City of Chelsea

Five Year Financial Forecast
for Fiscal Years 2007-2011
and
Preliminary FY'07 Budget Overview

Presented to the City Council

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March 13, 2006

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Charter Requirements

- Annual "Financial Procedures" are mandated by the City Charter.
  - Review of the financial condition of the City prior to the commencement of the budget process.
  - Submission and adoption of an Operation Budget.
  - Submission and Adoption of a Capital Improvements Program (CIP).
  - Creation of an Annual Audit.
  - Preparation of a Long-Term Financial Forecast.

- Adherence to Financial Procedures ensures the status of the City's finances for the present and future and identifies areas of need or concern going forward.

- The budget process will begin with the submission of the Operating Budget for FY'07 to the City Council by May 1st; the CIP has been submitted, and the Annual Audit for FY'05 has been completed.

- This Five Year Financial Forecast meets the requirements of a pre-budget financial review and a Long-Term Financial Forecast.

- In addition to the Charter requirements, the City also maintains a Three Year Budget Plan for FY'06-FY'08. Information from the Five Year Financial Forecast is used to update the Three Year Budget Plan.

Five Year Financial Forecast

Revenue and Expenditure Summary

GENERAL FUND	Projected FY2007	Projected FY2008	Projected FY2009	Projected FY2010	Projected FY2011
REVENUES:					
Taxes	32,634,023	34,191,702	36,865,327	39,596,166	42,428,321
Charges for Services	1,710,773	1,772,185	1,836,725	1,904,412	1,975,281
Licenses & Permits	910,710	910,710	910,710	933,478	933,478
Fines & Forfeits	1,947,690	1,947,690	1,947,690	2,115,189	2,115,189
Intergovernmental - State Cherry Sheet	63,119,259	64,116,194	65,141,339	66,198,200	67,282,390
Intergovernmental - State Other	-	-	-	-	-
Intergovernmental - Federal	600,000	600,000	600,000	600,000	600,000
Interfund Operating Transfers	1,613,526	1,646,864	1,681,036	1,752,312	1,788,213
Miscellaneous	1,501,000	1,501,000	1,501,000	1,501,000	1,501,000
Total Revenues	104,036,981	106,686,346	110,483,827	114,600,756	118,623,873

	Projected FY2007	Projected FY2008	Projected FY2009	Projected FY2010	Projected FY2010
EXPENDITURES:					
General Government	3,083,967	3,153,910	3,236,425	3,321,143	3,419,577
Public Safety	15,865,478	16,193,956	16,602,351	17,021,176	17,527,311
Education	48,170,805	49,281,382	50,419,639	51,586,265	52,781,968
Public Works	4,677,305	4,806,173	4,944,371	5,086,573	5,238,870
Health & Human Services	1,378,356	1,409,020	1,445,796	1,483,541	1,527,957
Debt Service	10,109,756	9,451,801	9,198,134	8,848,361	8,579,982
Employee Benefits	18,463,933	19,580,793	21,328,347	23,368,580	25,644,059
General Liability Insurance	528,506	544,362	560,692	577,513	594,839
Judgements	25,000	25,000	25,000	25,000	25,000
State Assessments Non-School	2,491,324	2,566,064	2,643,046	2,722,337	2,804,007
State Assessments School	1,567,085	1,614,098	1,662,520	1,712,396	1,763,768
Total Expenditures	106,361,515	108,626,557	112,066,322	115,752,884	119,907,337
Surplus (Deficit)	**(2,324,534)**	**(1,940,211)**	**(1,582,494)**	**(1,152,128)**	**(1,283,464)**

Five Year Financial Forecast
Revenue and Expenditure Summary

	FY'07	FY'08	FY'09	FY'10	FY'11
Revenues					
	$104,036,981	106,686,346	110,483,827	114,600,456	118,623,873
%↑	4.83%	2.55%	3.56%	3.73%	3.51%
Expenditures					
	$106,361,515	108,626,557	112,066,322	115,752,884	119,907,337
%↑	3.81%	2.13%	3.17%	3.29%	3.59%
Deficit					
	($2,324,534)	(1,940,211)	(1,582,494)	(1,152,128)	(1,283,464)

Understanding the Numbers

REVENUES

- House 1, Governor Romney's State Budget recommendation for FY'07, increases Lottery Aid by $1,183,133, or $21.4%, and level funds Additional Assistance at $3.4 M.
- Chapter 70 School Aid increases by $1,739,960, or 4.1%, under House 1.
- The future of Local Aid for FY'08-'11 is difficult to predict. For planning purposes the City is assuming for those years: no increase in Additional Assistance, a 3% annual average increase in Lottery Aid and a 2.5% annual average increase in Chapter 70 School Aid.
- Tax Levy and Levy Limit are projected to grow by 2.5% plus New Growth. New Growth is projected at $750,000 for FY'07 and FY'08, and then substantially more thereafter as a result of projected residential development activity. The Overlay provision is 2% of the prior year levy.
- Fines & Forfeits and Licenses & Permits are expected to be level until FY'10, when increases in charges are then projected. Trash fees are expected to rise in the area of 4.75% yearly.
- Interest on Investment is projected to remain at current budgeted levels.

Understanding the Numbers

EXPENSES

- Salary Costs assume a 2% increase to meet contractual obligations through FY'08 with seven of the City's eight bargaining units (negotiations continue with the final unit) . For planning purposes, Salary Costs are assumed to rise by 2.5% for FY'09 – FY'10 and 3% in FY'11.
- Health Insurance rates will increase by 10.5% for FY'07 and a projected 13% thereafter. In FY'08, as the maximum City contribution towards employee health insurance drops from 90% to 85%, an adjustment in the Health Insurance base of $691,383 is projected.
- Retirement costs are per the PERAC schedule at an average 5.6% over the 5 years.
- Operating expenses will remain below the rate of inflation by increasing 2.8% for FY'07 versus an expected national inflation rate of 3.7% for calendar year 2006. Operating expenses relate to departmental budgets.
- School Spending reflects Chapter 70 increases of 4.1% in FY'07 and a projected 2.5% per year thereafter. Other increases in the City's portion of school spending are in State Assessments for Charter Schools and School Department Indirects, including Health Insurance and Retirement. The Northeast Regional Vocational School Assessment is down for FY'07.
- Debt Service is based upon current and future infrastructure related costs, and is declining.

