

**Town of Hopkinton
Fiscal Year 2025 Budget
Initial Discussion Issue Paper
October 5, 2023**

This paper provides background to support the launch of the fiscal year 2025 (FY25) budget process for the Town of Hopkinton. There is a level of uncertainty at the beginning of every budget process, and the high inflation and associated operating cost challenges that characterize the preparations for the FY25 budget are no exception to that general rule. Town practice is to complete a review of available funding and a bottom-up budget review of the cost and value of services delivered each year.

Projected FY25 Revenues

The following table summarizes current initial estimates of FY25 General Fund sources of funding compared to budgeted funding estimates for FY24 under a 2.5% tax impact scenario:

Table 1: Sources of Funds		FY24 Budgeted Sources of Funds	FY25 Estimated Sources of Funds	% Chg. FY24 - FY25
1	Levy Base	\$83,567,525	\$88,183,133	5.5%
2	New Growth	\$1,650,000	\$1,567,500	-5.0%
3	Debt Exclusions	\$6,725,617	\$6,347,047	-5.6%
4	Less - Provision for tax abatements/exemptions	-\$500,000	\$0	<u>-100.0%</u>
5	Estimated Net Property Tax Revenue	\$91,443,142	\$96,097,680	5.1%
6	State Aid	\$11,490,752	\$12,065,290	5.0%
7	Less - Regional and State Program Charges	-\$398,619	-\$418,550	<u>5.0%</u>
8	Estimated Net State Aid	\$11,092,133	\$11,646,740	5.0%
9	Excise Tax, Licenses, other Local Receipts	\$5,650,050	\$5,932,553	5.0%
10	Cost Share from Enterprise Funds	\$780,076	\$799,578	2.5%
11	Ambulance, misc. sources	\$688,643	\$655,835	-4.8%
Total Recurring Sources of Funds		\$109,654,044	\$115,132,385	5.0%
12	Non -Recurring Sources: Cert. Free Cash	\$3,545,463	\$3,353,671	-5.4%
Total Sources of Funds		\$113,199,507	\$118,486,056	4.7%

Almost all of the Town’s revenue comes from a few sources, most of which have very good prospects over the next budget cycle. As discussed at length in the 2023 Appropriation Committee Report, residential property tax is the Town’s dominant revenue source. While the general real estate market is

cooling somewhat due to recent-record interest rates which limit affordability for buyers; that cooling is likely to have little or no impact on the Town's collection of levied property tax. Restated, tax collection is not dependent on a continuous rise in property values and is very stable.

While property tax collection is solid, the amount of new revenue from new residential and commercial construction is budgeted down again for FY25, which is a significant change from the prolonged period when new residential and commercial construction provided more than half the new revenue for the Town for inflationary and service level cost increases.

The Town's second largest revenue stream is from Local Aid from the Commonwealth, and the news in that area is again somewhat unfavorable. After a period of robust revenue growth, the latest estimates from State officials indicate that overall State revenue is trending about 1.8% below projections. It is difficult to predict how a shortfall below projections will impact the Governor's proposal for Local Aid. Eversource Energy's aggressive tax strategy continues to pose a bounded challenge to the Town which will be discussed below.

On Table 1 row 1, the Tax Levy Base is projected to rise due to two factors: a revision in the estimate of new growth in the tax base for FY24 upward from \$1,650,000 to \$2,464,800, driven by higher residential construction than was expected and a greater increase in valuation than was expected at the Eversource Energy Hopkinton liquid natural gas (LNG) facility; and through a 2.5% statutorily allowed increase in the tax levy (\$2,150,808). Since property tax contributes 81% of total expected net revenue, it is vastly dominant in importance; and because it is based on firm, known data, and because collections are secured by the Town's right to lien; this existing estimate of this dominant source of funding is very solid. The levy base could be adjusted somewhat later in the budget process, if actual new growth for FY24 comes in above or below the revised estimate of \$2,464,800. The actual New Growth number will be computed in six to eight weeks.

