

# Special Report

June 27, 2018 No. 18-2

## Highlights

- The City's top eight budget accounts represent 84% of the total FY19 budget and 66% of the total increase.
- City-funded employee levels will increase by 220 positions to 17,554 by January 1, 2019, with 29% of the growth attributable to the School Department.
- State Aid in FY19 grew by \$5.9M but assessment expenses increased by \$22.9M, resulting in \$17M less operating revenue for Boston than in FY18.

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## Boston's FY19 Budget Grows 4.4%

*City should maintain vigilance in managing employee expenses*

Mayor Walsh's fiscal 2019 budget of \$3.30 billion is allocated primarily among eight large budget accounts and is funded chiefly by the property tax. The Mayor's budget represents an increase of \$138.5 million or 4.4% over the fiscal 2018 budget. The higher growth of non-discretionary expenses and the cost increases of major departments are creating more pressure on other departmental spending. Revenues are estimated conservatively, but some funds are available for selected initiatives. Employee expenses for salaries and benefits represent 68% of the total recommended budget and 63% of the budget increase. The City's heavy reliance on the property tax continues with the net property tax levy (gross levy less overlay) representing 70% of total General Fund operating revenue and 85% of the total revenue increase in fiscal 2019. The State is not keeping pace, with state aid representing 4.3% of the total revenue increase.

Other highlights of this report include:

- With employee costs representing 68% of the recommended budget, the City must be vigilant in managing its personnel expenses. That means continuing its tight control over employee headcount and being firm in contract negotiations about employee compensation and benefit expenses.
- As the City begins to implement planning initiatives such as Build BPS, Go Boston 2030 and Climate Ready Boston, more capital spending will be required. The five-year capital plan (FY19-FY23) totals \$2.43 billion and plans on higher borrowing by the City and utilization of other revenue sources.
- The City is fortunate in the robust growth of its property tax levy from new development, which should continue over the near term. However, the City should prepare for a time when the development pipeline will slow down.

### Where the Money Comes From

(\$ in millions)

Account	FY18 Current	FY19 June	% of Total	FY18-FY19 Variance	% Variance	% of Increase
Net Property Tax	\$2,185.9	\$2,304.0	69.9%	\$118.1	5.4%	85.3%
State Aid	\$440.6	\$446.5	13.5%	\$5.9	1.3%	4.3%
Excises	\$188.1	\$197.3	6.0%	\$9.2	4.9%	6.6%
All Others	\$343.1	\$348.3	10.6%	\$5.3	1.5%	3.8%
<b>General Fund Revenues</b>	<b>\$3,157.6</b>	<b>\$3,296.1</b>	<b>100.0%</b>	<b>\$138.5</b>	<b>4.4%</b>	<b>100.0%</b>

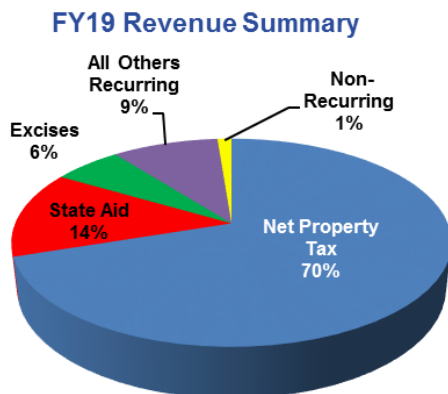
### Where the Money Goes

Department	FY18 Current	FY19 June	% of Total	FY18-FY19 Variance	% Variance	% of Increase
Total Departmental	\$2,200.6	\$2,287.3	69.4%	\$86.7	3.9%	62.6%
Non Departmental	\$15.5	\$15.5	0.5%	\$0.0	0.2%	0.0%
Benefits/Mandatory	\$941.6	\$993.3	30.1%	\$51.7	5.5%	37.4%
<b>Expenditures</b>	<b>\$3,157.6</b>	<b>\$3,296.1</b>	<b>100.0%</b>	<b>\$138.5</b>	<b>4.4%</b>	<b>100.0%</b>

## I. WHERE THE MONEY COMES FROM

The primary revenue source for Boston's General Fund operating budget continues to be the net property tax, which in fiscal 2019 totals \$2.30 billion and represents 69.9% of total operating revenues and 85.3% of the total revenue increase over the prior year. The second largest revenue source is state aid at \$446.5 million followed by excise revenues totaling \$197.3 million. The City is relying on its own revenue sources for 96% of its total operating revenue increase. The City continues to follow its prudent practice of using conservative revenue estimates in developing its operating budget to prepare for unforeseen circumstances.