Budget Pressures

SUMMARY

- Despite a growing economy, it will take several more years for the State and its municipalities to fully recover from the recent recession and the financial devastation caused by what was arguably the worst municipal finance period in more than 50-years.
- The State budget crisis, which has had a devastating direct and indirect impact on the City's budget, appears to be easing, although in no way subsiding.
- The most significant of those direct impacts is the status of Local Aid, as even the recent announcement of planned increases in Lottery Aid will fail to push non-school Local Aid to pre-recession levels.
- Despite the City's ability to control discretionary spending, Employee Wages and Benefits, most notably Health Insurance and Retirement, continue to create a structural imbalance within the City's budget.
- Health Insurance continues to increase dramatically, with annual premium increases engulfing the natural rate of property tax growth.
- Retirement assessments aimed to recover from the lack of funding provided over decades of mayoral administrations are substantially greater than the projected budget gaps.

Budget Pressures

SUMMARY (continued)

- The City has exhausted cost-cutting measures over the last decade and a half, and may only be able to rely upon significant service rollbacks, including, for example, taking a fire piece out of service, reducing library hours or closing the senior center, if other expenditures cannot be controlled and revenues do not increase.

- While employee wages are held in check through FY'08, it is not reasonable to expect that employee unions will continue to accept nominal wage increases too far into the future.

- Non-school Local Aid remains below FY'01 highs, while other revenues, including excise tax and Payments In Lieu Of Taxes (PILOT) receipts, combined with revenues derived by economic development activities may not be sufficient enough to eliminate projected deficits, and may therefore require additional revenue growth measures, including the consideration of a Proposition 2 ½ Override.

- Free Cash and other reserves continue to dwindle, as previous budget deficits, even after budget cutting and revenue enhancing, have needed to be eliminated.

- As reserves dwindle, the City's current financial flexibility and ability to meet future downturns become more restricted.

- Without success on an aggressive economic development plan, one of or a combination of three occurrences will need to take place to balance out-year budgets: a depletion of Stabilization balances, deep service cuts and/or a Proposition 2 ½ Override.

Budget Pressures

BUDGET BUSTERS FY'07 - EXPENDITURES

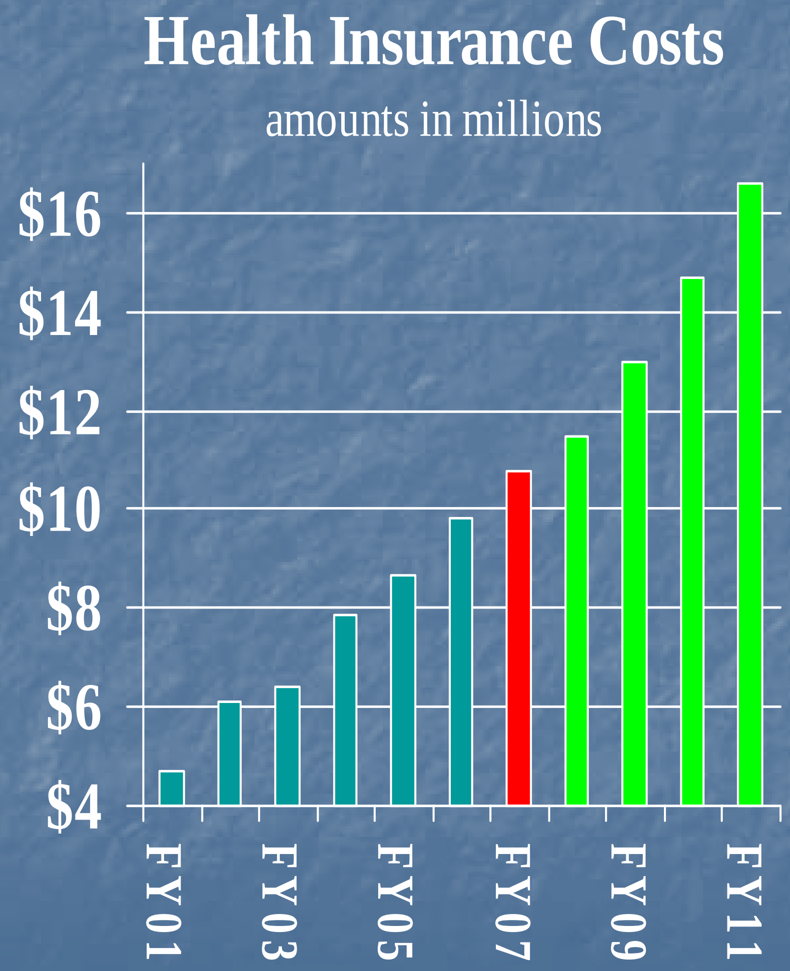
In addition to the budget expansion caused by wage increases, contracts for service, supplies, energy and the like, "Budget Busters" have historically had a significant impact on the City's budgets. In FY'07, the impact of Budget Busters will be:

- Health Insurance which will *rise* 10.5%, or $1,025,657. The City, like most other entities, public or private, continues to grapple with double-digit increases and searches, with varying success, for substantive relief.
- Retirement costs are scheduled to *rise* by 7.6%, or $470,590.
- School Choice & Charter School Assessments is *up* a net 26.4%, or $138,801, as a result of increased out-of-district enrollments. The net amount includes offsets as a result of additional State reimbursements.
- Debt Service is up 0.4%, or $35,606, reflecting a one-time urban renewal borrowing charge. Debt is projected to decrease thereafter as a result of conscious efforts to reign-in capital spending, while still adequately investing in infrastructure. Debt reduction includes a continuing decline in the repayment of bonds for the school financing projects.
- Other State Assessments are increasing slightly by $65,513, primarily due to an increase of 1%, or $21,407, for MBTA service and an increase of 18%, or $48,500 for the Registry Non Renewal Program.
- The Northeast Regional Vocational School Assessment is *down* 34.1%, or $442,288, reflective of reducing enrollment by local students in the regional vocational school.