On Table 1 row 2, the modest 5% reduction in projected New Growth in the tax levy from last year's approved budget reflects a new phase of Town development, where large residential and commercial projects are no longer in the pipeline, and growth is resulting from smaller residential developments and commercial projects. New Growth is expected to contribute about 1.3% of available resources, but about 35% of new recurring funding to support service growth and inflationary cost growth.

On Table 1, row 4, for the first time in several years, the recommendation is to budget \$0 for transfer to the account to cover tax appeals. The Town's only current tax appeals are from Eversource Energy (\$5.7 million) covering a variety of tax bills issued between 2017 and 2022, and for the first time in many years, and to the surprise of the Town Finance Team, Eversource Energy did not initiate any new tax appeals in the last appeal cycle. Within the past few months, Eversource Energy even withdrew some appeals on taxes from 2019 and 2020 for NSTAR Electric and Gas taxable business personal property totaling \$715,065. An additional \$1.2 million in pending appeals are scheduled to go to trial with the Commonwealth Appellate Tax Board before December 1, 2023. Tax appeal cases often experience trial date delays, but irrespective of delays or of the outcome of those appeals, with the recent case withdrawals, the

Town's overlay reserve for tax appeals has been built to \$7.2M, which exceeds current appeals by \$1.5M. Because of this excess, it is reasonable to enter the budget with a \$0 contribution to that reserve account budgeted. As the budget process progresses, if the Town prevails as expected in pending tax appeal cases, if Eversource again refrains from filing new tax appeals, or if both occur; consideration will be given of recommending that the Board of Assessors withdrawal some amount of funding from the Overlay account and return it to the Town General Fund, where it would be available as a one-time source of funding to support one-time budget needs consistent with Town policy. Resolution of pending tax appeals may be known before December, and information about the status of new tax appeals will be known around February 10, 2024.

Table 1 rows 6 and 7, estimate a 5.0% increase in local aid from the Commonwealth and a corresponding 5.0% increase in charges for state and regional programs administered through the Commonwealth. Net Local Aid is an important source of funds, contributing 10% of expected net revenue. This estimate reflects a cautious budgeting approach based on both multi-year experience and on the State's current revenue experience, which is tracking 1.8% below the State's own planned revenue.

Net Local Aid experience:

FY21 Hopkinton Local Aid +6.3% with prior year State revenue +4.3%;
FY22 Hopkinton Local Aid +10.6% with prior year State revenue +3.4%;
FY23 Hopkinton Local Aid +9.9% with prior year State revenue + 18.4%;
FY24 Hopkinton Local Aid +12.0% with prior year State revenue +4%;
FY25 Hopkinton Local Aid +?% with prior year State revenue trending to +4.6%.

There is not a tight correlation between overall Hopkinton Local Aid and prior year State revenue, in part because Local Aid is strongly influenced by lagging measures of public school student enrollment. While Hopkinton saw significant growth in Local Aid tied to strong school enrollment growth and to overall increases in education funding in FY22 - FY24, there is not strong evidence to support continuation of that trend into FY25.

Because the State's revenue trend suggests a second consecutive year of low revenue growth for the State, this initial budget cautiously projects a 5% increase in net Local Aid. The actual level of local aid could be higher or lower based on the actions of the new Governor and the Legislature, and will be tracked through the budget process. The municipal financial regulatory framework requires caution budgeting of revenue, and there is an insufficient basis for projecting growth of this source above 5% at this time.

On Table 1 row 9, local receipts (including motor vehicle excise tax) are projected to rise by 5%. This is a noteworthy source of funds, contributing 5% of expected net revenue. This source is dominated by Motor Vehicle Excise Tax. Motor Vehicle Excise Tax receipts were remarkably flat from FY19 to FY23, varying by less than 1% over that entire period. Interest income from Town General Fund deposits was up in FY23, as short term interest rates rose. While higher rates hurt the Town as a borrower, they help the Town Treasury with earnings on deposits placed with the

State-sponsored Massachusetts Municipal Depository Trust and with commercial banks. Largely on the strength of the earnings from short term interest from deposits, the Local Receipts category is budgeted up 5% based on current and forecast interest rates.