Figure 1



### Property Tax Fuels Budget Growth

The net property tax in fiscal 2019 represents an increase of \$118.1 million or 85.3% of the total revenue increase. The net property tax is the gross tax levy less the overlay set aside for abatements and non-payment of taxes. Due to the decline in abatement applications, this year's overlay was reduced by \$7.6 million, which allowed the property tax levy for operations to increase by the same amount. In fiscal 2019, the increase in the property tax comprises the existing base levy increase of 2.5% or \$55.4 million and an estimated \$55 million from new growth. New growth for the fiscal 2018 budget was initially \$53 million, but later increased to \$77.6 million when the tax rate was set.

### State Aid Falls Short

State aid for Boston in fiscal 2019 is budgeted at \$446.5 million, which represents an increase of \$5.9 million or 1.3%. Even though state aid is the City's second largest revenue source, its increase in fiscal 2019 represents only 4.3% of the total revenue growth compared with the property tax share at 85.3%. The largest state aid account, Chapter 70 education aid at \$219.4 million, increased by only \$1.3 million or 0.6%. The actual state aid available for operations in fiscal 2019 is \$17.0 million less than was available in fiscal 2018 after the \$22.9 million in state assessments is netted out. Also, the state charter tuition reimbursement is projected to be underfunded by \$25.8 million.

The recommended budget state aid numbers are based on the House budget. State aid levels are currently being negotiated in House-Senate Conference Committee.

### Excise Taxes Continue to Expand

After the property tax and state aid, the excise tax revenues from 10 sources represent the third largest revenue group totaling \$197.3 million, an increase of \$9.2 million or 4.9%. The larger excise sources are room occupancy (\$92M), motor vehicle (\$52M), meals (\$29M) and jet fuel (\$18M). New to the budget is the marijuana excise of \$2.25 million. The City adopted a 3% local option recreational marijuana sales tax, which will go into effect July 1, 2018. The budget, for the second year, includes \$2.0 million from a per-ride assessment collected from transportation network companies (TNCs) such as Uber and Lyft, as allowed by the state.

**Other Revenues  
Grow with Economy**

All other recurring revenue is budgeted at \$307.8 million, an increase of \$4.8 million or 1.6%. Included in this group are revenues from licenses and permits (\$76.3M), fines (\$69.1M), PILOTs (\$46.0M), miscellaneous departmental revenues (\$44.0M), Chapter 121A (\$27.5M), penalties and interest (\$9.0M), and a group of separate accounts (\$35.9M), including parking meter fees (\$22.5M) and Medicaid reimbursements (\$7.5M). Parking fines are estimated at \$66.3 million, an increase of \$5.0 million, reflecting the City’s increase of parking fines unchanged since fiscal 2008 to improve transportation services. Building permits peaked at \$62.0 million in fiscal 2017, but declined last year and is estimated at \$45 million in fiscal 2019.

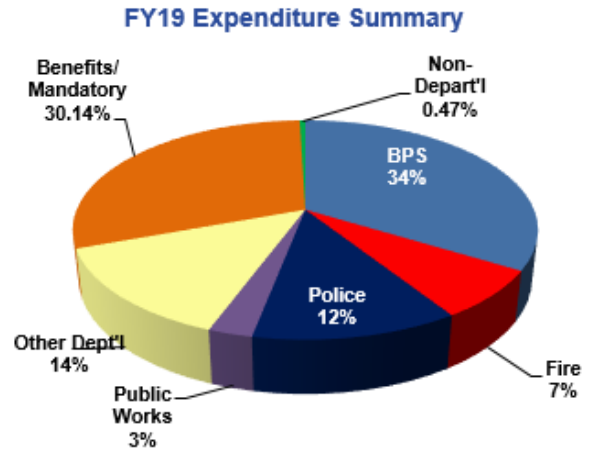
**Free Cash Funds  
OPEB Trust**

The primary use of non-recurring revenue in the City’s fiscal 2019 budget is the appropriation of \$40 million of Budgetary Fund Balance (Free Cash) revenue for the Other-Post Employment Benefit (OPEB) Trust Fund to help fund a portion of the current \$2.37 billion retiree health insurance liability. The OPEB Trust Fund had a balance of \$547 million as of December 31, 2017.

**II. WHERE THE MONEY GOES**

Typical of public budgets, a few large accounts can represent a significant percentage of the total budget and that is true for Boston as well. In fiscal 2019, the top four departments (School, Police, Fire and Public Works) and the top four non-discretionary accounts (Pensions, Debt Service, Health Insurance and State Assessments) total \$2.77 billion or 84.1% of the total operating budget and 65.5% of the total budget increase.