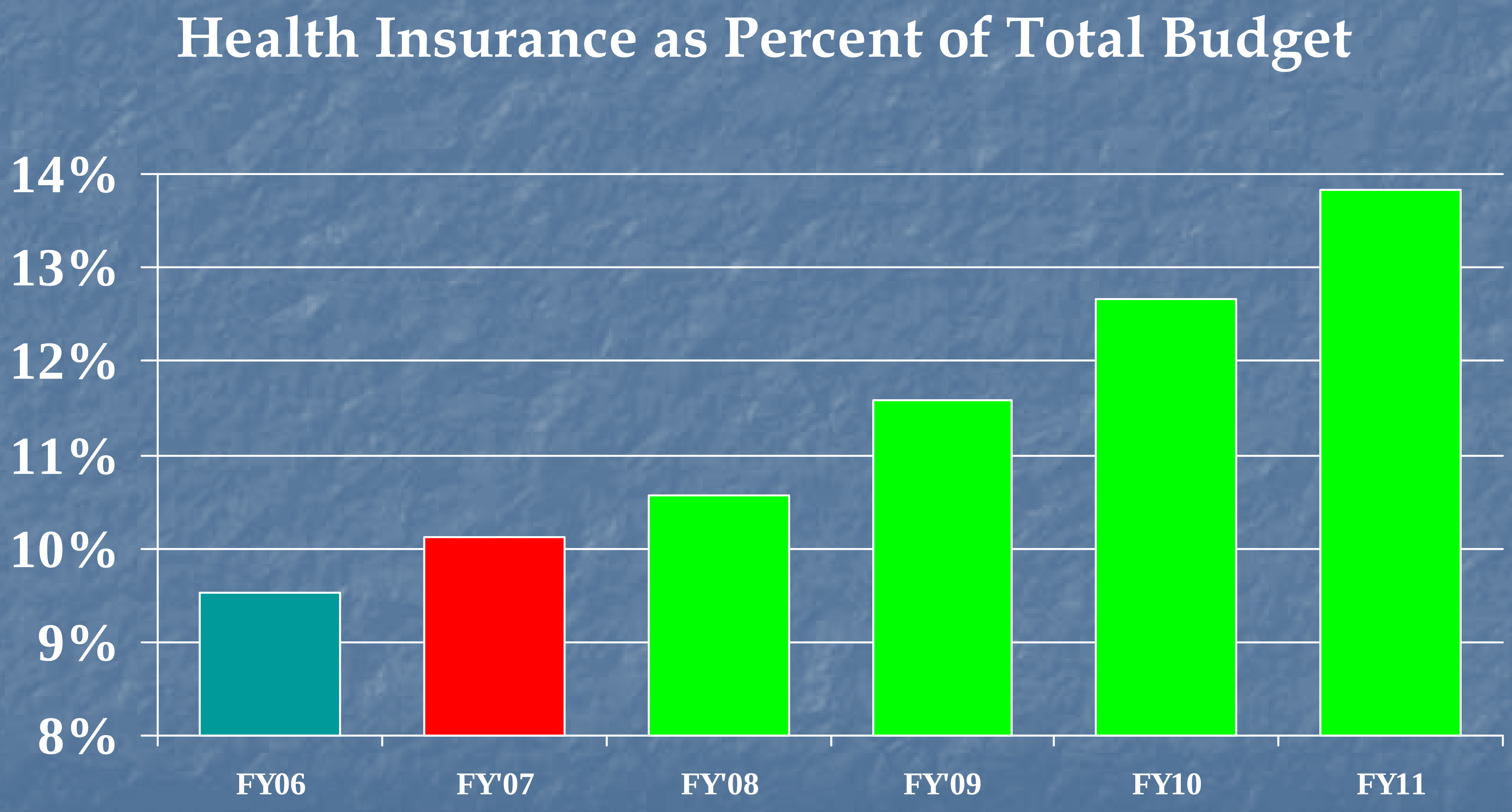
Budget Pressures

Expenditures:

- By contract, the City covers 90% HMO (85% starting in FY'08) and 75% of Indemnity and Medex costs for employees. The same coverages are provided for eligible retirees.
- For more than a decade, the City has been part of the City of Boston's health insurance pool, the results of which have been the savings of hundreds of thousands of dollars annually.
- In addition, the City has attempted to control costs by agreeing to higher co-pays and deductibles, as well as reducing the overall number of plans offered.
- Despite those efforts, Health Insurance has averaged a 15% increase from FY'01-FY'07 (projected).
- For FY'07, Health Insurance is projected to increase 10.5, or $1,025,657.
- In the out years, the City is forecasting increases of 13% annually.



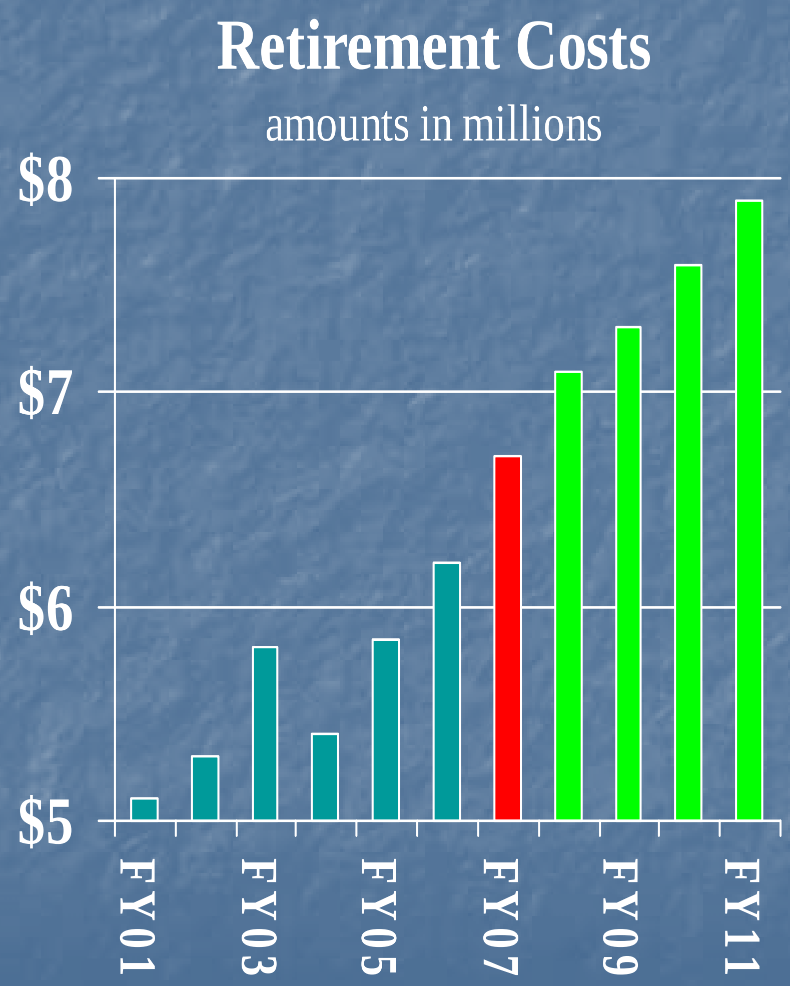
Budget Pressures



Budget Pressures

Expenditures:

- The City is required to make annual payments into its Retirement System as a benefit to employees.
- Payments are based upon a schedule which seeks to have the City's under-funded system fully funded by 2028.
- 63.6% of the FY'07 charge, or $4,257,764, is a "catch-up" payment required as a result of the failure of mayoral administrations to provide for retirement costs.
- Catch-up payments continue to grow into 2028, including $5,104,230 for FY'11 and $9,160,435 in FY'28.
- Retirement costs have increased by an average of 3.3% from FY'01 to FY'07.
- For FY'07, Retirement is projected to increase by 7.6%, or $470,590.
- For the period FY'07-'11, Retirement will increase on average by 5.6%.



Budget Pressures

BUDGET BUSTERS (NON-SCHOOL) FY'07 - EXPENDITURES

■ Health Insurance up 10.5%	$1,025,657
■ Retirement up 7.6%	$470,590
■ School Choice/Charter up 26.4%	$138,801
■ Debt Service up 0.4%	$35,606
■ State Assessments (MBTA) up 1.7%	$42,187
TOTAL	**$1,712,841**
By comparison, Property Taxes are up	$1,461,011

Budget Pressures

BUDGET BUSTERS FY’07 - REVENUES

Contributing as Budget Busters are certain revenue related issues that are either off of historical highs or reducing as a result of general economic conditions, including:

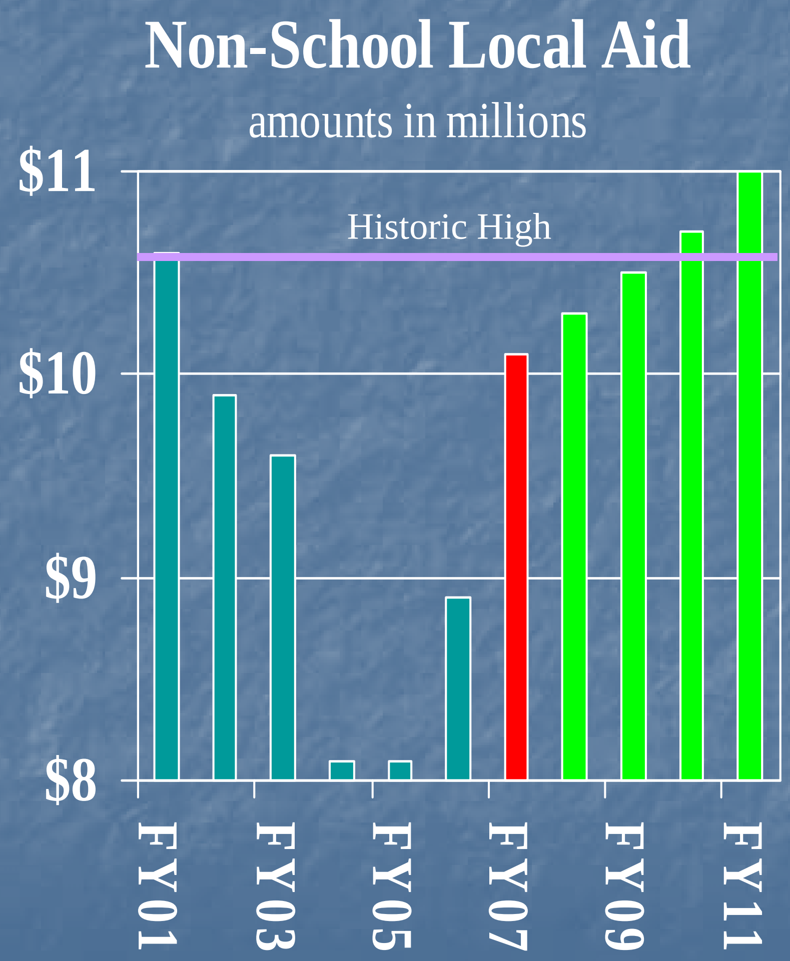
- Lottery Aid is projected to rise by $1,183,133, while Additional Assistance is level-funded. The result of the two combined non-school state aid contributions is $517,598 below FY’01 receipts.

- Revenues derived from Motor Vehicle Excise are falling an estimated 7.7%, or $150,000, as a result of smaller rental car fleets being required to service Logan Airport and hosted in Chelsea.

Budget Pressures

Revenues:

- Non-School Local Aid provides funding for general municipal services.
- The two greatest sources of Non-School Local Aid are Lottery Aid and Additional Assistance.
- For FY'07, House 1 recommends a 13.3% increase to Non School Local Aid.
- For FY07, the total aid of $10.1 M is $517,598 less than FY'01, or 95% of the historic high for the two accounts.
- The cumulative loss in Non-School Local aid revenue from the FY'01 high through FY'07 is $8.9 M (meaning that $8.9 M in Free Cash has been used to make up for Local Aid shortages).
- Non-School Local Aid accounts are very volatile. For planning purposes, the City assumes a 3% increase in Lottery Aid and a 0% increase in Additional Assistance.



Budget Pressures

BUDGET TRENDS FY'07 & BEYOND

On the positive:

- The City's fiscal discipline continues to provide for budget stability.
- The recession is over and the economy is growing.
- Local Aid is increasing.
- Major economic development initiatives, including the City's 1,200–unit housing goal, are promising, thereby providing the potential for increasing New Growth and building permit fees to offset looming deficits.
- Debt Service is declining.

