

TOWN OF HOLLISTON FINANCIAL POLICIES

I. INTRODUCTION

The following financial policies are established by the Town of Holliston through its Select Board and Finance Committee in order to set forth the broad framework for management of the Town's finances and to inform the annual budgeting process. The intent of these financial policies is that they serve as a guide for policy makers, administrators, department heads and advisors, recognizing that Town Meeting retains full right to appropriate funds and incur debt as it deems appropriate, subject to statutory constraints.

Definitions:

Capital Expenditure Fund: An account created by a special act of the legislature allowing Holliston to set aside funds in reserve for capital expenditures. For GAAP purposes (see below) the Capital Expenditure Fund is part of the restricted fund balance.

Capital Subcommittee: The subcommittee of the Finance Committee authorized under Section 3 of Article XXXIII of the Town of Holliston General By-Laws (May 2019).

Free Cash: A fund certified annually by the Massachusetts Department of Revenue by deducting from surplus revenue non-deferred taxes for prior years. Actual spending below budget can also drive Free Cash. In terms of GAAP accounting, Free Cash is the State-certified portion of the Town's "Unassigned Fund Balance."

GAAP Accounting: Generally Accepted Accounting Principles (GAAP) refer to a common set of accounting principles, standards, and procedures issued by the Financial Accounting Standards Board (FASB). The Town employs an independent auditor on an annual basis, per Mass. General Law, to audit the Town's financial statements. The GAAP accounting figures from the annual audit are used to calculate ratios in the policies described in this document, where applicable.

General Stabilization Fund: A special account created originally to provide a reserve for capital expenditures but changed by State law many years ago to allow its use for any purpose. For GAAP purposes, the General Stabilization Fund is considered a part of the "Unassigned Fund Balance." See UFB definition below.

Omnibus Budget: The total operational expenditures of the town, including spending from the Water Enterprise Fund, for a given fiscal year.

OPEB Trust Fund: This fund was created through special legislation in 2013 for the purpose of setting aside money to cover the future costs of other post-employment benefits for former Town employees.

Reserve Fund: This fund is established annually in the Omnibus Budget by the voters at the Annual Town Meeting and may be composed of (1) an appropriation not exceeding 5% of the tax levy of the preceding year; or (2) money transferred from the Overlay

Reserve. Transfers from the Reserve Fund are within the exclusive control of the Finance Committee. The purpose of the Reserve Fund is to fund extraordinary and unforeseen items. It is not intended as a supplement to departmental budgets.

Unassigned Fund Balance (UFB): An accounting specific term that encompasses both “Free Cash” and “General Stabilization Fund” balances, as well as any other funds that are not set aside for a specific purpose. Bond rating agencies, such as S&P Global, encourage a UFB of over 18% of general fund expenditures.

Water Enterprise Fund: A special account that is comprised of water department revenue, realized from fees, and from which operating costs are paid. Use of these funds is limited to water capital projects and water system development.

II. RESERVE FUND

Policy: Set aside a minimum of \$300,000 and not more than 1% of the Omnibus Budget each year to provide for extraordinary or unforeseen expenditures not anticipated before Town Meeting, and/or to allow immediate expenditures of funds in the event of an emergency.

Practice: The Reserve Fund is authorized by section 6 of Chapter 40 of the General Laws (see Appendix C) and has been utilized by the Town for more than seventy-five years. The unexpended balance, if any, at fiscal year’s end is closed out to the General Fund and becomes part of the Free Cash calculation.

Plan: Maintain the existing Reserve Fund level.

Progress: The Reserve Fund was increased in FY21 above 1% of Omnibus Budget (\$790,000) as a precautionary measure during the COVID-19 pandemic but has been reduced back to the pre-pandemic level of \$325,000 in FY22.

III. GENERAL STABILIZATION FUND

Policy: Maintain a minimum balance equal to 8.1% of General Fund expenditures with a target goal of 12% and a maximum goal of reaching 18% of General Fund expenditures.

Practice: Stabilization Funds are authorized by section 5B of Chapter 40 of the General Laws. The Stabilization Fund provides financial flexibility in times of economic stress (rainy day fund) and has been utilized by the Town for more than fifty years. It should be used only for extreme events, such as natural disasters, emergency conditions, sudden economic stress or as a bridge for a short-term financial event. A plan to replenish the fund, preferably within one year but not more than three years, should be developed when the fund is used. The minimum balance is set to enable the Town of Holliston to reach and maintain a “very strong” budgetary flexibility rating from Standard & Poor’s based on the Stabilization Fund alone, without reference to the variable and volatile Free Cash balances. The Town will endeavor to reach the target balance, so that the fund can be used without impacting the credit rating.

