Minutes
Town of Lexington Appropriation Committee
February 24, 2005

Place and time: Town Office Building, Room G-15, 7:30 p.m.

Members present: Al Levine, Deborah Brown, Paul Hamburger, Rick Eurich, Rod Cole, David Kanter, Ron Pawliczek, Eric Michelson, John Bartenstein

Also present: Michael Young, Dawn McKenna, Cinder McNerney

1. **Approval of Minutes**. Discussion of minutes of the February 9, 2005 meeting was postponed.

2. **Discussion with Bond Consultant**. Cynthia "Cinder" McNerney, Senior Vice President of First Southwest Corporation, attended the meeting to discuss the implications of Moody's most recent bond rating. McNerney was engaged by the Town in the fall of 2004 as an additional bond consultant/financial advisor and assisted the Town with its presentation to Moody's in mid-January.

The Moody's rating, issued on January 21, 2005 in connection with the sale of $11.8 million in Bond Anticipation Notes (BAN's) for school construction projects, affirmed Lexington's Aaa rating with a continued negative outlook. McNerney noted that the Town was planning to issue additional BAN's later in the spring, at which point Moody's would again update its rating.

McNerney emphasized that it is very important for the Town to continue building its financial reserves although she did not specify a particular target. Standard & Poor's looks at reserves as a percentage of the General Fund budget, and Moody's looks at reserves as a percentage of General Fund revenues. Many Triple-A rated communities maintain 10% of revenues in reserve, some less. At the end of FY01, Lexington had about $6.7 million, or 8.5% of revenues, in reserve, which was adequate. Current reserves are now at about $4 million, or about 4% of revenues. It would not be necessary to rebuild reserves overnight as long as steady progress is made. Steady progress to a healthier level of reserves over five years or so would be acceptable.

There was extensive discussion about how a steady increase in financial reserves can be achieved given our current model of seeking overrides designed to last two or three years. This model tends to produce a "sawtooth" effect, where reserves are increased significantly immediately following the passage of an override, then reduced in the "out" years to meet budgetary needs. McNerney said there was no inherent problem with drawing down reserves in this fashion over a two or three-year budget cycle as long as the funds withdrawn are fully replenished, and then some, to maintain overall steady progress toward the reserve goal.

McNerney pointed out that debt is rated based on a community's ability and willingness to repay. Reserves are important to preserve a community's liquidity, just as one must maintain personal savings to deal with potential setbacks and crises. It is important to build reserves into the base budget, otherwise reserves have to compete with the threat of a cut in services. Reserves are necessary for financial flexibility. When a town has adequate reserves, it has room to make adjustments; without adequate reserves, there is very little wiggle room.

Reserves can be built into a base budget by use of conservative estimates. There should be continued attention to promoting efficiency by each department and building financial strength in many ways. Diversification of the revenue base, however that might be achieved, is desirable. Ultimately, it is critical that the Town live within its means; it is imprudent to buy a Cadillac if you cannot afford one. There must be a structurally balanced budget.

McNerney explained that the rating agencies typically look at the total general fund balance and undesignated fund balance, rather than "free cash." Free Cash is an accounting concept unique to Massachusetts. Fund balances are more useful because they are the recognized measure of reserves under GAAP and enable financial comparison of communities across the nation. Free Cash is a very conservative estimate of the funds the Town has available for appropriation. For example, unlike the UFB, it does not include uncollected receivables and state aid payments that are anticipated but have not yet been received. The precise ingredients of Free Cash can be determined by looking at the DOR's calculations when it makes its Free Cash certification after the end of each fiscal year.

The stabilization fund is not considered part of either the General Fund Balance or the Undesignated Fund Balance, but it is treated as an additional reserve. The town gets credit from the rating agency for both the UFB and the stabilization fund.

McNerney pointed out that Lexington had experienced two years of decline in its UFB after 2001, and had yet to get back to the reserve position it maintained in 2001 when it enjoyed a "solid" Aaa rating. The 2001 UFB was $6.7M ($5.4M free cash), and the 2004 UFB was $3.2M ($2.3M free cash). Increasing the stabilization fund from virtually zero in 2003 to about $1M has brought total current reserves to about $4M.

Four fundamental factors go into a credit rating: management, debt (which is a huge factor), economics and financial results. The town's debt position is strong. Paying debt back relatively quickly (less than 20 years for long-term debt) is perceived as a strength.

To help manage its financial health and build reserves, the Town should establish and follow a clear set of financial policies. Guidance can be found from financial policy statements recently adopted by the Towns of Brookline and Concord, which are available on their town web sites. Other towns that have done a good job in this area are Danvers and Wayland.

There are also steps the Town can take to communicate better to the public the importance of building financial strength. In particular, it should emphasize that the Town's reserves (UFB plus stabilization fund) have slipped to almost half of what they were five years ago: 8.5% to about 5%. The current level of reserves does not give the Town adequate flexibility given the size of its budget.

3. **Preparation of Annual Report to Town Meeting**. The Committee discussed the preparation of its Annual Report to Town Meeting, including the allocation of responsibility for drafting various sections of the report, the mechanics of preparing the final report, and deadlines.

4. **Discussion of CPA Warrant Articles**. Eric Michelson made a presentation on the warrant articles seeking adoption of the Community Preservation Act (Article 7) and creation of a Community Preservation Committee (Article 8). After extensive discussion of the potential pro's and con's of the CPA, it was agreed to invite the proponents of the articles to the next meeting to provide further information, and to postpone taking a position on these articles until after that meeting.

The meeting concluded at approximately 10:00 p.m.

Respectfully submitted,

John Bartenstein

Approved July 2, 2005