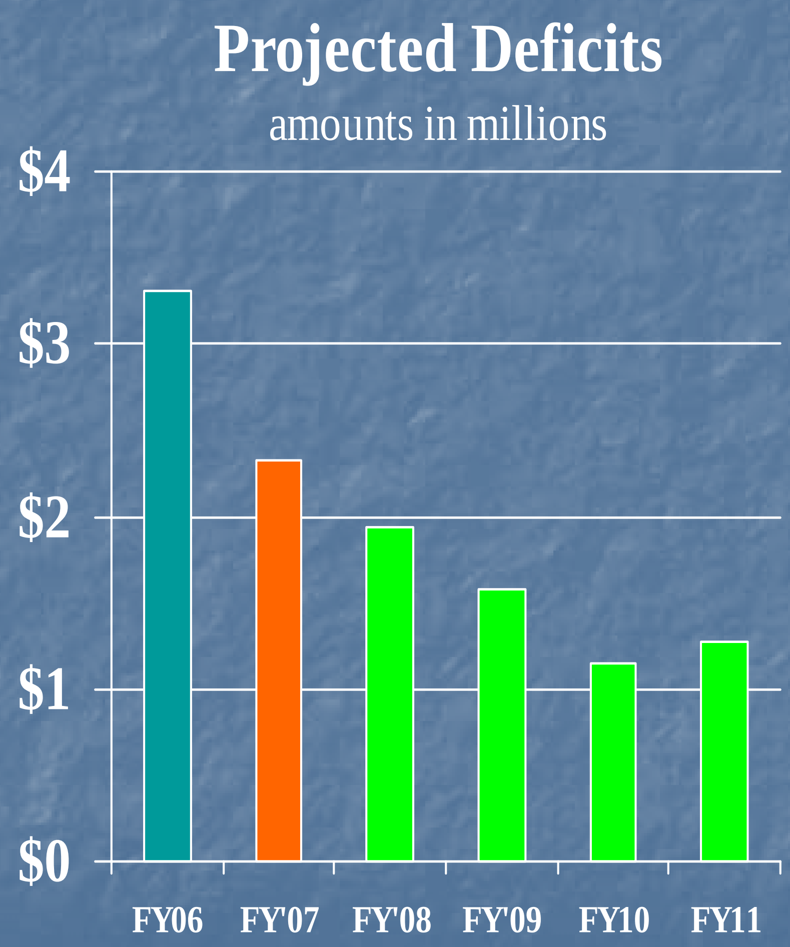
On the negative:

- Health Insurance is increasing 10.5% for FY'07, and has increased an average of 15.2% for the years FY'01 -FY'06, with no signs of abating in the future.
- Retirement costs continue to expand, by 7.6% in FY'07 and on average by 5.6% for FY'07-'11.
- Labor wage increases impact projected structural deficits.
- Locally raised revenues may be unable to grow at rates necessary to offset static Local Aid levels and increasing spending requirements, especially non-discretionary spending.
- Free Cash continues to dwindle, reducing budget flexibility and potentially impacting core municipal services.

Budget Pressures

<u>FIVE YEAR DEFICITS:</u>

- Should no action be taken, substantial deficits do exist in each of the next five years:
  - FY'07 $ 2.325 M
  - FY'08 $ 1.940 M
  - FY'09 $ 1.582 M
  - FY'10 $ 1.152 M
  - FY'11 $ 1.283 M
- The deficits are primarily a result of sluggish Local Aid growth, and skyrocketing Employee Benefit costs.
- The deficits reflect City success in attracting 1,200+ residential units, fully taxable beginning in FY'09.
- The City is not alone in projecting deficits. Many other municipalities are experiencing similar budgetary pressures and operating deficits, or worse.
- Local management has resulted in fund balances available to offset deficits.



Budget Pressures

Deficits compared to Health Insurance and Retirement Costs

	FY'07	FY'08	FY'09	FY'10	FY'11
Projected Deficits					
	($2,324,534)	(1,940,211)	(1,582,494)	(1,152,128)	(1,283,464)
Health Insurance Increases (Actual FY'07, Projected FY'08-'11)					
	$1,025,675	709,682	1,493,477	1,687,357	1,906,797
Retirement "Catch-Up" Charges (Actual FY'07, Projected FY'08-'11)					
	$4,257,764	4,918,730	5,180,314	5,361,625	5,549,282

Deficit Reduction Plan

As has been the case since FY'03, the City will continue to:

- Leave dozens of positions unfilled that were eliminated to reduce overall expenses.
- Prohibit out-of-state travel, except travel covered by grants.
- Provide no tuition reimbursement.
- Restrict training accounts.
- Scrutinize all expenditures over $500.
- Reduce "pay as you go" capital projects, especially in the CIP.
- Reduce the issuance of new debt.
- Further prioritize economic development, including an aggressive residential development program, and other efforts to seek additional, non-tax revenue sources, including the recovery of back taxes owed.
- Seek additional efficiencies in government and potential debt refinancing opportunities.
- Manage Reserves to reduce the lingering impacts of the recession and allow the City to prosper during the economic recovery.
- Conduct labor negotiations, being mindful of looming deficits.
- Consider service reductions against the City's ability to pay for elevated service levels.

Deficit Reduction Plan

1,200-Unit Goal

- The City announced in January, 2005 a plan to encourage the new construction of 1,200-units by the end of FY’08. Upon further review, the target date was extended to the end of FY’09.
- 1,200-units, at an average assessed value of $250,000 x a tax rate of $9.50 per $1,000 of value would produce $2,850,000 in recurring property tax revenues. Building permit fees of an estimated $5 million could offset many one-time production costs, including infrastructure needs, urban renewal borrowing costs and consulting services.
- Projects completed by January 1, 2008 will be fully assessed for FY’09, January 1, 2009 for FY’10 and so on. Partial assessments do take place in the interim.
- Tools utilized in the pursuit of the 1,200-unit goal include zoning relief, eminent domain, infrastructure improvements and tax relief.
- Part of the 1,200-unit goal is a 15% affordability goal.