On Table 1 row 12, Certified Free Cash is one-time funding available to support priorities in the coming year. The exact amount of Certified Free Cash available for use in the FY25 budget will not be known until the end of the calendar year, when the Town's financial regulators with the Commonwealth of Massachusetts certify a specific amount as available. Town Financial Policy calls for paying for recurring expenses with recurring funds. The one time uses of funds being proposed are detailed in Table 2 (rows 25, 16, 27), and sum to the amount shown on row 12. If more or less than \$3.4 million is certified, the amount drawn from Certified Free Cash and spent on one-time expenses can be increased or decreased, within policy guidelines.

Projected FY25 Expenditures

On a strategic level, the Town Manager's priorities in initiating the FY25 budget process are to advance accomplishment of the Town's vision and mission, including the priority to advance diversity, equity, inclusion, and belonging in the Town of Hopkinton. This effort is informed in part by the Strategic Planning initiative undertaken in 2023 and 2024, which will continue as part of this budget process. On an operational level, the budget process pursues those aims with a focus on change and improvement in three areas:

- Sustaining and improving Town service delivery operations through a rigorous budget process that prioritizes finding efficiencies and focusing spending to support key service outcomes and impacts; with a priority on diversity, equity, inclusion, and belonging
- Sustaining and improving the Town's capital infrastructure through judicious recapitalization and investment practices
- Ensuring long term fiscal stability by allocating resources to support adequate reserves, steady funding of long-term liabilities, and adherence to best practices in Hopkinton Financial Policies

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Table 2 below shows a possible distribution of FY25 expenditures if revenue is limited to the current estimates shown in Table 1, and if Financial Policy is strictly adhered to:

Table 2: Uses of Funds		FY24 Budgeted Uses of Funds	FY25 Estimated Uses of Funds	% Chg. FY24 - FY25
13	Tax lien administration costs	\$50,000	\$50,000	0.0%
14	State funded Library spending	\$35,070	\$28,335	-19.2%
15	Repayment of Debt Principal and Interest*	\$7,417,184	\$7,114,757	-4.1%
15a	<i>Repayment of Existing Debt P&I, Excluded</i>	<i>\$6,725,617</i>	<i>\$6,347,047</i>	<i>-5.6%</i>
15b	<i>Repayment of Existing Debt P&I, In Levy</i>	<i>\$691,567</i>	<i>\$767,710</i>	<i>11.0%</i>
16	Deficits and Judgments	\$0	\$0	0.0%
17	Snow and Ice Surge Costs	\$0	\$0	0.0%
18	General Government	\$5,410,449	\$88,409,371	4.4%
19	Public Safety	\$8,191,856		
20	Education	\$61,597,652		
20a	<i>Hopkinton Public Schools</i>	<i>\$59,937,752</i>		
20b	<i>Special Education Reserve Fund</i>	<i>\$1,094,024</i>		
20c	<i>Regional Vocational Technical School</i>	<i>\$565,876</i>		
21	Public Works	\$6,868,502		
22	Health and Human Services	\$1,465,230		
23	Culture and Recreation	\$1,162,724		
24	Employee Benefits and Insurance	<u>\$17,570,377</u>	<u>\$19,529,921</u>	<u>11.2%</u>
Sub-Total Departmental Expenses		\$102,266,790	\$107,939,292	5.5%
Total Recurring Uses of Funds		\$109,769,044	\$115,132,384	4.9%
25	Transfer to OPEB (post-retirement health care)	\$832,850	\$853,671	2.5%
26	Transfer to Stabilization	\$700,000	\$700,000	0.0%
27	Town Meeting Capital Articles, free cash	\$1,897,613	\$1,800,000	-5.1%
Total Non-Recurring Uses of Funds		\$3,430,463	\$3,353,671	-2.2%
Total Uses of Funds		\$113,199,507	\$118,486,056	4.7%

