

# **Report of the Treasurer to Town Meeting**



**June 2009**

**Town of Arlington, MA**

## **Report of the Treasurer to Town Meeting**

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## **Report of the Treasurer to Town Meeting**

### **Overview**

This Treasurer's report will describe the Town of Arlington's current cash flow, investments, and debt for fiscal year 2009 and, where appropriate, fiscal year 2010. While the Treasurer is not directly involved in Town and School operations, the Treasurer's office manages the cash flow and investments that provide the financial means for other departments to continue their activities.

Decisions that Town Meeting makes regarding financial issues such as budgets, capital expenditures, debt or collective bargaining have a strong impact on Town finances. Based on those decisions, the Treasurer's office will manage cash flow, deposits, investments and debt to maximize the Town's financial resources and provide the fullest support possible to all departments and programs.

I hope that, at the end of this report, Town Meeting members, Town officials and citizens of Arlington will have a clearer picture of the critical elements that make up the Town's financial position for the upcoming fiscal year which starts July 1<sup>st</sup>, 2009.

## **Cash Flow**

Cash flow is critical to any Town's operations, enabling it to:

- Meet its payroll obligations;
- Pay the many vendors who provide occasional or regular services to the Town and pay existing short and long-term debt;
- Determine the amount of funds available to be invested, the length of those investments and the estimated investment income.
- Manage cash flow that becomes negative effectively to identify the amount needed to be borrowed, the length of the loan and the cost of that loan.

As seen in Exhibit 1, the End of Fiscal Year Cash Flow for the Town of Arlington from 1999 to 2008 has ranged from a low of \$12.3M to a high of \$13.8M. In the current Fiscal Year, the end of month balance has ranged from a low of \$4.1M to a high of \$11.2M. The highest daily cash balance, for FY09, has been \$13.5M and the lowest cash flow has been \$479,000. These fluctuations demonstrate how volatile cash balances can be. The amount available at the end of any fiscal year is very important. The Town's payment of approximately \$7 Million is due on July 1<sup>st</sup> to the Town's pension fund. In addition, payments of \$3-4 Million to existing bondholders are generally due the first month of the fiscal year.

Exhibit 2 shows the cash receipts for interest income, excise and other local fees for FY09 to date to be less than FY08. Some of the initial projections for FY10 indicate a potential need for short-term borrowing sometime in FY10. A number of factors such as state aid, interest income, and potential interest expense for short-term borrowing and local receipts will all have a significant impact on the Town's cash flow for FY10.

The Treasurer's office has initiated procedures to very closely monitor the Town's cash balances. In the event that a negative cash flow does occur it will be the responsibility of the Treasurer to determine how any temporary shortfall in funds will be handled.

## **Investments**

### **Up To 1 year**

The receipts from the Real Estate tax, Motor Vehicle Excise, and other local receipts are needed to fund the Town's payroll and other obligations before any decision can be made regarding the amount of, type and length of investment.

These tax receipts are generally invested in short-term investment vehicles such as money market funds or CD's. The critical variable here is to predict, with as much certainty as possible, how long these monies can be invested before being needed to fund ongoing operations. The Treasurers ability to generate investment income is dictated, in large part, by the market conditions that exist at the time the funds are available for investment. The expectation, for FY10, is that the short-term interest rates will be between .25% and 1.25%. Those rates would cause a significant reduction in interest income for FY10. As shown in Exhibit 2 the projected interest income for FY09 is \$422,842, which is less than half of the FY08 amount.

### **1 Year To 5 Years**

Stabilization funds have a longer investment length than the tax receipts earmarked for General Fund purposes. Stabilization funds have the following characteristics:

- They are established by Town Meeting
- They are a reserve for a specific purpose,
- The withdrawals from a particular fund can be at regularly scheduled intervals or can be allowed to be withdrawn at any time when it is required to meet the stabilization fund's individual requirements and stabilization funds are removed by a vote of Town Meeting

The Town's stabilization funds are invested either in the Massachusetts Municipal Depository Trust (MMDT) or the Town's Trust Fund Portfolio, managed by State Street Global Advisors (SSgA), or a combination of both. The MMDT provides their municipal clients access to competitive money-market rates and is designed for maximum liquidity. SSgA manages the Towns Trust Fund portfolio, which is made up of cash, fixed income and equities.