Deficit Reduction Plan

1,200-Unit Goal (continued)

- The City anticipates the following projects to realize their fullest contributions to new growth by the following time frames:

  - For FY'09

Forbes Phase I	64 units	$160,000 in new property taxes
Atlas Bedding	120 units	$270,000 in new property taxes
Parkway Plaza	238 units	$476,000 in new property taxes
Scattered Sites	75 units	$168,750 in new property taxes
TOTAL	497 units	$1,074,750 in new property taxes

  - For FY'10

Forbes Phase II	100 units	$250,000 in new property taxes
Urb. Ren. Phase I	250 units	$500,000 in new property taxes
Scattered Sites	193 units	$450,000 in new property taxes
TOTAL	543 units	$1,200,000 in new property taxes

  - For FY'11

Forbes Phase II	61 units	$152,500 in new property taxes
Urb. Ren. Phase II	250 units	$625,000 in new property taxes
Scattered Sites	150 units	$337,500 in new property taxes
TOTAL	461 units	$1,115,000 in new property taxes

Deficit Reduction Plan

Impact of 1,200-unit goal on Projected Deficits

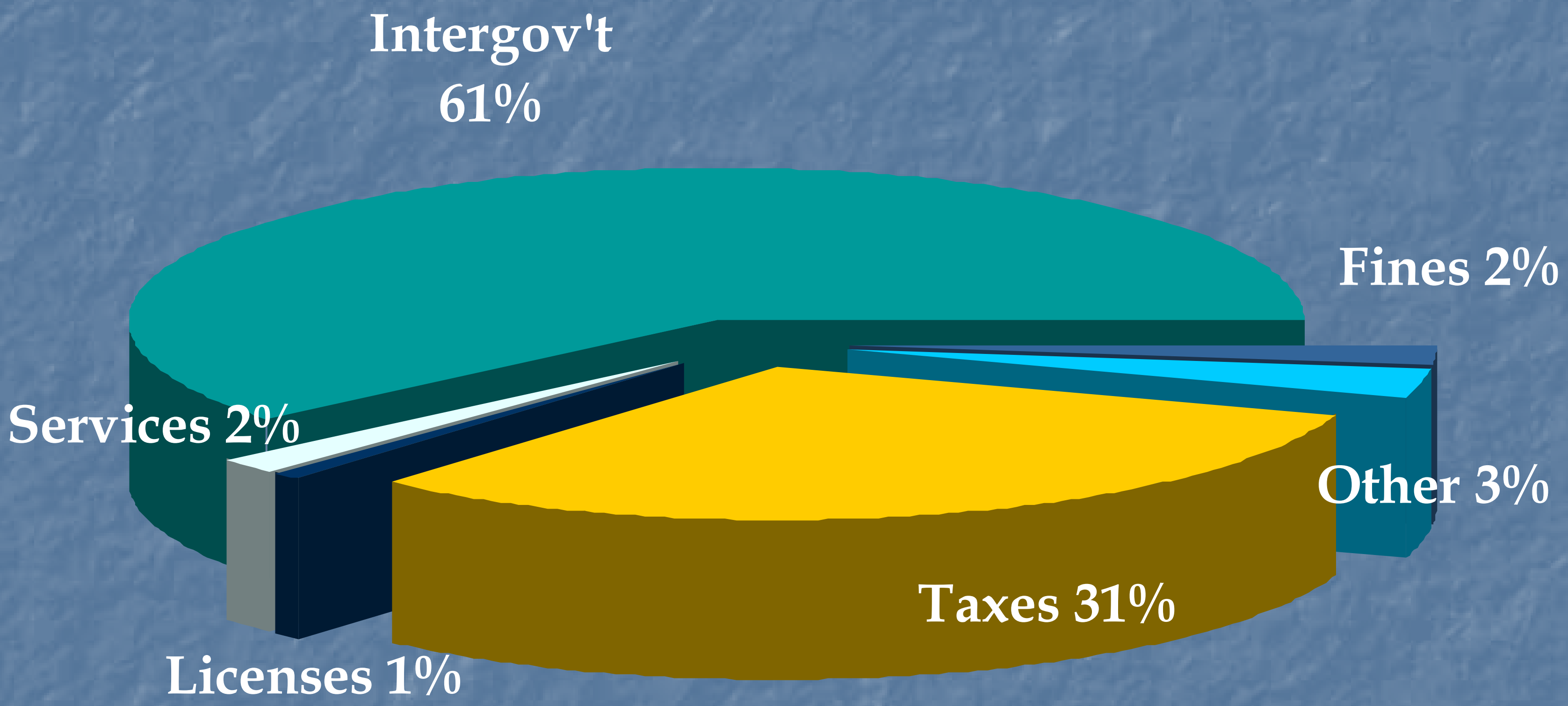
	FY'07	FY'08	FY'09	FY'10	FY'11
Deficit with 1,200-unit goal (Numbers reflect 1501 units taxable by FY'11)					
	($2,324,534)	(1,940,211)	(1,582,494)	(1,152,128)	(1,283,464)
Deficit without 1,200-unit goal (Numbers reflect no new units)					
	($2,324,534)	(1,940,211)	(2,657,244)	(3,451,878)	(4,723,214)

- If none of the 1,200+ units were built, Free Cash would be exhausted in FY'08 and all the City's Reserves would be spent by FY'10.