The presentation in Table 2 is based on a balanced budget within the tax levy rise constraints of proposition 2 ½, and in compliance with Town Financial Policies requiring recurring costs to be paid for with recurring sources of income. Table 2, line 24, Employee Benefits and Insurance is budgeted up 11.2%, driven by a projected 13% rise in the Town's cost for employee health insurance for current

employees only, and under current plan offerings and cost share approaches. With the foregoing constraints, Table 2 shows an initial anticipated amount available for recurring costs across all departments of \$88.4 million, which is 4.4% (\$3.7 million) above the amount provided in the FY24 Budget.

At a September 19, 2023 joint meeting of the Select Board, School Committee, and Appropriation Committee, members expressed a desire to see even a very preliminary estimate of any prospective gap between estimated revenue and anticipated expense needs for FY25. Of course, as the budget process is in its most nascent stage, these estimates are preliminary in the extreme; but, as shown on Table 3, they may reflect a floor of need.

Table 3: FY25 Prospective New Recurring Revenue & Needs			
Prospective New FY25 Recurring Revenue			\$3,712,958
Prospective New FY25 Costs			
Approved Debt within Levy		-\$76,143	
Hopkinton Public Schools			
8.4 Teachers	-\$630,000		
5.5 SPED Already Added	-\$599,000		
ELA Director	-\$100,000		
2.5 SPED Teachers	-\$212,500		
Administrators	-\$200,000		
25% Benefits for New School Staff*	-\$435,375		
HPS Contractual Obligations	<u>-\$2,635,600</u>		
Initial School Estimate		-\$4,812,475	
Non-School Contractual Obligations		<u>-\$500,000</u>	
Sum, Prospective FY25 New Costs			<u>-\$5,388,618</u>
Prospective Budget Shortfall			-\$1,675,660

* Benefits are paid outside the School Budget, but are presented here to reflect staff growth cost

Again, the prospective new recurring revenue shown in Table 3 is the product of a number of early initial estimates of revenue, and early estimates on the cost to continue health and liability insurance coverage for existing employees. The list of prospective new recurring costs is very likely to grow, perhaps substantially, as the work of the actual budget process progresses.

As a preliminary floor figure, reflecting only those initial aspirations or needs which are known or have been publicly communicated, the Town is beginning the FY25 budget process with a \$1.7 million shortfall, again - subject to significant change.

Table 4 shows that the approach reflected in the tables above, without accounting for any shortfall, would be compliant with all Town Financial Policies, as well as the constraints of Proposition 2 ½.

Table 4: Recurring and 1-Time Sources & Uses of Funds	FY24 Budgeted	FY25 Projected	% Chg. FY24 - FY25
Recurring Sources of Funds	\$109,654,044	\$115,132,385	5.0%
Recurring Uses of Funds	<u>\$109,769,044</u>	<u>\$115,132,385</u>	4.9%
Net Recurring Funds	-\$115,000	\$0	
Non-Recurring Sources of Funds	\$3,545,463	\$3,353,671	-5.4%
Non-Recurring Uses of Funds	<u>\$3,430,463</u>	<u>\$3,353,671</u>	-2.2%
Net Non-Recurring Funds	\$115,000	\$0	

There are several potential paths or combination of paths for dealing with the prospective shortfall identified in Table 3:

- Funding requests could be reduced
- Additional revenue could be forthcoming from Commonwealth Local Aid, new growth in the tax base, or another source
- A decision could be made to deviate from Financial Policy and support recurring costs with one-time sources of revenue which may become available (e.g., Certified Free Cash from prior year operations or withdrawals from the tax overlay account if the Town prevails in pending tax litigation with Eversource Energy)
- An override of the tax levy limit of Proposition 2 ½ could be considered

