

FY20 BUDGET: WHAT TO WATCH FOR

Analysis of Boston's fiscal year 2020 proposed budget

Boston's fiscal year 2020 (FY20) proposed operating budget and 5-year capital plan were recently released by the Mayor and are now before the City Council for review. The operating budget totals \$3.48B, a growth of \$166M or 5% over FY19. The 5-year capital plan totals \$2.78B.

The City's annual budget is more than a document about revenues and expenditures. The budget is a policy document that indicates the City's priorities for the coming year and how it is preparing now to be in a position to meet future challenges.

Report Objectives

This report highlights eight budget dynamics with potential for significant impact on City finances and service delivery in FY20 and beyond.

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1. Economic Growth: the Upside and the Downside

What steps is the City taking to prepare for the financial impact of a potential economic downturn?

In recent years, as the City has recovered from the Great Recession, Boston has experienced unprecedented economic activity, bringing with it both additional resources (growth across all tax revenue accounts) and challenges (including rising housing costs, congestion, and economic inequality).

- ***The City has been conservatively budgeting its tax revenue accounts, including new growth in property tax revenue related to development, and must continue this practice throughout this period of strong economic growth.***
- ***New growth depends on the development cycle and economy. In preparation for managing through an economic downturn, the City should be allocating more new growth tax revenue to one-time or capital expenses.***

2. New Revenues

Does the budget include new revenue strategies to address city challenges and reduce its reliance on property taxes?

The City's budget expands two revenue streams. First, to fund additional transportation related projects, Mayor Walsh proposes to increase parking meter rates to \$2 per hour city-wide. The City will also add the Bulfinch Triangle and Fenway to the City's performance parking program, building on two pilots in the Seaport and Back Bay. By raising parking meter prices and using performance pricing, the City is hoping to create more turnover at meters and improve traffic flow. With performance pricing, the City can adjust parking meter rates in response to demand.

Second, to fund new housing initiatives for the City's homeless population, Mayor Walsh proposes that the City increase its local room occupancy tax to 6.5% as now allowed under state law. Tax revenue from the rooms tax has been strong and growing over recent years. The City should recognize that this is taking place during a period of strong growth and maintain its conservative approach to local rooms tax revenue projections. Further increases on rooms taxes beyond 6.5% would first require approval by the state legislature.

- ***The City should be recognized for clearly identifying how new revenues will be invested around Boston.***
- ***The City should continue to explore revenue strategies, as it does here for FY20, to generate resources for important investments and reduce its reliance on the property tax.***

3. Public Works – Trash and Recycling

How significantly will the shifting dynamics of the global recycling market impact Boston's budget?

Boston, and cities across the country, are facing sharp increases in recycling costs. In FY20, the Public Works budget is expected to grow by \$9.5 million, an 11% increase in just one year, from \$85.9 million to \$95.4 million. \$8.2 million of the increase is in the Waste Reduction program alone, which is budgeted at \$50.2 million in FY20. On a per ton basis, recycling costs are now expected to exceed the costs of trash disposal, a dramatic reversal from previous years.

→ ***Although the recycling market could readjust over the long-term, the City must explore all options to reduce these costs.***

4. Education Aid for Boston

How might the changing state education aid dynamic affect the City of Boston?

Boston is challenged by state education aid programs that fail to recognize the BPS student population's high concentration of high need students (including English Language Learners, students with disabilities, and economically disadvantaged students) and fail to fully fund the charter tuition reimbursement.

Momentum is building for the state to both invest more in education aid to cities and towns and to adjust the state education aid program (Chapter 70) which determines how this aid is distributed to cities and towns.

State education aid to Boston, less charter assessments, has decreased in recent years from \$106.4 million in FY15 to an anticipated \$44 million in FY20, according to the House Ways and Means budget. This is caused by the state's distribution formula which does not recognize Boston's unique student population. The reduction in state funding is also a result of a high number of Boston students attending public charter schools. In the 2014-2015 school year, 8,423 Boston students attended public charter schools, but that number has increased to 10,660 this school year. The state's failure to fully fund the charter school reimbursement has resulted in \$101.5 million less in state funding for Boston since FY15.

Governor Baker and the House of Representatives have proposed increasing the state's funding for education and the Senate is expected to propose additional funding as well. Even with the state budgeting an additional \$210 million over FY19 for Chapter 70 education aid statewide, Boston's distribution of education aid is increasing by \$1.9 million. In other words, a 5% increase in education aid statewide under the current distribution formula translates to a less than 1% increase for Boston.

The ongoing uncertainty in Washington D.C. could also impact the City's education funding. For FY20, BPS expects to spend \$138.8 million in external funds in addition to its \$1.139 billion appropriation from the City. Federal education grants comprise much of the \$138.8 million and reductions could shift even more of the burden to the City.