Figure 2



**Departmental  
Spending on the Rise**

The fiscal 2019 budget for all departmental services totals \$2.29 billion, an increase of 3.9%. Departmental budgets represent 69.4% of the total budget. The fiscal 2019 budgets of the top four departments of School, Police, Fire and Public Works total \$1.83 billion or 55.7% of the total budget and 80% of the departmental total of \$2.29 billion. The aggregate budget increase of these four departments totals \$39.0 million, which represents total growth of 2.2%.

The fiscal 2019 budgets of the remaining 43 departments, offices or boards in the departmental category, in aggregate, total \$414.1 million or 18.1% of total departmental budget and 12.5% of the total budget. Human Resources saw the largest percentage increase of 22.5%, which includes \$500,000 for workplace sensitivity training. The Office of Economic Development had the second largest increase of 18.7%, which funds new equity and inclusion staff.

## Salaries & Benefits Drive Spending

Government service is labor intensive, which is why the City’s fiscal 2019 budget for salaries and benefits totals \$2.24 billion, representing 68% of the total operating budget and 63.1% of the total city budget increase over the prior year. The increase of employee costs over the prior year is \$87.4 million or 4%. By January 2019, the Administration expects the number of city employees to total 17,554, an increase of 220 employees since January of 2018. The School Department accounts for 65 or 29.4% of the increase. Salaries total \$1.57 billion in fiscal 2019, an increase of \$58.1 million or 3.9% over the prior year. Over the past five years since fiscal 2014, salary costs have increased by a total of 22.6%, or an average annual increase of 4.5% due to salary increases and an increase in employee levels. Pensions, health insurance and other benefits total \$670.8 million in fiscal 2019, an increase of \$154.4 million or 29.9% over fiscal 2014 and an increase of 4.6% since fiscal 2018.

Table 1

### Personnel vs. Non-Personnel Spending FY19

(\$ in millions)

	FY19	% of Total
Salaries	\$1,568.6	48%
Health Insurance	\$344.4	10%
Pensions	\$238.7	7%
Other Benefits	\$87.7	3%
<b>Total Personnel</b>	<b>\$2,239.4</b>	<b>68%</b>
Non-Personnel	\$1,056.7	32%
<b>Total Budget</b>	<b>\$3,296.1</b>	<b>100%</b>

## Education Comes Out on Top

The School Department budget for fiscal 2019 is \$1.112 billion, an increase of \$19.0 million or 1.7% over the current fiscal 2018 appropriation to support services for approximately 57,000 students. This budget represents 34% of the Mayor’s total fiscal 2019 recommended budget. However, this budget will increase when school employee contracts that include fiscal 2019 are settled. In addition, the City will pay a charter school tuition assessment of \$194.2 million to support approximately 11,000 Boston students attending Commonwealth charter schools. Together, the BPS budget and the state tuition assessment total \$1.31 billion for education or 40% of the total fiscal 2019 operating budget.

*Typical of education budgets, 79% of the School Department budget is allocated to employee salaries and benefits.*

Typical of education budgets, 79% of the School Department General Fund budget in fiscal 2019 is allocated to employee salaries and benefits. School employees account for approximately 52% of the City’s total workforce. About 94% of the BPS budget is allocated to the 125 schools either directly or are school services budgeted centrally but serving the schools. That leaves 6% of the budget for central offices expenses. Through a Weighted Student Funding system and a new Opportunity Index, resources are intended to be allocated to the schools equitably depending on student need and family circumstances. Excess capacity is not significantly addressed and \$2.8 million is used to support schools with declining enrollments.

## Pressure on Spending Continues

Expenses for health insurance, pensions, state assessments and debt service total \$937.2 million in fiscal 2019, an increase of \$51.8 million or 6%. These four accounts represent 28.4% of the total city budget and 37.4% of the total budget increase. The pension budget increased by \$17.4 million or 7.9% while state assessments, primarily driven by the charter school tuition assessment, grew by \$22.9 million or 8.7%.

Total growth of 6% for these four accounts significantly exceeds the cost increase of city departmental spending of 3.9%, with the collective bargaining reserve. This faster growth is a contributing factor to the budget tightening of departments, other than the top four.

## Healthy Capital Investment

The City's five-year capital plan (FY19-FY23) totals \$2.43 billion, an increase of \$344.6 million or 16.5% over last year's five-year plan. That compares with a \$152.9 million or 7.9% increase in the prior five-year plan. This more ambitious capital budget ties to the implementation of initiatives from various planning efforts as part of Imagine Boston 2030. The City estimates that 84% of its investments in this five-year plan align with its planning efforts.

