

Budget Committee Memo to the Town Council

First Council Work Session on FY24 Budget and 5 Year Budget (FY24-28)

March 13, 2023

Process Update and Key Assumptions

- The current budget draft reflects (1) the Budget Committee's forecast of revenue and (2) the Town Manager's recommendations for operational and capital expenses.
- The FY25 property tax increase (\$0.10/\$100 → \$0.12/\$100) is kept at the same level as the Mayor's proposed 5-Year Budget from last year.
- Inflation rates are pegged to 1-, 2-, 3-, 4-, and 5-year T-bills as a market-based approach to forecasting inflation.
- ARPA funds are included in the overall budget but are used for specific, ARPA-designated capital and operating uses – and will be used in full by FY25 (a year before FY26 required use);
- Capital expense assumptions reflect the Town Manager's recommendations, including recommended Committee requests.
- The Rainy Day Fund is growing towards 12 months' operating expenses goal per RDF resolution.
- A reminder that Town goals for reserves are as follows:
 - 12 months' operating expenses in the Rainy Day Fund
 - 2 months' operating expenses in Unencumbered Reserves (roughly \$300K - \$325K)
- This is intended to be a working draft budget for the Council to see the financial implications of current assumptions and understand financial scenarios associated with policy decisions – the Budget Committee is not recommending the Council adopt this budget.

Topline Budget Summary

	FY 20 Audit	FY 21 Audit	FY 22 Audit	FY 23 Projection	FY 24 Projection	FY 25 Projection	FY 26 Projection	FY 27 Projection	FY 28 Projection
Property tax rate (\$ per \$100)	0.10	0.10	0.10	0.10	0.10	0.12	0.12	0.12	0.12
Revenues									
Total revenues	2,067,614	1,748,029	2,546,135	3,341,880	2,165,211	2,428,047	2,551,571	2,679,817	2,783,474
growth		-15.5%	45.7%	31.3%	-35.2%	12.1%	5.1%	5.0%	3.9%
Operating expenses									
Total operating expenses	1,365,284	1,589,498	1,731,740	1,678,264	1,929,072	1,952,039	2,022,709	2,098,260	2,173,556
growth		16.4%	8.9%	-3.1%	14.9%	1.2%	3.6%	3.7%	3.6%
Revenues less operating expenses									
expenses	702,330	158,530	814,395	1,663,615	236,139	476,008	528,862	581,557	609,918
growth		-77.4%	413.7%	104.3%	-85.8%	101.6%	11.1%	10.0%	4.9%
Capital expenses									
Total capital expenses	596,788	87,573	187,988	476,538	1,754,727	620,564	416,219	431,912	444,580
growth		-85.3%	114.7%	153.5%	268.2%	-64.6%	-32.9%	3.8%	2.9%
Beginning-year Reserves	1,812,820	1,918,362	1,989,319	2,615,726	3,802,803	2,284,215	2,139,658	2,252,301	2,401,947
+ Rev. less oper. expenses	702,330	158,530	814,395	1,663,615	236,139	476,008	528,862	581,557	609,918
- Capital expenses	596,788	87,573	187,988	476,538	1,754,727	620,564	416,219	431,912	444,580
End-year Reserves	1,918,362	1,989,319	2,615,726	3,802,803	2,284,215	2,139,658	2,252,301	2,401,947	2,567,285
Rainy Day Fund	1,023,963	1,258,353	1,258,353	1,356,720	1,585,167	1,630,039	1,715,991	1,808,031	1,901,862
Special Capital Fund					0	0	0	0	0
Wynne Case Special Acct.	250,549	244,285	212,967	200,439	187,912	175,384	162,857	150,329	137,802
Unencumbered	643,850	486,681	1,144,407	2,245,644	282,688	289,364	287,502	351,546	433,791

Preliminary Budget Committee Analysis and Recommendations

(1) FY23 Income Tax revenue is projected with high confidence to be \$576K higher than we budgeted, suggesting an unanticipated recovery of income tax revenue

- This is a positive data point suggesting our structural concerns about ongoing lower income tax levels are potentially not what we feared
- This increase appears due to higher net taxable income per household between CY2019 (\$355K/HH) and CY2021 (\$555K/HH)
- In 2019, 49.6% of income tax revenue came from 104 households earning more than \$500K; by 2021, 52% of income tax revenue came from 59 households earning more than \$1M
- For the first time, Somerset saw a sizeable tax distribution in January from prior year tax return reconciliations – characteristic of higher income returns and also the use of pass-through entities, new in Maryland and utilized by higher income earners
- **Recommendation:** with only a single year datapoint, the Budget Committee recommends a more conservative forecast for FY24 revenue that assumes our FY23 budgeted amount grows only at the rate of inflation. This is why we show revenue declining by 35% for FY24 compared to FY23.