The Town's Stabilization Funds are the following:

Tip Fee Stabilization- 100% MMDT

Municipal Building Trust Fund-100% SSgA

Long-Term Stabilization Fund- 80% MMDT, 20% SSgA

Article 65 Stabilization Fund-100% SSgA (Override Stabilization Fund-OSF)\*

#### STABILIZATION FUND BALANCES

<b>Municipal Building Trust Fund</b>	<b>\$953,341</b>
<b>Long Term Stabilization Fund</b>	<b>\$2,501,592</b>
<b>Override Stabilization Fund (OSF)*</b>	<b>\$3,958,224</b>
<b>Tip-Fee Stabilization Fund</b>	<b>\$2,555,376</b>
<b>Total</b>	<b>\$9,968,533</b>

These balances are as of April 30, 2009. Please refer to Exhibit 3 for annual balances.

As described above, three of the stabilization funds have all or some of their monies in the Trust Fund Portfolio. The Municipal Building Fund shows a market value of \$953,341, which includes an unrealized gain of \$348,835. The Long Term Stabilization Fund overall balance is \$2,501,592 with \$340,554 in the Trust Fund Portfolio, which has an unrealized loss of \$89,866. The Override Stabilization Fund balance is \$3,958,224, which includes an unrealized loss of \$692,914.

The votes of the Town Meeting have simply been to either authorize the appropriation, withdrawal or transfer of a specific dollar amount to or from any of the Town's stabilization funds. An example of this would be Exhibit 4 that details the most recent year-by-year withdrawals from the Municipal Building Fund. The available data shows that from FY02 to FY09, \$952,849 was transferred from the Municipal Building Fund to the Insurance Budget as an offset. Additionally, \$1,500,000 was transferred from the Municipal Building Fund to the Long Term Stabilization Fund in 2005.

By placing the Municipal Building Fund in the Town's Trust Fund portfolio, the amount available to be used as an offset for the insurance budget, or to be transferred to the Long Term Stabilization Fund, is estimated to be 100% greater than a standard fixed income investment.

The most recent attempt to establish an investment and spending policy for the Town's stabilization funds was submitted to the 2004 Annual Town Meeting. The Finance Committee's recommendation of no-action included a statement that they and the Budget and Revenue Task Force would develop a policy for building the Town's reserve funds. In the absence of a jointly developed investment policy by the Treasurer, Budget & Revenue Task Force, and the Finance Committee, the Treasurer has continued the investment policy that takes full advantage of the opportunities of the Trust Fund portfolio to increase the returns of the Override Stabilization and the Municipal Building funds.

In early March 2009 the Treasurer initiated discussions with other Town officials to determine the most cost effective withdrawal plan for the Article 65 Stabilization Fund/OSF, as well as a comprehensive investment policy for any future stabilization or reserve funds. The Budget and Revenue Task Force established, on April 29, 2009, a sub-committee to develop an investment policy for the Town's stabilization funds. It is the Treasurer's hope that this effort by the Budget and Revenue Task Force will deliver a recommendation in time for Town Meeting to vote on the manner that Stabilization Fund monies will be transferred to the FY 2010 Budget.

### **Greater Than 5 Years**

The Town's Trust Fund is made up of a variety of charitable trusts such as the John J. Bilafer-Arlington Citizen's Scholarship Foundation/Dollars for Scholars, Library Trusts, Cemetery Trusts, and Poor Widow's Trusts, as well as the above-mentioned Stabilization Funds. The Trusts are combined into one investment vehicle, a balanced portfolio of equities, fixed income and cash. There are approximately 102 sub-accounts within the portfolio. The Trust Fund Portfolio is currently being managed by State Street Global Advisors (SSgA) with a passive management approach that follows the guidelines of the Town of Arlington's Investment Policy developed by the Town Treasurer in 2007. The Treasurer's Office issued a Request for Information on November 26, 2008 to seek responses for an Investment Advisor, Investment Manager and Custodian for the Town's Trust Fund Portfolio. The Treasurer has selected an investment firm to perform the role of Investment Advisor, Investment Manager and Custodian and will replace State Street Global Advisors.