Tax Impact

All funding scenarios for the operating budget other than an override of the property tax limits under Proposition 2 ½ would have a tax increase impact of approximately 2.35% on existing property owners. There will be an additional tax impact, not tied to the FY25 operating budget, of approximately 11.5% in the peak year if the Elmwood School Replacement is approved as debt to be excluded from the tax levy limit in a Special Town Meeting and subsequent vote in the coming weeks; and there will be additional tax impact not tied to the FY25 operating budget for any Capital Articles approved as debt excluded from the tax levy at the May, 2024 Annual Town Meeting. Information about aggregate tax impact will be developed as part of the FY25 budget process and will be communicated in the Town Manager’s January, 2024 Budget Transmittal and in the Appropriation Committee Report to be delivered in April, 2024.

Additional Discussion

There are particular economic factors that create higher-than-usual uncertainty with respect to FY25 spending to sustain FY24 service levels. Inflation and economic volatility have been at the highest levels in decades, and that impacts the Town in several specific ways:

- Wage inflation - Wages represent about 70% of Town operating spending, and are therefore the most material factor in considering inflation overall. Restated, a 1.4% increase in wages results in a 1% increase in the overall budget. The Town should be mindful that wage inflation is a dominant long term issue that should be carefully considered when contemplating staff expansions in FY25 or beyond.
- Energy Cost Escalation - Although energy is a central factor in many industries, Hopkinton spends approximately 1% of its budget on fuel for vehicles and energy for buildings. Additionally, the Town holds some advantageous contracts for the purchase of energy in the near term, and the Town's solar installations help buffer energy cost volatility and help dampen the FY25 impact of energy volatility. Energy saving measures through LEED engineering in modern facilities have also improved energy efficiency. However, it is noteworthy that, while local electricity prices have backed off significantly from a peak in February, 2023, electricity costs in August, 2023 were 33% above costs for August, 2020. Energy price volatility remains as a budget risk for the Town.
- Project Costs - Over the past several years there has been an increasing trend of rapid capital project price escalation that outpaces the lengthy Town budget cycle. Those outcomes were sometimes driven by well-documented national supply chain challenges. Because of this price volatility, and because of the Town's long lead time for adjusting budget requests through Town Meeting action, Town Meeting began budgeting for capital projects with much higher than usual contingency amounts in FY24; entrusting the Select Board to monitoring execution, with "proceed or pause" authority with respect to contingency funds. This proposal would continue that approach for Pay-As-You-Go capital items funded in the Operating Budget in FY25.
- Economic Volatility - The Town is over seven months from a May 2024 Town Meeting vote on the FY25 budget. In economically stable times, moderate change could be expected over that period. Given the significant uncertainty about how military events in Eastern Europe and the Pacific may affect global stability, and specifically world-market energy price stability; and given the governance challenges being faced by Congress because of the very narrow majority in the House of Representatives, and the very significant policy differences within the slim House majority, the cone of uncertainty extending to May, 2024 is wider in terms of potential outcomes than is typically seen. Moderate portions of the FY25 operating budget are sensitive to that volatility, and budgeting to address that volatility will be covered in the budget submission directions.

Revisiting the three operational priorities in the budget process in the context of resources available:

- Sustaining and improving Town service delivery operations through a rigorous budget process that prioritizes finding efficiencies and focusing spending to support key service outcomes and impacts: The constrained spending position in Table 2 above suggests that the amount initially estimated to be available for Departmental increases, 4.4%, will be insufficient to satisfy contractual, inflationary, and service growth costs (including diversity, equity, inclusion and belonging) for Hopkinton Operating Departments (Table 2 rows 18 - 24), including the Hopkinton Public Schools.