Plan: Build the Stabilization Fund through transfers from Free Cash and other available funds and appropriations of unanticipated and/or one-time revenues.

Progress: The Stabilization Fund balance (\$6,737,488) was at 9.1% of FY20 General Fund expenditures (\$74,313,726) as of June 30, 2020.

IV. CAPITAL OUTLAY

Policy: The “cash” Capital Outlay policy seeks to ensure that the Town of Holliston maintains, preserves, and replaces the equipment, vehicles, technology, infrastructure and buildings needed to efficiently and effectively support the Town’s programs and operations. Regularly scheduled updates and refreshes to capital assets are required to prevent larger costs or loss of services that could result from deferral or inadequate funding. The Town will maintain a 5-year Capital Improvement Plan (CIP), updated annually based on new information and departmental requests.

- The annual “cash” capital outlay/expenditure will be funded through a combination of budgeted capital, allocations from Free Cash, and allocations from the Capital Expenditure Fund (CEF).
- The minimum balance in the CEF should be maintained at not less than 2% of the Omnibus Budget.
- The annual Capital Outlay (the sum of the appropriations to the Capital Expenditure Fund and appropriation to fund capital debt within the Tax Levy) should be 3%-5% of the Omnibus Budget

Practice: A capital expenditure funded under the “cash” Capital Outlay policy will have a useful economic life of three or more years and cost more than \$10,000. Bulk purchase of similar items such as technology and furniture should be aggregated and the total considered a capital item. Larger capital investments involving the replacement of Town buildings, major facilities and the construction of new facilities to expand or upgrade Town programs, or capital needs exceeding \$1 million will typically be funded through borrowing and/or overrides, or as recommended by the Capital Subcommittee and are addressed within the 5-Year CIP. Smaller and routine annual asset maintenance is to be managed within the departmental operating budgets, referred to in the Omnibus Budget as “Capital Outlay.”

The CEF was created by Chapter 46 of the Acts of 1993 and exists to support the annual “Cash” capital outlay when budgeted capital and free cash allocated to capital are insufficient, and as a mechanism to hold funds intended for planned and/or unforeseen capital investments. The CEF can be used to sustain the annual capital outlay, to offset debt service in times of economic stress, or to avoid borrowing for a capital acquisition. If the fund drops below the recommended minimum balance, a plan to replenish the fund, preferably within one year but not more than three years, should be developed. Maintaining the stated minimum balance in the CEF contributes to a “very strong” liquidity rating from Standard & Poor’s; the Capital Expenditure Fund is not calculated as a component of the Unassigned Fund Balance, as it is a Restricted Fund, per GAAP.

Plan: To reach compliance on the newly established 3%-5% policy, the Town will progressively increase the annual capital set-aside over the next two years (in relation to the next biennial policy update) to achieve the minimum 3% policy level, though any potential new authorization(s) of debt service within the Levy would also be applied towards this ratio. The

Town will maintain a 5-Year CIP document, updated annually upon review of the Select Board and Finance Committee (including the Capital Subcommittee). Use the 5-Year CIP document to determine the appropriate allocation of cash for capital and long-term borrowing.

Progress: The capital set-aside for budgeting purposes has been increased to \$1,750,000 in FY20 (2.8% of the Omnibus Budget) in FY20 as voted at the May 2019 Annual Town Meeting; further appropriation of \$2,467,154 from Free Cash was approved at the October 2019 Fall Town Meeting. The Capital Expenditure Fund balance of \$6,503,194 as of June 30, 2020, is 10.4% of the FY20 Omnibus Budget.

V. FREE CASH

Policy: To be used to increase reserves, to fund capital or other one-time expenditures, to reduce debt, or to reduce the tax levy, and not to support or supplement the Omnibus Budget.

Practice: Free Cash should be prioritized for allocation to reach the reserve targets laid out in this financial policy document, including the General Stabilization (Section III), the Capital Expenditure Fund (Section IV), and reserves to address liabilities (Section X). Remaining Free Cash should be used for specific one-time projects or articles, as appropriate; otherwise, money not specifically allocated should remain in Free Cash after Fall Town Meeting for maximum flexibility at the following Annual Town Meeting.

