To: Falmouth Town Council

From: Nathan Poore, Town Manager
John McNaughton, Finance Director
Randy Davis, Budget/Purchasing Director

Date: January 22, 2009

Re: 2008-2009 Mid-year Budget Review

As you know, for the past few weeks, with the sudden, unanticipated decline in the national and state economy, we have expressed our concerns to you verbally about the possible decline in our non-property tax revenue accounts and the impact of this decline on our current fiscal year budget.

The purpose of this memo is to present to you a financial review for the 2008 – 2009 fiscal year, which is now six months complete. The current economic conditions have caused havoc with many towns as well as state budgets, and Falmouth is no exception. Due to this sudden decline in the economy, a formal mid-year analysis of the Town's 2008-09 revenue and expenditure budgets is warranted.

This memo begins by analyzing the major non-property tax revenue accounts, including excise taxes, municipal revenue sharing, investment earnings, and building and planning permits and fees. As we show below, we are anticipating an overall $275,000 revenue shortfall for this fiscal year.

Having identified this shortfall, we then propose an equivalent $275,000 in expenditure cuts and/or realized savings that will offset the revenue shortfall without requiring any additional supplemental appropriations (barring any emergencies such as another overly severe winter). In doing our analysis, we realized that this revenue shortfall will not only impact us in this current fiscal year, but also extend into our next budget year. Therefore, we looked for expenditure cuts that not only are available in the current year but are sustainable in future years as well.

Our analysis will show the detail behind the $275,000 in expenditure cuts and realized savings for the current fiscal year. As will be explained below, these cuts will be broken out by capital and operating expenditure cuts, "realized savings" and "other savings."

This analysis is based on six months of actual data and our best projections on what will happen in the remaining six months of this year. Of course, our analysis does not include any expenditure or revenue items relating to the school department. We will continue to monitor the budget closely throughout the remainder of the year.

NON-PROPERTY TAX REVENUES

Fortunately, with all its other structural drawbacks, the property tax, which represents about 70% of total Town revenue, provides the Town with a relatively stable tax base, compared with the state, for example, which is heavily dependent on cyclical revenues, such as sales and income taxes. Nonetheless, the Town is still dependent on several large revenue line-items, which are cyclical, or dependent on external economic conditions.

Regarding the remaining non-property tax (and non-school) revenue line-items, which total $4,968,300 in this year's budget, there are four major revenue areas, which are cyclical in nature, that comprise the bulk (77%) of non-property tax revenues:

- Auto excise taxes ($2,370,000 budget)
- State municipal revenue sharing ($875,000)
- Interest earnings ($325,000)
- Building/planning permits and fees ($246,700)

The remaining revenue line-items are smaller or more stable in nature. As you can imagine, projecting cyclical revenues is not an exact science, as it involves speculating on national economic trends. Nonetheless, as we will show below, our best estimate at this time is that we will have a non-property tax revenue shortfall in the area of about $275,000.

Auto Excise Taxes. By far, the largest non property tax revenue is auto excise taxes, which are budgeted at $2,370,000 for this fiscal year. Attached to this memo is a detailed month-by-month revenue analysis covering the past ten years. Based on this trend analysis, revenues would project to be about $92,000 short for this fiscal year. However, as you will note, the sharp decline did not begin until November, so this projected number does not accurately reflect the sudden drop. Adjusting for this, we are projecting an excise tax shortfall this year of $125,000.

State Municipal Revenue Sharing. State municipal revenue sharing represents a monthly allocation to municipalities of a portion of total state sales and income taxes, based on a state allocation formula. The amount budgeted in this account is $875,000 for this year. For the first six months of the fiscal year, revenue sharing receipts are running only slightly behind (about $7,000) last year. However, because of the two-month lag between state sales and income tax receipts and revenue sharing payments, the first six months' revenue to the Town reflects state revenues through October and does not reflect the sharp drop in November and December and the projected drop in 2009. Based on these projected declines, we are projecting that revenue sharing revenue will be about $50,000 below budget this fiscal year.