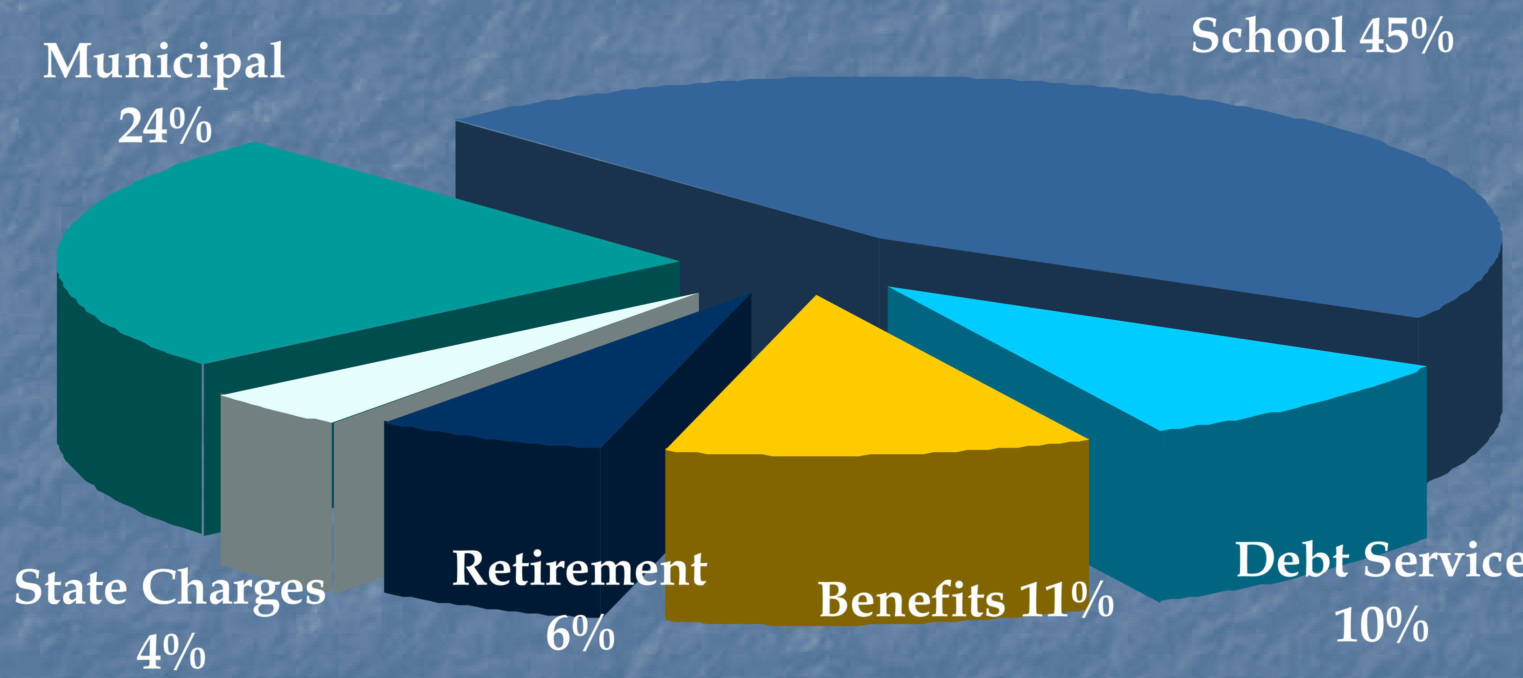
Projected Use of Reserves

	FY'07	FY'08	FY'09	FY'10	FY'11
General Fund					
Free Cash Certified at Start of Year	4,150,000	1,975,466	1,228,955	747,761	713,732
Free Cash Used for Budget Gap	(2,324,534)	(1,940,211)	(1,582,494)	(1,152,128)	(1,283,464)
Supplemental Appropriations from Free Cash	(250,000)	(250,000)	(250,000)	(250,000)	(250,000)
Accounting and Managerial Activities	0	0		0	0
Year's Net Activities Affecting Free Cash	400,000	1,443,700	1,351,300	1,368,100	400,000
Free Cash Estimated at Year End	1,975,466	1,228,955	747,761	713,732	(419,732)
Stabilization Balance at start of year					
General *7020*	3,369,429	3,504,207	3,644,375	3,790,150	3,941,756
Capital *7022*	783,749	815,099	847,703	881,611	916,876
Planning & Development *7021*	130,619	135,844	141,277	146,928	152,806