The new investment firm, Boston Advisors, will assume responsibility for investment management of the Trust Fund portfolio by July 1st, 2009.

As shown in Exhibit 5 the average return for the Town's Trust Fund Portfolio, from 1993 through 2008, is approximately 7.5%. As is the usual case with

investment portfolio's there has been wide fluctuations in the rate of return ranging from a high of 20.65% for 2003 to a low of -14% for 2008.

## **Town Debt**

The current debt limit for the Town of Arlington is \$377,932,385.

Massachusetts General Law dictates that the debt limit of any city or town is 5% of the equalized valuation for the entire town or city.

The total gross debt for the Town of Arlington is \$62,186,800. The gross debt includes the actual outstanding debt and debt that is authorized but not yet incurred. The actual debt for the Town of Arlington is \$52,953,584.

Within the \$52,953,584 there is \$23,082,530 of debt that is outside the debt limit. The \$23,082,530 is made up primarily for the debt exclusion for the rebuilding of the elementary schools. \$9,593,216 is the additional amount that the Town can borrow without obtaining additional authorization.

The Town of Arlington borrows money via two different financial instruments: General Obligation Bonds and Bond Anticipatory Notes (BANs). The definition of a General Obligation Bond is: a written promise to pay a specified sum of money at a specified date, called the maturity date, together with periodic interest at a specified rate. A bond requires an opinion by bond counsel on its legal aspects and tax status. BANs are bond anticipation notes that are a means of acquiring short term financing that will be repaid by the subsequent issuance of bonds. The BANs that Arlington employs for the Symmes Project received a special legislative waiver that allowed the maximum time for a BAN to be extended from 5 years to 10 years. However, the length of Arlington's BANs will reduce the maximum length of its General Obligation Bonds for the Symmes project by 10 years. This means that a 25-year bond would be reduced to 15 years and a 20-year bond would be reduced to just 10 years.

The management of the Town's bond operation does not end with the issuance of bonds. The issuance of Town bonds may provide for a callable feature enabling the Treasurer to reissue any bond at a reduced rate. The most recent occurrence of the Treasurer taking advantage of lower rates to refinance Town bonds occurred in FY08. \$11,690,000 of General Obligation Bonds, originally issued in August 1998 and December 1999 was refinanced with savings of \$675,507. At the present time there are no opportunities to refinance existing bonds until 2011.



## Symmes Project

Exhibit 6 shows the total expenses and revenue for the Symmes Project, from 2002 to the current fiscal year, to be \$7,338,177 for expenses and \$2,292,496 in revenue for a net expense of \$5,068,479. Included in this cost is the interest and issuing expense for the BANs, from 2002 through 2009, which amounts to \$2,269,698. At this moment in time, there are no firm estimates as to when the project's developers will receive proper financing to renew the Symmes project. Therefore the ability to project the timing of a revenue stream to offset the known expenses is not available at this time.

The existing \$6.2M debt for the Symmes Project is currently being paid for by the use of a BAN. This BAN must be converted no later than FY12 to a General Obligation Bond. Exhibit 6A shows a budgetary comparison on the current estimated cost for 10 and 15 year bonds at a 4% and 5.5% coupon rate.