→ **Any reworking of state education aid programs must:**

- 1) recognize Boston's concentration of high needs students**
- 2) include a commitment to fully fund the charter school tuition reimbursement**
- 3) ensure that new funding is directed to evidence-based interventions to improve student achievement**

5. Boston Public Schools

What effect could the teachers' contract have on the Boston Public Schools?

From FY19 to FY20, the proposed Boston Public Schools budget is expected to grow by less than 2.5% to \$1.139 billion, but this does not yet include any contractual increases for members of the Boston Teachers Union, which includes teachers, paraprofessionals, nurses, guidance counselors, and other student-support employees. The School Committee and the Boston Teachers Union are in negotiations on a new contract that will significantly increase the budget for FY20 and moving forward, and also presumably include retroactive payments.

→ **The new contract is a reform opportunity and it must include provisions that will affect student achievement. The two previous contracts were expensive and teacher-centric, pushing the average teacher compensation to \$97,000.**

6. Capital Spending

In recent years, the City has published several planning documents that identify areas of capital investment. How does the FY20-FY24 Capital Improvement Plan fund these projects?

The City's \$2.8 billion five-year capital plan for FY20 through FY24 is included as part of the annual budget approval process. The five-year plan anticipates borrowing \$1.06 billion over five years to fund investments in infrastructure and new capital initiatives. While Mayor Walsh and the City have stated that 10% of its capital investments in this five-year plan will fund climate resilient projects, the budget document clarifies that this 10% includes not only climate resilient projects, but also projects that make Boston more environmentally friendly. Anticipated state and federal grants plus other non-City funds comprise approximately one-third of the City's capital funds, with City funds comprising approximately \$1.9 billion.

The FY20 budget devotes a very modest 5.4% (\$188.9 million) of the City's operating budget to borrowing costs, a reduction from 5.8% of the FY19 budget. Over the long-term, the City anticipates bringing its borrowing costs closer to 7% of its operating budget.

→ ***The City's current fiscal conditions allow it to increase its borrowing costs closer to the 7% mark identified in its debt management policies. Boston's supreme credit-worthiness is demonstrated by its AAA rating. This AAA rating will ensure that the City obtains favorable pricing when selling bonds to support projects identified in its various planning initiatives, such as Go Boston 2030, Climate Ready Boston, and BuildBPS.***

7. Personnel Costs Drive Expenditures

What personnel level is necessary and affordable for the City to sustain City services and expand key programs?

Government is labor intensive and the City's expenditures are driven by personnel costs, which total more than \$2.3 billion in salaries and benefits, representing 67% of the City's FY20 budget. By January 2020, the Administration anticipates employing 17,718.5 full-time equivalents, an increase of 146 from January 2019. The additional headcount from FY19 is largely found in the police, fire, and transportation departments. High personnel costs are due not only to headcount alone, but is also caused by hidden compensation in union contracts.

→ ***As Boston's population grows, the City should pay particular attention to managing personnel levels - and related salary and other benefit costs – both to meet a growing city's needs and remain sustainable going forward. That means exercising tight control over employee headcount and being firm in employee contract negotiations regarding compensation and benefit increases.***

8. Employee Benefits

What are the long-term impacts of employee benefits?

Boston faces two long-term liabilities related to employee benefits: pension and retiree health insurance. In FY20, the City will appropriate \$265.6 million for pensions, a \$23.5 million, or a 9.7%, increase over FY19. Boston's retirement system is currently 76.9% fully-funded and the City is moving steadily towards full-funding by FY25. Changes to benefits, such as recent proposals to move Boston School Police Officers to Group 2, or to increase the COLA base for retirees, will increase the City's annual appropriation and affect the unfunded liability. Increasing employee and retiree benefits reduces funds available for other initiatives.

Similarly, the City faces a long-term liability for its post-employment health care and life insurance costs, or "OPEB." The City began funding its OPEB liability and created the OPEB Trust in FY08. Boston's liability is \$2.4 billion as of June 30, 2017 and its OPEB Trust balance stands at \$557.1 million as of December 31, 2018. Each year since FY13, the City has contributed \$40 million in funds from the Budgetary Fund Balance or "Free Cash" to the OPEB Trust, but the OPEB liability continues to grow.

→ ***By prudently investing in these long-term liabilities today, Boston can reduce burden of these employee benefits on future budgets and taxpayers.***

Conclusion

Continued Vigilance Needed

Boston's current financial picture is impacted by dual forces: eight years of unprecedented economic growth combined with the need for increased reliance on its own local revenue sources due to cuts in federal funds and stagnant growth in state aid.

In this time of historic growth and challenge for Boston, the City needs to continue to execute very thoughtful fiscal stewardship with attention to meeting Boston's needs both today and during the inevitable economic slowdown.