,485,723	\$5,271,000	\$5,309,272	\$5,379,272	\$6,200,000	



State-mandated local required contributions have been rising at a rate of \$150,000 to \$250,000 annually since FY 2010. Maintaining the current level funding, although expedient for FY 2013, will result in major annual increases in mandated school funding starting in FY 2014. Those increases are likely to be unsustainable and will inevitably erode other municipal services.

As general government has done elsewhere in the budget, the School Department must present a plan to contain costs in such a way as to ensure a sustainable financial future. We are mutually dependent in this regard, as the Town's future depends on well-educated children, and schools

depend on a well-run town to support their education mission. The School Department and general government recognize each other as partners in our Town's commonwealth.

There are no easy answers to this. Barring a significant downward adjustment to the School Department's number, the Town will need to balance the budget by (1) using reserves in excess of \$800,000, (2) cutting programs and departments throughout town government, and (3) placing the matter before the voters in the form of a general override.

Department of Public Works: The Department of Public Works continues to improve services. Resources and labor are being deployed more consistently and strategically in the performance of duties. Duties and responsibilities that were given scant attention due to scarce resources are being addressed in a productive and responsible manner. Diverse and sometimes conflicting policies controlling personnel, finances, and operations have been consolidated. Of note, the rules for assigning overtime have been completely rewritten to provide more equity to all workers and at the same time save money for the taxpayers.

In this budget, the apportionment of costs between the General Fund (for highway), and the Enterprise Funds (for wastewater and water) has been recalculated. The result is that the enterprise funds are no longer used to subsidize the Highway Division operations. Costs are being tracked much more accurately, and the Town is getting a much better picture of what it really costs to operate the Wastewater, Water, and Highway Divisions.

There are two areas that still need to be addressed. The first is the police cruiser repair budget contained within the Highway Division. I recommend that the financial responsibility for maintaining and repairing police cruisers be borne by the Police Department budget. This will entail a reduction in the Highway Division budget and a concomitant increase to the Police Department budget. The effect should be a net zero impact to the overall budget, and the Chief of Police can make repair and maintenance decisions that take cost considerations into account.

The second issue is the Finance Committee's recommendation that the Highway Division establish and fund a separate snow and ice account. Mr. Terry Williams, Field Representative of the Division of Local resources, made the same recommendation at his presentation about municipal finances. I, however, recommend against establishing a separate snow and ice budget for two reasons. First, in order to qualify for FEMA and MEMA reimbursements, the Town needs minimally to maintain and report its current levels of funding for the snow and ice budget from year to year. In order to establish a separate snow and ice budget, the Town will need to set aside an amount for overtime in excess of its current overtime budget. Overtime associated with non-snow and ice management events (e.g., wind damage from thunderstorms, drifting snow and ice not part of a snowfall event, and road work from washouts) would also have to be added back into the Highway Division budget to avoid disqualifying the Town for disaster assistance. The effect would be to increase Highway Division overtime costs in order to achieve an accounting

task. It is in the better financial interests of the taxpayers to keep the accounting for snow and ice as it is.

The second reason for not creating a separate snow and ice budget is that such a segregation of resources infringes on the Select Board's managerial authority and unnecessarily constrains the Select Board's options to deliver public works services according to the Board's priorities. For example, if a snow and ice account exists and if there is less snowfall in any particular year, then the Select Board would not be able to access the unused money to address other important needs (e.g., backlogs in catch basin cleaning, side walk repairs, and tree trimming). Under the current arrangement, if there is a surplus within snow and ice line items, then the Select Board has the flexibility to repurpose money to address other important needs associated with roads and highways.

Enterprise Funds

Water: I am pleased to report that the Water Enterprise Fund is in better shape than it was last year.

The Town of Hadley has faced very difficult choices concerning water production, treatment, and distribution for almost a decade. In the 1990s, the Town discovered perchlorate in one of the Mount Warner wells (at the time that was the main source of drinking water for the town), and immediately set about developing a second main drinking water source. After considerable expense, the Town built the Callahan Water Treatment Plant, using ultra-filtration technology to treat the water.

The Water Commissioners agreed to raise water rates gradually and then freeze those rates for a three-year period, FY 2006 through FY 2009. This was done out of concern for the rate payers, who would see heightened water bills to fund the water debt incurred in building the water treatment plant.

