

Using the Stabilization Fund to balance the budget takes a 2/3rds vote at town meeting. Unlike an override it does not impact taxes. However, it does create a dependency on its' continued use in subsequent years. Because it funds the operation budget, the use of that same amount will be needed to fund the next year's operating budget if that budget is the same as the current year's. But most likely the total will increase, so the amount used from the Stabilization Fund will need to increase accordingly. A hallmark of good budgeting is "only current revenues should be used to fund current expenses". The Stabilization Fund is not a current revenue. It will be only a matter of time before the Stabilization Fund is depleted.

The following are excerpts from various publications that speak to that issue.

"Use Reserves and Non-recurring revenue to purchase capital items or make one-time expenditures. Appropriations from reserves should be made for unanticipated or capital costs, not regular operating expenses" From: DLS New Officials Finance Forum

"We recommend that Becket establish policies defining adequate reserve levels based on the community's needs and the circumstances under which reserves will be spent. The combination of competing spending priorities and limited revenue options make building reserves a challenging task. Often depending on the culture of town meeting, it can be difficult to justify a budget that requires a Proposition 2 ½ override while the town is sitting on any sizable reserve balance. However, communities in Massachusetts have been able to build and maintain reserves through a combination of exercising fiscal restraint, conservative revenue estimates, and current year cost containment.

As a best practice, reserve policies should focus on two key elements (free cash and stabilization). The free cash portion of the reserves should be in the 3-5% range on an annual basis. Free cash in excess of this amount should be treated as one-time revenue and, therefore, only be put toward one-time expenses"...From TOWN OF BECKET RECOMMENDATIONS DIVISION OF LOCAL SERVICES FINANCIAL MANAGEMENT REVIEW

"Phase Out the Use of Free Cash as a Funding Source for the Operational Budget To ultimately establish a consistent, long-term budget model designed to mitigate the risk of fiscal instability, we recommend Cheshire phase out the use of free cash as a funding source for the annual budget. Similar to advice provided by the Collins Center in its draft policy on financial reserves, we suggest the town set a goal of doing this as a gradual series of reductions over the next four to six years. With discipline and commitment, this

strategy will help the town achieve a more sustainable budgeting model while also avoiding major cuts to the budget or services along the way.

As the table below illustrates, Cheshire's current reserve levels are slightly above the averages for its peer group. Cheshire's higher average level of free cash is not surprising given the town's ingrained habit of relying on it as a direct funding source for the annual operating budget. None of Cheshire's peer towns appropriate free cash in this manner. As Cheshire gradually moves away from this approach, we advise appropriating any certified free cash amounts above the upper six percent target to build up any below-target **stabilization funds, pay for capital projects or other one-time costs**

On the other hand, the town has also been in the habit of drawing on reserves to fund ongoing operating costs. To help support the general fund budget, the town has annually been appropriating portions of its certified free cash "to reduce the tax rate," as reported on the tax recapitulation sheet. As the table below shows, on average each year for this past decade, the town has used \$211,000 in free cash for this purpose, representing 3.61 percent of the total general fund operating budget. **Free Cash Used to Support the General Fund Budget, FY2013 to FY2022 *Cheshire applies a single tax rate to all property classes. While this use of free cash as a revenue source for the ongoing budget slightly decreases the proportion of the budget funded by tax levy revenue, this is a hollow achievement given the inherent risks associated with a budget that is not structurally balanced. In a structurally balanced budget, all recurring (or "current") expenditures are supported only by recurring (or "current") revenues. Recurring revenues are those that can be reliably expected to occur again each year, and they never include reserve funds,** which are sums set aside to mitigate risk. Conversely, any significant use of reserves like free cash², or other nonrecurring revenue source, to fund ongoing services in a given year increases the risk of fiscal instability for the community. In a future year when an unreliable revenue source is unavailable to the town to draw on, budget leaders will be forced to make painful budget cuts. ² Free cash is a reserve that represents the remaining, unrestricted funds from the previous year's fiscal operations based on the June 30 balance sheet. In any fiscal year, the town may only appropriate free cash after the amount has been certified by DLS. Included in the free cash calculation are unspent budget line items and the excess of actual receipts versus estimates, which are added to the unexpended free cash balance from the prior certification. DLS deducts outstanding receivables and certain deficits from this total to arrive at the new certified amount"... **Source FINANCIAL MANAGEMENT REVIEW TOWN OF CHESHIRE SEPTEMBER 2022 PREPARED BY: DLS**

"Over the last several years, a portion of free cash has also been appropriated to reduce the tax rate, including \$100,000 in FY2022. We generally discourage towns from

this practice, since it is equivalent to using free cash to fund the operating budget, and thus represents using a one-time revenue source to fund recurring expenses. If a one-time revenue source becomes unavailable in a subsequent year it may result in difficult budget decisions, including cuts and reductions to service"...Source:TOWN OF WESTHAMPTON FINANCIAL MANAGEMENT REVIEW MARCH 2022 PREPARED BY DLS

As was stated in the first paragraph, It will be only a matter of time before the Stabilization Fund is depleted. That time easily would be shortened if large one-time items are charged that exceed the deposits into the fund.

One example is the need to replace the Fire Department's oldest pump truck and the ladder truck. It was suggested that one new truck could take the place of both trucks. An estimate has not yet been provided but based on the insurance company's current estimate for both trucks the replacement could easily exceed 800,000.00 dollars.

When it is decided that the time has come to replace and there is not enough in the Stabilization Fund the only alternative would be to borrow. Borrowing adds another component.....the cost of money or interest. Hence the truck will cost more if it is not funded from the Stabilization Fund. A borrowing will most likely require a Proposition 2½ ballot vote to increase taxes each year to pay back the annual principle and interest payment.

Hopefully this document provides additional information on the impacts of using the Stabilization Fund to balance the operating budget.