Plan: Continue the practice of not using Free Cash to support the Omnibus Budget, except for any Capital Outlay reflected in the Omnibus Budget.

Progress: In FY20 Free Cash was certified by MassDOR's Division of Local Services (DLS) at \$3,067,104; no Free Cash was used to support the Omnibus Budget as a continuing practice.

VI. DEBT SERVICE

Policy: Debt should be reserved for the purchase of large, non-recurring capital items of \$1 million or more and which have a life of ten years or more, and the term of the debt cannot exceed the life of the asset, pursuant to Mass. General Laws. The Town will endeavor to maintain a very strong S&P rating in this category by keeping the General Fund debt service to expenditures ratio below 8% and by keeping the net direct debt to General Fund revenue ratio between 30% and 60%.

Practice: When considering the use of debt, the Town will take into account:

- The debt exclusion option – a temporary tax increase used to raise additional taxes to fund capital projects for which the community may borrow. The additional amount is added to the levy limit only during the life of the debt.
- The Capital Outlay expenditure exclusion option is a temporary tax increase used for the year in which the capital item is acquired.

- The annual fixed-cost that additional debt will add to the debt service portion of the Omnibus Budget. (Note that S&P considers total governmental fund debt service as a percentage of total governmental funds expenditure lower than 8% to be “very strong”.)
- The burden that additional debt will place on the Town's revenue position. (Note that S&P considers net direct debt as a percentage of total governmental funds revenues at between 30 to 60% to be “strong”.)

Plan: Minimize long term debt through more robust annual capital spending and through short term financing. Evaluate planned borrowings to determine if projects will be excluded from Proposition 2 ½ or will be debt within the Levy Limit. Borrowings within the Levy Limit will be considered to be part of the 3%-5% Capital Outlay policy (Section IV).

Progress: The last bond rating assessment by S&P, based on FY20 results, found that total governmental fund debt service as a percentage of total governmental funds expenditures was 6.3% and the net direct debt as a percentage of total governmental funds revenues was 14.6% per S&P. According to S&P our overall net debt is low at less than 3% of market value which they view as a positive credit factor.

VII. WATER ENTERPRISE FUND

Policy: The Water Enterprise Fund fully supports the annual operating and capital costs, including indirect costs related to the staffing, operation, and maintenance of the system, and including debt service, for the Town’s water supply and distribution system; and maintain an unencumbered fund balance (retained earnings) of at least 10% of the annual gross water revenues.

Practice: All receipts, revenues, and funds, including interest derived from all activities of the enterprise, are deposited into the water enterprise fund. User fees are comprised of tiered rates for consumption based on metered use, a fixed rate meter service charge based upon the meter size, and a fixed rate private fire service based on pipe size (sprinkler system).

The target Unassigned Fund Balance (Retained Earnings) of the Water Enterprise Fund should be maintained at a level that is not less than 10% of annual gross water revenues. By vote of the Select Board and Town Meeting the balance in the fund may fall below this minimum level to fund capital needs or to provide for payment for unanticipated (emergency) repairs to the water supply and distribution system. The Unassigned Fund Balance (Retained Earnings) may be used as a rate stabilization mechanism to protect rate payers from unnecessary fluctuations in water rates, or for financial planning purposes in rate projections.

Plan: Use the Water Rate Analysis (2020) and Water Modernization Study (2021) to continue to plan, develop and execute capital improvements to the water system in Holliston. Evaluate annually the need for, and rate of, the Water Infrastructure Fee, which is set at \$75 per quarter per connection and generates over \$1 million annually as of FY21.

Continue to use the Water Meter Fee to plan for the cyclical replacement of meters in Town to keep up with changing technology and best practices.

Maintain Retain Earnings at 20% of gross water revenues as the only reserve fund for the Water Enterprise Fund operations and to protect rate payers from rate volatility. Should the balance fall below 20%, a plan will be developed to replenish the Retained Earnings preferably within one year, but not more than three years.

Progress: The Unencumbered Fund Balance (Retained Earnings) in the Fund was \$1,433,969, or 33.6%, of FY20 gross water revenues as of June 30, 2020.

VIII. OPEB (Other Post-employment Benefits)

Policy: The OPEB Trust Committee will continue to engage 3rd party services on a biennial basis to provide an actuarial valuation in accordance with Governmental Accounting Standards Board (GASB) Statements Number 74 and 75 (see Appendix G). These valuations will provide the OPEB Trust Committee and the Town with options for a funding schedule, including the annual Actuarial Determined Contribution (ADC) which are designed to lead the Town to a fully funded OPEB liability over time. The actuarial valuation data is also used, per GASB, in the Town's annual audit.