The Water Commissioners kept that promise, even during a prolonged period of wet seasons that dramatically reduced water consumption, and hence water revenue. In addition, bacteria counts in scheduled water testing resulted in the Massachusetts Department of Environmental Protection imposing an order to chlorinate the entire water system, thus driving up expenses. Third, the Water Department experienced a series of personnel issues that required hiring an outside vendor to run the treatment plant and distribution system for most of FY 2010, further driving up unplanned expenses. Finally, the 2010 summer was very hot and dry, and water consumption rose dramatically. Higher water consumption created the illusion that the Water Division's revenue problems were solved, but FY 2011 turned out to be another cold and wet year. Such climatological fluctuations just point out the need to have a stable source of revenue that is not

dependent on the weather. These factors combine to threaten the long-term solvency of the water enterprise fund.

Water reserves declined from a high of \$600,000 in FY 2008 to \$557,295 in FY 2010. In FY 2011, those reserves rose again to \$677,699, largely due to the hot summer. Water reserves policy states that water reserves should be at 100% of the enterprise operating fund, but we see those reserves at only 54% of the target today.

Water enterprise fund operating deficit hit -3.57% of the operating revenue in FY 2010, but rebounded to 12.6% in FY 2011.

Water Enterprise Fund revenues were now at -12% in FY 2010, but recovered to 4.4% in FY 2011.

We find ourselves at a plateau with respect to water. Freezing water rates for a three year period certainly helped water rate payers adjust to a major upgrade to the water system in FY 2006. By freezing the rates, the Water Commissioners were aware that the Water Enterprise Fund would experience some constriction, which in the short-term was acceptable. However, three years has now been extended to six years with no adjustment to water rates.

The solutions proposed in this budget are three-fold. First, water expenses need to be reduced wherever possible. Mr. Gary Girouard and his staff are to be commended for examining the Water Division's budget and finding cost avoidance and savings throughout. This will be an on-going effort.

Second, the apportionment of labor costs between the Highway Division and Water Division needs to be adjusted to reflect more accurately the true costs of maintaining each division. The new DPW has identified significant cost sharing arrangements that burden the Water Enterprise Fund unnecessarily. This budget continues to shift those apportioned costs toward a much more realistic arrangement. This realignment is too radical to accomplish in a single budget cycle, so the FY 2012 budget began the process that will conclude in FY 2014. For FY 2013, we have achieved a very realistic budget that correctly apportions costs, leaving only fine tuning to be done in FY 2014.

These budget reductions and reorganizations are important and necessary, but they do not address the long-term solvency issue, which brings us to the third component of the water budget. The Water Commissioners need to restructure water rate schedules and set new water rates. Decisions regarding water rates have a lag of months, so for example setting the rates in June 2012 will not generate revenue until February 2013. I again strongly recommend that the Water Commissioners order a study of water rates, set policies concerning water rates that reflect best management practices, and set rates that will begin to address long-term solvency issues.

Wastewater: On February 19, 2010, the former Sewer Commission, an independently elected body having broad powers over wastewater since 1962, was dissolved by special statute, and the Select Board assumed all the powers and duties of the former Sewer Commission. I am pleased to report that the Wastewater Enterprise Fund is in healthy shape.

Wastewater Reserves have grown to \$529,872 in FY 2011, representing 63.3% of wastewater operating revenues; Wastewater Enterprise Fund operating surplus has shown steady growth, and stands at 16.8% of operating revenues in FY 2011; and Wastewater Enterprise Fund revenue shortfall of -5% in FY 2009 has been transformed into a revenue surplus of 6.4% in FY 2011.

Still, there is more to be done. This budget contains two recommendations regarding wastewater management. First, the budget has been examined to continue to find costs savings and implement reductions wherever possible. Second, labor within the newly-formed Department of Public Works needs to be apportioned to account for wastewater in new ways that more accurately reflect the true costs of operating the Wastewater Division. The DPW has identified cost sharing arrangements that formerly were not practiced in the Wastewater Enterprise Fund. This budget continues shifting those apportioned costs toward a much more realistic arrangement. As with Water, this realignment is too radical to accomplish in a single budget cycle, so the FY 2012 budget began a process that will conclude in FY 2014. For FY 2013, we have achieved a very realistic budget that correctly apportions costs, leaving only fine tuning to be done in FY 2014.

Conclusion

Under the circumstances imposed by the School Department's budget request, it is impossible to balance the budget and still remain within the guidelines established by the Select Board.

The Town of Hadley is fortunate to have a strong foundation on which to meet the challenge. Our local economy, although damaged by the global recession, is resilient, and recovery is assured. Unemployment, although unacceptably high, is still lower than the state or national average. We have built our reserves, even within these trying times. Our partnerships with strategic allies in the educational system and the business community remain strong, and will deliver many opportunities in the future.

I sincerely thank the department heads, elected officials, agents, committees, and commissions for their efforts to maintain quality municipal services at an affordable price. We are fortunate to have high quality, highly skilled and trained, hardworking government work force, and effective leadership to guide the town.

Sincerely,

David G. Nixon
Town Administrator