(2) Positive income tax story aside, Somerset has more demand for spending than our revenue base can support over the medium term primarily driven by:

- Capital spending plans: many critical but expensive infrastructure investments (roads, sidewalks, pool) have been deferred for years, first due to the pandemic and then due to the time required to build well-vetted master capital plans.
- Town Committee requests: Committees have increased their activities and requests for spending.
- **Recommendation:** Raise the bar for incorporating committee budget requests so they are well designed, specific, and in alignment with Town Manager and the Council's overall budget plans

(3) Significant savings in Opex are unlikely since 84% of costs are people (personnel, professional services, and associated costs = 45% of opex) directly performing essential government functions and Council-approved policy decisions and other essential services (13% sanitation; 15% recreation; 12% streets/sidewalks/trees)

- Personnel hiring decisions contemplated for FY24 were essentially approved for FY23 but not yet implemented.
- **Recommendation:** Any decision to defer additional personnel or professional service expenses should be tied to specific reductions in Town functions.

(4) Long-deferred but necessary capital expenditures only get more expensive with time and more difficult to budget

- Critical investment in the pool, streets, and sidewalks have been deferred for several years pending master plans, increasing the size of the investment needed.
- **Recommendation:** Town Manager has prioritized those expenditures based on prior analysis and/or master plans. Budget Committee strongly recommends that master plans should precede every single major capital expenditure that is budgeted so the universe of total investment required is well understood *before those costs appear in the budget*
- **Recommendation:** The Town should prioritize contributions to the Special Capital Fund to ensure funds are available when master plans are completed and approved

(5) Trade-offs will need to be made in the medium term to keep Unencumbered Reserves at the Town's target of 2 months' operating expenses. The budget levers the Council can pull to improve the budget outlook are as follows:

- Decline or defer committee expenditure requests;
- Seek operational expenditure savings;
- Seek capital expenditure savings;
- Raise the property tax;
- Defer/lower new contributions to the Rainy Day Fund;

Next Steps

- The Budget Committee will incorporate Council recommendations into a new budget working draft;
- The Budget Committee would like to target an initial Town Journal article for April (due March 15) to explain updates on FY23 actuals and remind residents about the budget process, timeline, and opportunities for public comment.

Appendix Table 1: Sources for Operating Expenditure Growth FY23 to FY28

	FY23	FY24	FY25	FY26	FY27	FY28
Total growth	-4.4	9.4	1.2	3.6	3.7	3.6
Personnel	-2.9	6.2	0.8	1.2	1.2	1.0
Professional services	1.2	-0.4	-0.9	0.8	0.5	0.7
Streets and sidewalks	-2.5	0.3	-0.2	-0.1	0.0	0.3
Sanitation	0.2	0.9	0.6	0.6	0.6	0.6
Pool	-2.0	0.8	0.6	0.6	0.6	0.5
Debt service	0.5	0.4	-0.1	0.1	0.3	-0.0
Wynne case	0.0	0.0	0.0	0.0	0.0	0.0
Other	1.2	1.3	0.3	0.5	0.5	0.5
Memo:						
Operating revenue growth 1/	41.4	-20.2	12.1	5.1	5.0	3.9
1/ Excluding ARPA grant and operating contingency.						
NB: operating expenditures are exclusive of Holiday Fund.						

Appendix Table 2: Projected ARPA Funds Use

ARPA Fund Uses (Projections)						
Capital	FY22	FY23	FY24	FY25	TOTAL	%
LED Streetlights	\$ -	\$ 80,000.00	\$ 160,000.00	\$ -	\$ 240,000.00	12.0%
Roadway Master Plan	\$ -	\$ 64,000.00	\$ -	\$ -	\$ 64,000.00	3.2%
Street/Sidewalk Repairs	\$ -	\$ 47,650.00	\$ 305,000.00	\$ 325,000.00	\$ 677,650.00	33.9%
Stormwater Mitigation	\$ 56,500.00	\$ 27,000.00	\$ 100,000.00	\$ 75,000.00	\$ 258,500.00	12.9%
Town Hall Repairs	\$ -	\$ 32,205.45	\$ 20,000.00	\$ -	\$ 52,205.45	2.6%
Electric Vehicle	\$ -	\$ 85,000.00	\$ -	\$ -	\$ 85,000.00	4.3%
Operating						
Stormwater Review	\$ -	\$ 23,275.00	\$ 45,000.00	\$ 47,160.00	\$ 115,435.00	5.8%
Attorney Fees (Building/Stormwater Review)	\$ 3,600.00	\$ 3,600.00	\$ 3,600.00	\$ 3,600.00	\$ 14,400.00	0.7%
Trees/Grounds Maintenance	\$ -	\$ 155,543.53	\$ 163,056.59	\$ 170,883.31	\$ 489,483.43	24.5%
Arbor Day	\$ -	\$ 500.00	\$ 500.00	\$ 500.00	\$ 1,500.00	0.1%
TOTAL	\$ 60,100.00	\$ 518,773.98	\$ 797,156.59	\$ 622,143.31	\$ 1,998,173.88	
ARPA Funds	\$ 627,117.67	\$ 627,501.11	\$ -	\$ -	\$ 1,254,618.78	