Practice: Holliston's Net OPEB Liability was valued at \$29.8 million as of June 30, 2020. OPEB covers the Town's share of the current and anticipated future health and life insurance benefits costs for the Town's municipal and school employees who retire through the Middlesex Retirement or Massachusetts Teachers Retirement Systems (and firefighters) after having worked for a minimum of 20 hours a week for a minimum of 10 years. This liability is based on the following key assumptions in the actuarial valuation dated July 1, 2019:

- 378 beneficiaries and 619 active participants
- A medical/drug cost trend of 4.5% per year
- A discount rate of 7%
- A maximum 30-year amortization period

Plan: For the two fiscal years covered by this biennial policy update (FY23 and FY24), the Town will continue to contribute a minimum of \$1.5 million per year to the OPEB and Pension liabilities (Section X) as "two sides of the same coin."

Progress: An OPEB Trust Fund was established in 2014 (see Appendix F) and \$12,370,423 (principal) has been deposited into the Trust as of June 30, 2020. The OPEB Trust Fund Board has invested with the Commonwealth of Massachusetts' Pension Reserves Investment Management Board (PRIM). The FY20 appropriation for retiree health benefits plus the FY20 OPEB set-aside total approximately \$2.86 million, or 4.4% of the FY20 Omnibus Budget. The OPEB Trust balance as of June 30, 2020, is \$15,469,023. As of June 30, 2020, the OPEB obligation is 34% funded.

IX. RETIREMENT (PENSION SYSTEMS)

Policy: Fund the Town's annual assessment from the Middlesex County Retirement System (MCRS) and make annual payments toward the Town's share of the System's unfunded liability. Continue to monitor the State's approach to the Massachusetts Teachers Retirement System (MTRS). Fund the Town's new Pension Stabilization Fund, established at the May 2021 Annual

Town Meeting under MGL Ch. 40, Sec. 5D, with \$250,000 per year through either Free Cash or the Omnibus Budget; funding source to be determined based on budget performance over the following two fiscal years and information from the OPEB actuary on ADC recommendations (Section VIII).

Practice: The Town of Holliston has fully funded the annual assessment without fail for more than 50 years. Starting in FY15, the Town has designated the “credit” for early payment toward the Town’s share of the System’s unfunded liability, and in FY21 and FY22 has applied this credit to be the initial funding of the new Pension Fund established under Sec. 5D. The MCRS covers the pension benefits for the Town’s 126 retired municipal and school non-teaching employees who have worked for the Town for a minimum of 20 hours a week for a minimum of 10 years. Teachers are covered by the Massachusetts Teacher’s Retirement System, which does not currently assess the Town for benefits. The Commonwealth’s proportionate share of the net pension liability for the Town of Holliston as of June 30, 2020, is \$81.17 million, and the Commonwealth contributed \$9.43 million in FY20 on behalf of the Town. The Town will continue to fund its legally required contributions to MCRS, and independently determine the level to which it will fund the new Pension Fund established under Sec. 5D, which is initially planned at \$250,000 per year with the plan to reassess this funding target with the next biennial policy review.

Plan: Apply the amount of the difference between paying the MCRS annual assessment in one installment and paying it in multiple installments (the “credits”) to the Town’s new Pension Fund annually. Use the Town’s annual Free Cash or budget capacity from the annual \$1.5 million appropriation to OPEB/Pension liabilities to ensure a minimum of \$250,000 is contributed to the Pension Fund each year. The Pension Stabilization Fund has been invested by the Town’s Treasurer with the Commonwealth of Massachusetts’ Pension Reserves Investment Management Board (PRIM).

Progress: In FY15 the Town began to make payments toward its share of the unfunded liability. As of June 30, 2020, the amount of \$245,627 was applied to our unfunded pension liability. The Town’s share of the System’s unfunded accrued actuarial liability as of January 1, 2020 was \$27.8 million.