The capital budget of \$2.43 billion is allocated among 18 departments with 79% of the total accounted for by the five departments of Public Works, School, Parks and Recreation, Library and Transportation.

Table 2

### Capital Spending Top 5 Departments

FY19-FY23 Plan

	Budget	% of Total
Public Works	\$851,431,071	35.0%
School	591,175,917	24.3%
Parks and Recreation	228,686,232	9.4%
Library	128,535,000	5.3%
Transportation	115,073,965	4.7%
Subtotal	1,914,902,185	78.7%
Other	518,323,884	21.3%
<b>Total</b>	<b>\$2,433,226,069</b>	<b>100.0%</b>

Bond funding will increase and other revenue sources will be utilized to support more capital investment. The City's use of the existing bond authorization of \$930.1 million and proposed and future bond authorizations totaling \$556.6 million together represent 61.1% of the capital project financing over the five years. Expected federal and state funds make up 28.9% of the financing and other source represent 10.0%. The Other category includes sources such as \$115.2 million from the Parking Meter Fund to support transportation-related projects and \$18.6 million from the Surplus Property Disposition Fund.

*Bond funding will increase and other revenue sources will be utilized to support more capital investment.*

In this five-year plan, the City will issue \$1.01 billion of GO bonds, 7% greater than indicated in last year's plan. The annual bond issues will range from \$177 million to \$220 million. Debt service costs will increase from \$183.6 million in fiscal 2018 to \$248.9 million in fiscal 2023, an increase of \$65.3 million or 35.6%. The Administration believes that the annual increase in debt service will stay within its debt service standard of not exceeding 7% of the budget. Debt service as a percent of the operating budget is 5.8% in the Mayor's fiscal 2019 recommended budget, providing opportunity for larger growth.

The City's AAA bond rating will ensure relatively low interest rates for Boston bonds. Moody's Investors Service initially increased Boston's bond rating to its highest rating of Aaa in March of 2011 during the Menino Administration. Standard and Poor's increased the City's bond rating to AAA three years later on March 5, 2014.



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### III. OPPORTUNITIES & CHALLENGES

The growth of the City's budget by 4.4% or \$138.5 million in fiscal 2019 should enable the City to meet its basic service needs. Even so, the City must be vigilant in managing its employee expenses, which represent 68% of its total operating budget. That means maintaining its tight control over employee headcount and being firm in its negotiations with the 13 city and school bargaining units that have yet to settle, and expecting the Public Health Commission to do the same with its four bargaining units not yet settled. Expected ongoing higher increases in the non-discretionary accounts of pensions, debt service, health insurance and state assessments will continue to intensify budget pressure on departmental services and require tighter control over personnel expenses.

The City is fortunate that the growth in the property tax from the base levy increase of 2.5% and new growth can represent 85.3% of this year's revenue increase. While this above average new growth can be expected to continue for the near future, the City should prepare for a time when the robust development pipeline will slow down. The City should be careful of its reliance on new growth to support recurring operating expenses. That seemed to be the approach of the Walsh Administration last year when its original budget estimated \$53 million in new growth, but when the tax rate was set in December, the reliance on new growth had increased to \$77 million. Going forward, the City should look for opportunities to gradually allocate more new growth revenue to capital or one-time expenses and less to support recurring operating expenses.

The Commonwealth is not keeping pace with financial aid to its largest city, an important driver of the state's economy. Boston's largest state aid account, Chapter 70 education aid, will increase by only \$1.3 million or 0.6% in fiscal 2019 for a \$1.112 billion School Department budget. The state also is not fully funding its obligation for the charter reimbursement account and the reimbursement for

Boston in fiscal 2019 is estimated to be underfunded by \$25.8 million.

City borrowing costs to support capital projects is set at 5.8% of the total operating budget, still below the City's standard of 7%, leaving the City additional room to responsibly fund important city initiatives through borrowing as part of an overall capital financing program. While the City has been creative in utilizing other revenue sources to support the capital budget, it should take advantage of the current relatively low interest rates to address sooner the key priorities of its planning initiatives.

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Note: The Mayor submitted his original recommended budget for 2019 on April 11, 2018 with state aid estimates based on the Governor's budget. With updated information and issues raised in City Council budget hearings, the Mayor resubmitted his budget on June 20, 2018. The resubmitted budget represents an increase of \$1.5 million primarily due to additional state aid for charter student tuition reimbursements. This report summarizes the Mayor's \$3.30 billion budget that will be voted on by the City Council today.

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