Investment earnings. This account represents all interest earnings not allocated to specific accounts, such as reserves and capital accounts. This account is budgeted at $325,000 for this year. This has been a difficult few months for interest yields, to say the least. For example, current yields on Treasuries have plummeted to below 0.1% for one to three month T-bills. Fortunately, at the beginning of the fiscal year, we were able to “ladder out” government agency notes at yields from 2.1 to 2.6%. Also, our liquid government money market mutual fund has performed well, as it, too, was able to ladder out investments at higher yields during the summer and early fall, before the market dropped.

Nonetheless, we are still looking at average yields over the next six months only in the 1%, rather than the budgeted 2%, range. Fortunately, because of the better yields in the early part of the fiscal year, I am still in hopes of achieving our budgetary target, subject to any further market decline or unanticipated cash flow needs. Needless to say, we will need to reduce sharply our budgetary projections for 2009-10 in this line item.

Building/planning permits and fees. These various accounts, including building, electrical, and plumbing permits, planning and zoning board review fees, and planning inspection fees, represent a total budgeted amount of $246,700. As you can imagine, they are all very much cyclical and subject to economic conditions.

As of December 31, these accounts have received a combined actual amount of $91,055 in revenues, or only 37% of the budgeted total. This number is even more skewed in that includes a single $32,000 building permit for the Tidewater project. Discounting for this permit, combined revenues are at only $59,000, or 24% of budget. Based on prior year trending, we are projecting that combined building and planning revenue will be $100,000 short for this year. The shortage is based mainly on two accounts, building permits and planning inspection fees.

EXPENSES

As noted previously, our expenditure analysis is broken down into four categories:

- Capital Budget expense cuts,
- Operating Budget expense cuts,
- Realized Savings, and
- Other Savings.

Capital Budget expense cuts. In reviewing the capital reserve accounts, we looked for items that we could eliminate, postpone, or extend the depreciable life in order to have a sustainable reduction in funding to those accounts. We found that by paying less down and extending the payments on the Open Space properties, we will be able to cut $50,000 from the Open Space funds this year. Eliminating one pumper from the fire apparatus fleet and/or extending the depreciable life of this equipment will enable us to reduce capital funding for this equipment by $25,000. Eliminating the Legion Field Pathway and the Outdoor Ice Rink Roof from our Parks capital plan will allow us to save $25,000 in funding. The savings from the Capital Budget is $100,000 in FY09 and future years.

Operating Budget expense cuts. We analyzed all the operating accounts for budgeted items that have not yet been spent to see if we could eliminate either all or a portion of the remaining balance. We were able to accomplish these budget reductions by using all available funds in some accounts, eliminating unneeded budgeted items, or changing current practices that would allow budget cuts. We decided that projects needing consultants will be reduced from a budgeted $64,000 to $34,000, saving $30,000 between the Administration and Council budgets.

We will not fill the part-time administration position budgeted for the Public Works department which will save $10,000. As we have previously discussed with you, we will move to a four-day work week for the last eighteen weeks of this fiscal year, operating at 37 hours instead of 40 hours, which will save $10,000 in salary and energy costs this year. Finally, department heads will review and trim $15,000 of miscellaneous expense from their remaining budgets. These cuts will result in a total of $65,000 in Operating Budget expense cuts.

Realized Savings. In our review of all the Operating Budget accounts, we found that in some areas actual spending for this fiscal year will be less than anticipated. The actual increases to our Health Insurance and Worker's Compensation Insurance were less than budgeted, which resulted in $35,000 in realized savings. Changes in personnel and reallocation of duties at the Police Station are showing a $17,000 savings. The reduction in the price of fuel is showing a $15,000 savings at the Police Station. These give us a total Realized Savings of $67,000.

Other Savings. The Other Savings will come from reduced spending of the money assessed in property taxes that is in excess of the authorized commitment (Overlay). Since this is a revaluation year, we have over $200,000 set aside in Overlay, of which, very little has been or is anticipated to be spent. We propose to use $33,000 of these funds to offset part of the revenue shortfall.

In summary, we believe that the combination of cuts and savings proposed above will offset the projected revenue shortfall, so that no supplemental appropriations will be needed, barring any unforeseen emergencies or further state-aid cuts. Also, as noted above, many of these cuts will be sustainable in future budget years. It goes without saying that this is a very volatile budget year, such that we may need to come back to you if there is any further deterioration in the revenue picture.

Please let us know if you have any questions regarding this memo.