The Town’s liability is based on the following key assumptions in the actuarial valuation of the MCRS dated January 1, 2020:

- 5,862 beneficiaries and 9,282 active participants (276 active in Holliston)
- Appropriations increase 6.5% per year through 2024, increase at a lower rate thereafter
- An investment return rate of 7.30%
- Fully funded by 2037

X. OPEB & PENSION – Aggregate Benchmark

In the aggregate: (1) the FY20 appropriation for retiree health benefits (\$1.36 million); (2) the FY20 OPEB set-aside (\$1.50 million), and (3) the FY20 MCRS assessment for pension obligation (\$2.29 million) totaled \$5.15 million, or 7.94% of the FY20 Omnibus Budget. A standard benchmark of S&P Global is that the annual pension payment and the annual OPEB payment as a percentage of total governmental funds expenditures should be less than 10%.

Plan: The Town will continue to (1) pay annual health care benefits for retirees and (2) meet the legally obligated funding of the MTRS and MCRS systems out of the Omnibus Budget on a pay-as-you-go basis and account for these costs, per GASB, in the annual audit. Additionally, the Town will continue, for the FY23 and FY24 budget cycles, to contribute at least \$1.5 million annually to the OPEB and Pension liabilities. If a funding schedule of less than \$1.5 million per year for the OPEB Trust Fund were adopted, the intention of the Town is to apply any subsequent budget capacity to the Pension Stabilization Fund, and reassess this approach on a biennial basis with the review of these financial policies.

XI. APPENDICES

- A. U.S. Local Governments General Obligation Ratings: Methodology and Assumptions, Standard and Poor's Rating Services, September 2013
- B. Massachusetts General Laws Chapter 40, section 5B & 5D (Stabilization Funds)
- C. Massachusetts General Laws Chapter 40, section 6 (Reserve Funds)
- D. Massachusetts General Laws Chapter 44, section 10 (Debt Limits)
- E. Chapter 46 of the Acts of 1993 (Capital Expenditure Fund for Holliston)
- F. Chapter 189 of the Acts of 2013 (Other Post-Employment Benefits Trust Fund for Holliston)
- G. Other Postemployment Benefits: Plain-Language Summary of GASB Statements No. 74 and No. 75, Governmental Accounting Standards Board

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**TOWN OF HOLLISTON
SUMMARY OF FINANCIAL POLICIES**

Policy	Summary of Terms	Purpose
Reserve Fund	A minimum of \$300,000 and not more than 1% of the Omnibus Budget each year.	To provide for extraordinary, unanticipated expenditures or immediate expenditure the event of an emergency.
Stabilization Fund	Maintain a minimum balance equal to 8.1% of General Fund expenditures; target is 12%, maximum is 18%.	A "rainy day" fund to provide for financial flexibility in times of economic stress, emergency conditions.
Capital Outlay	<p>Seeks to ensure that the Town of Holliston maintains, preserves and replaces the equipment, vehicles, technology, infrastructure and buildings needed to efficiently and effectively support the Town's programs and operations by investing in regularly scheduled updates and refreshes to capital assets.</p> <ul style="list-style-type: none"> • Annually target "cash" capital expenditures at 2% of Omnibus Budget • Minimum balance in the CEF of not less than 2% Omnibus Budget • Annually budget 3%-5% of the Omnibus Budget for Capital Outlays (including debt service within Tax Levy) • Economic life of 3+ years, cost between \$10,000 and \$1 million 	
Free Cash	To be used to increase reserves, to fund capital or other one-time expenditures, to reduce debt – or to reduce the tax levy, and not to support the Omnibus Budget.	
Debt	Debt should be reserved for the purchase of large, non-recurring capital items which have a life of ten years or more. The Town will endeavor to maintain a strong to very strong S&P rating in this category by keeping the General Fund Debt Service to Expenditures rating below 8%; keeping the Net Direct Debt to General Fund revenue ratio between 30 and 60%.	
Water	The Water Enterprise Fund, water rate structure, and spending plan fully supports all direct and indirect annual operating and capital costs for the Town's water supply and distribution system. The Water Enterprise Fund will maintain an unassigned fund balance (Retained Earnings) of 20% of operating costs, used to offset seasonal volatility and/or as a "rainy day" fund for the Water Enterprise.	
OPEB (individual)	Continue to pay annual health care costs of retirees out of the Omnibus Budget and procure biennial actuarial studies for the OPEB Trust Fund, per GASB.	
Pension (individual)	Fund the Town's annual assessment from the Middlesex County Retirement System (MCRS), and Town's annual share of the System's unfunded liability; Additionally fund \$250,000 per year into the Pension Stabilization Fund.	
OPEB & Pension	Set aside min. \$1.5 million annually to address the liabilities associated with Other Post Employment Benefits (OPEB) and the Town's Pension liability.	