FY'07 Budget
General Fund Revenue Sources

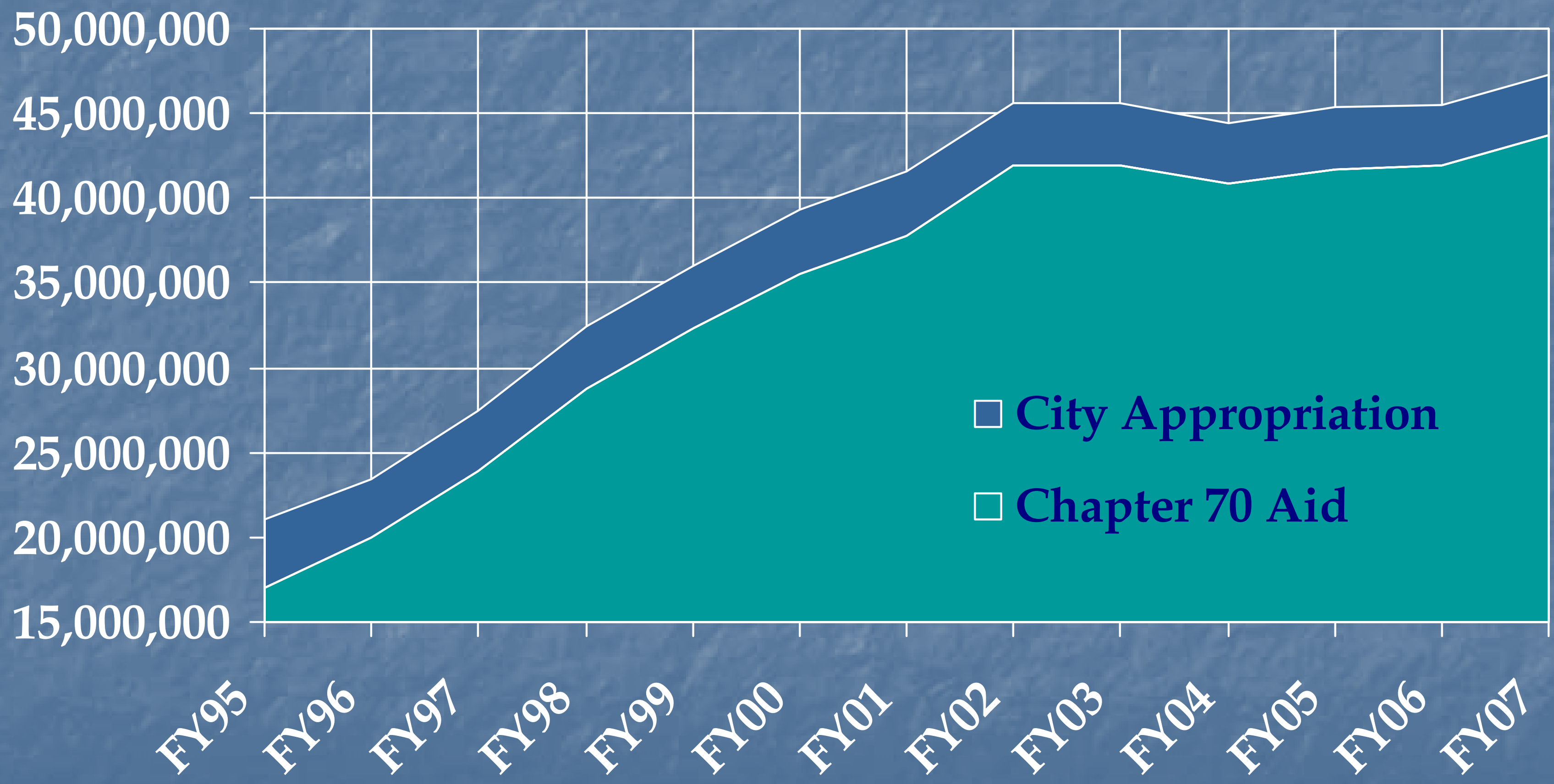


FY'07 Budget
General Fund Expenses



School Department Funding

Exclusive of Indirect Costs



Water and Sewer Enterprise Funds

- As Enterprise Funds, all costs associated with Water and Sewer services shall be recouped through Water and Sewer revenues.

- The largest revenue source for the Funds are user fees, which account for 99% of the $12,637,757 that will be raised in FY'07.

- The largest expense for the Funds are the annual MWRA Assessments, a formula driven charge. Preliminary Assessments indicate a 3.0% combined increase for FY'07. The MWRA Assessments comprise 59% of expenses for the funds, for a total of $7,422,949.

- Other charges to the funds include Direct expenses to pay RH White maintenance contract and other charges, Indirect Expenses to pay for other employee allocation costs of the General Fund, and debt services to pay for the continuing update of water and sewer infrastructure.

- The City projects that future rate increases, inclusive of MWRA Assessments and Debt Service to pay for continuing water, sewer and drainage infrastructure improvements, will be 5.70% for FY'07, and 5.25% thereafter.

Water and Sewer Enterprise Funds
Five Year Forecast and Rate Projection

Revenues:	**Projected 2007**	**Projected 2008**	**Projected 2009**	**Projected 2010**	**Projected 2011**
Interest & Penalties	62,500	62,500	62,500	62,500	62,500
Usage Charges	12,570,257	13,207,381	13,517,517	13,897,828	14,422,709
Liens	0	0	0	0	0
Final Readings	5,000	5,000	5,000	5,000	5,000
Transfer from General Fund	0	0	0	0	0
Transfer Other	0	0	0	0	0
Use of Fund Balance	0	0	0	0	0
Total Revenues	**12,637,757**	**13,274,881**	**13,585,017**	**13,965,328**	**14,490,209**
Expenditures:					
Personnel Services	234,474	239,163	245,142	251,271	258,809
Purchase of Services	1,339,592	1,379,780	1,421,173	1,463,809	1,507,723
Supplies	62,006	63,866	65,782	67,756	69,788
Intergovernmental - MWRA	7,422,949	7,645,638	7,875,007	8,111,257	8,354,595
Debt Service	2,064,715	1,742,872	1,927,280	2,167,991	2,377,884
Capital Expenditures	70,000	350,000	345,000	345,000	345,000
Indirect Costs back to General	1,327,021	1,353,561	1,380,633	1,408,245	1,436,410
Sub-Total Expenditures	**12,520,757**	**12,774,881**	**13,260,017**	**13,815,328**	**14,350,209**
Reserve	117,000	500,000	325,000	150,000	140,000
Total Expenditures	**12,637,757**	**13,274,881**	**13,585,017**	**13,965,328**	**14,490,209**
Combined Rate T1	$8.35	$8.79	$9.25	$9.74	$10.25
% Change	5.70%	5.25%	5.25%	5.25%	5.25%

Municipal Costs Affordability Index

- The City reviewed data from 7 neighboring cities to chart a Municipal Costs Affordability Index. Below, the chart refers to those communities anonymously, but lists out average tax and water & sewer bills for the average single-family owner occupied unit in each city.
- The data below indicates that municipal charges are less in Chelsea than all other cities.

City	Average Tax Bill	Residential Exemption	Average Tax Bill with Exemption	Combined Water & Sewer Bill	Combined Homeowner Costs	% Above Chelsea Cost
A	$3,209	$0	$3,209	$942	$4,151	74.31%
B	$2,875	$0	$2,875	$1,105	$3,980	67.14%
C	$4,433	$1,551	$2.883	$1,028	$3,911	64.22%
D	$2,735	$0	$2,735	$882	$3,617	51.88%
E	$2,626	$0	$2,616	$815	$3,431	44.06%
F	$3,743	1,223	$2,520	$829	$3,329	40.63%
G	$2,376	$0	$2,376	$674	$3,050	28.09%
Average	***$3,141***		***$2,745***	***$896***	***$3,641***	***52.90%***
Chelsea	$2492	$608	$1,883	$948	$2,831	

Conclusion

- The current municipal finance environment, of trouble for the last six fiscal years and considered by many to be the most severe in more than a half century, continues to threaten the viability of municipalities throughout the commonwealth and country.

- Out-year issues continue to be impacted by growth in non-discretionary spending areas, most notably, Health Insurance and Retirement, and limited Local Aid growth. The City has played a significant role in raising the statewide debate about these three "Budget Busters."

- With approximately 61% of the City's revenue coming from Local Aid, the lagging State budget crisis continues to impacting the City's budget. In FY'07, Non-School Local Aid will provide only 95% of that from FY'01. Cumulatively, and not taking into account any loss due to inflation, Non-School Local Aid reductions will cost the City $8.9 M from FY'02-'07.

- The City saved in "good times" to have Reserves to fund operations in the "bad times." Those Reserves continue to provide a cushion to allow for a maintenance of service levels while the City's deficit reduction plans work to eliminate budget deficits in the out-years.

- Central to City deficit reduction plans is the development of more than 1,200-units of housing by the end of FY'10. Absent that, Reserves would be completely exhausted and other deficit reduction plans would be insufficient to bring the FY'10 budget into balance.

- A municipal tax and fee study examining property tax and water & sewer fees for the City and seven neighboring communities finds that the City is the least expensive place to be a single-family owner occupant. With no local Proposition 2 ½ Overrides projected, the City's relative affordability should remain as such.