<b>Principal</b>	<b>Length of Bond</b>	<b>Interest Rate</b>	<b>Total Interest Cost</b>	<b>Net cost of bond borrowing</b>
\$6,200,000	10 year bond	4%	\$1,364,000	\$7,564,000
\$6,200,000	10 year bond	5.5%	\$1,875,000	\$8,075,500
\$6,200,000	15 year bond	4%	\$1,979,000	\$8,179,000
\$6,200,000	15 year bond	5.5%	\$2,721,125	\$8,921,125

The 4% borrowing rate assumes that the BAN of \$6.2M will be converted August 2009. The 5.5% borrowing rate assumes that the BAN will be converted in 2012. The 5.5% rate assumes that the recent Federal stimulus packages will generate additional inflationary pressures on interest rates.

As seen in Exhibit 6B, an estimated cost for borrowing and repaying the Symmes Project loan has been calculated as well as non-interest expenses. Scenario 1 shows the borrowing amount, at 5.5%, for the current and future BAN costs and a 10-year bond is \$11,095,198. The total cost for the 15-year bond with current and future BAN costs, at 5.5%, is \$11,940,823. Scenario 2 shows the total borrowing amount, at 4%, for the current BAN costs and 10-year bond is \$7,564,000. The 15-year bond with the current BAN costs has a total cost of \$8,179,000.

Exhibit 6B shows the different amount of savings the Town could receive depending upon which bond length is chosen as well as whether the Town chooses to bond now or at a later time. Scenario 2 with a 10-year bond at the estimated 4% interest rate has the maximum savings of \$2,129,889 when compared to Scenario 1's option of including all past and future BAN costs and a 15-year bond at the estimated 5.5%. While these possible savings are certainly attractive they need to be reviewed in conjunction with the many financial issues facing the Town in

FY10 and beyond. Exhibit 6C shows the interest only savings between the various BAN and bond scenarios.

The final decision when to borrow and under what circumstances is reserved for the Board of Selectmen, with input from the Finance Committee and Capital Planning Committee's as well as other Town departments. Information on the Symmes project has been presented to document the current situation and possible bonding options.

## **Closing**

Arlington has had to deal with a number of financial challenges during the current fiscal year 2009. The fiscal year 2010 will have similar or additional challenges.

As has been discussed earlier in this report one area that will require exceptional vigilance is the monitoring of the Town's cash balances. The combination of reduced state aid, higher costs for standard purchases and services, reduced local receipts and increased delays in the payment of real estate taxes and other fees is expected to reduce the amount of cash available to the Town from the previous years.

Investment income for FY10 General Fund purposes will be sharply reduced from previous years because of significantly lower interest rates and the smaller amount available to be invested. It is unknown when the financial situation will improve sufficiently for investments to generate the level of income the Town received prior to the current economic downturn. Investment management for the Town's Trust Fund Portfolio will be aided by the addition of an Investment Advisor. The Treasurer and the new Investment Advisor will be available to assist town officials in evaluating the Town's options for dealing with the transfer of stabilization funds to the FY10 General Fund.

The Town's debt, both short and long-term, has been prudently incurred and is well within the Town's debt limit set by the Commonwealth. As explained earlier in this report the Symmes Project debt will need to be converted, no later than April 2012, from the interest-only BANs to General Obligation Bonds. This conversion will add to the overall tax levy for the length of these bonds. The Treasurer's management of the Town's debt, as always, will require careful analysis of interest rate projections to select the most opportune time to issue bonds. This will be especially important as other Town officials decide whether the Symmes Project debt should be converted from interest only BANs to general obligation bonds earlier than the originally projected date of April 2012.

The Treasurer will continue to work with his staff to seek improvements in the areas of cash, investment and debt management. As has been the case for many years the Treasurers office will closely coordinate these improvements with the IT department's technical support staff.

The Treasurer's office goals have always been to efficiently manage the cash, investment and debt operations while serving our taxpayers in the most professional manner possible. The financial challenges facing the Treasurers office and the Town of Arlington for FY10 are one in the same. Improvement in processes, creative applications, and interdepartmental cooperation must be the cornerstone of the efforts initiated to maintain the high level of service Arlington's taxpayers have come to rely on. I pledge to Arlington's citizens that the Treasurers office will strive every day to maintain that high level of service.