- Sustaining and improving the Town’s capital infrastructure through judicious recapitalization and investment practices: The constrained spending position in Table 2 above allocates \$1.8 million in one-time funding (certified free cash) for pay-as-you-go capital projects (Table 2 row 27.) The estimates make no provision for funding additional debt within the tax levy, expecting that any large dollar value capital needs will be proposed as “excluded debt” under the Proposition 2 ½ budgeting framework; with due consideration to be given to Community Equity with respect to any additional tax impact from new excluded debt.
- Ensuring long term fiscal stability by allocating resources to support adequate reserves, steady funding of long-term liabilities, and adherence to best practices in Hopkinton Financial Policies: The constrained spending position in Table 2 above sets aside \$853,671 (Table 2 row 25) toward the long-term OPEB liability, a fund to pay the Town’s share of future health care costs being earned by Town employees working today. The Appropriation Committee Report dated April 18, 2023, available on the Town website, contains a detailed discussion of this long term liability beginning on page 39, and communicates an intention to fund at the level identified, to be escalated by 2.5% per year, to have this cost fully funded by the mid 2050’s. The constrained spending position in Table 2 above also sets aside \$700,000 in non-recurring funding to bolster the Town’s General Stabilization Trust Fund (Table 2 row 26), as a follow-on to the \$700,000 provided at the May, 2023 Annual Town Meeting. Town Financial Management Policy calls for a Stabilization reserve level of 5% of the Operating Budget. As the size of the Operating Budget grows, the recommended reserve rises. Based on the preliminary forecasts, the projected FY25 Stabilization Trust Fund Target would be \$5.3 million and based on the June 30, 2023 Stabilization Trust Fund level of \$4.6 million, the \$700,000 addition to the General Stabilization Trust Fund identified in Table 2 would close the remaining gap.

As part of ongoing revenue risk analysis, Town Treasurer Diane Hendrickson has completed a review of collections across Town Accounts. There are several pieces of good news from this analysis. First, over 90% of bills issued by the Town, including most water and sewer bills, are ultimately lienable against real property, which puts the Town in a very strong position to eventually collect the money. Interest rates on debt which is owed to the Town range from 12% to 16%, depending on the statute governing the specific category of billing; and those high rates support prompt payment. Motor Vehicle Excise Tax is not lienable, but the Registry of Motor Vehicles supports collections by withholding license and registration renewal for Excise Tax delinquent payers. A measure of risk exists when people move from the State or give up driving while owing Excise Tax. However, overall Ms. Hendrickson’s review shows that across categories collections are well over 99% current by dollar value (lagging somewhat, Sewer 95%, Water 97%), validating the soundness of both the Town’s collection practices and the stability of Town revenue estimates.

As a final issue, the status of the Overlay Account for Tax Appeals warrants discussion. In the past tax appeal cycle (February, 2023) Eversource Energy broke from its longstanding, costly, and deleterious practice of appealing all its property tax bills. While that change is a positive outcome, and while Eversource has withdrawn a modest portion of outstanding appeals, \$5.7 million in levied tax remains under appeal, with \$1.2 million of those appeals slated for adjudication before the State Appellate Tax Board (ATB) in November, 2023. A bundle of appeals were slated for trial in October, 2023, but, as is their consistent practice, Eversource Energy has again pleaded with the ATB for a delay at trial, and those

appeals remain pending. While Eversource Energy's actions continue to impose tax defense costs on all taxpayers in Hopkinton, Table 1 (row 4) shows a \$0 to the tax Overlay Account for FY25. The Overlay Account has accumulated a balance of \$7.2 million specifically to account for Eversource Energy appeals, an amount that now exceeds the level of appeals pending. If Eversource Energy withholds tax appeals again in February, 2025, the Board of Assessors may consider releasing some one-time funding from the Overlay Account.

Useful Link

April 18, 2023 Appropriation Committee Report -

<https://drive.google.com/file/d/1LBM0EJt5YvZ47FKabxlt6TnytaphKgCH/view>