

Finance Committee 2014 Report

Dear Town Voters,

The Finance Committee is pleased to present its 2014 Annual Report on the Town of Orleans' current financial condition and the Town's fiscal outlook for the future. Under the Orleans Town Charter, the Finance Committee is charged with independently examining and analyzing the financial affairs of the Town and informing Orleans citizens of the Committee's findings and recommendations. In examining and analyzing the financial affairs of the Town, the Committee is required to base its findings and recommendations on a full and fair examination of each issue in the broader context of Town policies, service objectives, and economic conditions.

This year, as it has in the previous two years, the Committee continued its focus on analyzing Town financial practices and the roles, responsibilities, and operations of Town Departments and Committees as they impact Town spending, forwarding recommendations that emerged from these analyses to the Board of Selectmen, the Town Administrator, and the Town Finance Director as appropriate. The Committee produced its third annual analysis of authorized, but unused, funds returned to the general fund. The knowledge gained through this effort provided the Committee with insights into opportunities for refining the management of department budgets and spending. This year, the Town Administrator and Town Finance Director shared that report with Town Department heads for their consideration in developing their respective FY 2015 budget requests.

The Committee also has been working with the Town Administrator and Town Finance Director on developing better analytical tools to apply to the budget process to achieve greater transparency and consistency of that process. The Committee believes that the budget development process should be approached as an opportunity to reevaluate and revise spending goals, objectives, and strategies and to improve fiscal administration. These tools, once implemented, will provide the Selectmen and Town leadership with a better means to analyze departmental budget development and Town finances as a whole, including long-term capital planning. For example, in November 2012, the Committee recommended to the Board of Selectmen that consideration be given to centralizing Town fleet management. The Town's current implementation of the new Department of Public Works & Natural Resources includes plans for centralizing that function in that Department. The Committee considers centralization of certain functions of Town administration to be critical to developing budgets that more accurately reflect the Town's actual spending needs, recognizing overlapping efficiencies, and aligning budgeting and spending priorities.

The Budget Numbers

The Proposed Fiscal Year 2015 Budget

The Fiscal Year 2015 budget that will be presented to Orleans voters for their consideration during the May 12, 2014, Town Meeting, reflects a 5% increase over the previous fiscal year, rising from \$30,470,000 for Fiscal Year 2014 to \$32,090,000 for Fiscal Year 2015. Non-school expenses will rise by 4% in FY 2015. Non-property tax revenue is anticipated to be up by 7% in FY 2015 from FY 2014. A 4.7% property tax increase is forecast for FY 2015.

Over the past five years -- from FY 2010 to FY 2014, Orleans' budget has increased by a total of 12%. In that same period, property tax revenues have increased by 14%. Looking forward to the five-year period ending in FY 2015, the Town's budget will have increased by 16.5% and property tax revenues will be up by 16%.

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The Capital Improvement Plan

The Capital Improvement Plan (CIP) for Fiscal Years 2016-2020 provides taxpayers with a plan of the estimated cost and timing for Capital Projects that the Town is considering. The approval of the plan is not a commitment to spend money, as each project must be approved subsequently at Town Meeting in the year in which it is to be funded.

The CIP to be presented at this year's Town Meeting totals \$68,903,220. The CIP presented to Town voters last year totaled \$63,447,050. The majority of these funds continue to represent contingency planning for an eventual town-wide wastewater system or systems.

Fiscal Health

The fiscal condition of Orleans remains very good. The Town retains its AA+ bond rating, and is managing its budgeting and spending effectively. The Town's effort to ensure the efficacy of its fiscal and operational performance has been further enhanced by the expansion of the scope of the annual audit to include one departmental activity review a year; the implementation of an internal departmental audit process; the formal documentation of financial policies and procedures, and the development of a written fraud policy.

The principal driver of the Town's fiscal policy has been the desire of Town leadership to control the growth of the tax rate. And they have managed that well by controlling spending and managing debt. The Finance Committee, after three years of analyses of year-end turn backs, has found that Town Departments annually are returning to the General Fund a total of between \$400,000 and \$600,000 in appropriated, but unused funds. The strategic use of BAN's (Bond Anticipation Notes), at a current interest rate of less than .5%, to finance debt for the short term contributed to a decline in budgeted debt amortization costs of 2 % in FY 2014. Debt amortization costs for FY 2015 are anticipated to increase by an additional 5% in FY 2015.

Orleans' property taxes have been stable for many years and remain among the lowest on Cape Cod. As in recent years, the Town continues to apply excess Free Cash to lowering the tax rate.

Financing the Future

With a vast array of high-cost projects looming on the horizon, the Committee broadened its focus on Town spending practices this year to analyze options for financing Town projects and services and to explore opportunities that may hold the potential for producing both near-term and long-term efficiencies and cost savings in services delivery.

Decisions regarding the financing of major capital expenditures must be carefully scrutinized for their long-term impact on the ability of the Town to maintain its critical infrastructure and economic health, including Town facilities repairs and maintenance; wastewater treatment investments; vital roadway and drainage improvements; and a stepping up of funding to pay down retirees' other post employment benefits (OPEB) unfunded liabilities. Voters expect Town leadership to achieve a reasonable balance between managing debt and spending to meet critical needs to which they have assigned a high priority.

The results of the Committee's analyses in these areas follow and comprise the centerpiece of this year's Finance Committee report to Orleans voters.

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Cash vs. Bonding . . .

Although the Town is required to fund certain asset acquisitions by borrowing because of size or legal restrictions, in certain instances the Town has the option to invest excess cash that may not be required for current operations to fund asset or other purchases or to borrow the money to make these acquisitions.

The Finance Committee has been studying this issue in an effort to better understand the principal drivers of a decision to bond or pay cash, and what factors are most significant in deciding the optimal approach to financing specific Town projects.

There are a number of considerations in deciding whether to finance a project through bonding or with cash. Chief among these are:

- whether the cash is available and if its rate of return is less than the interest cost of borrowing;
- whether the cash is available and if the rate of return is more than the interest cost of borrowing;
- borrowing causes predictable cash outflows, whereas a cash purchase can result in spikes in cash flows dictated by replacement or other contingency purchases; and
- cash avoids increases in interest costs, but also means that cash cannot be employed to improve rates of return on investments.

If the returns on cash exceed the interest costs of borrowing, it will be in the interest of the Town to borrow and invest the excess cash to gain the higher rates of return.

If, however, in the more typical case, where the cost of borrowing exceeds the returns on excess funds, there are more factors to consider. Principal among these factors is whether cash on hand is in excess of foreseeable and reasonable operating expenses. Second, what are the expectations of future borrowing or investment rates of return?

Finally, the decision to borrow or use excess cash depends on the nature of the asset being acquired and how the nature of the asset impacts the predictability of longer term cash requirements, e.g., borrowing may be favored to finance large one-time items so that debt repayment reflects asset life and also contribute to cash requirement predictability, whereas, cash use for routine and on-going purchases, even of capital items, gives the same predictability to cash requirements.

Taxes vs. Fees . . .

The topic of Town fees has been of interest to the Finance Committee for several years. The primary question that the Committee has been exploring on this topic is what should be the Town's policy with regard to the funding of services for which fees are assessed? Should 100 percent of the cost of those services be financed by fees paid by the user(s) of those services or should the cost be subsidized by revenue from the General Fund, which is largely funded through property taxes?

The primary purpose of a tax is to raise revenues that then are expended to provide services that benefit us all. A tax, while it may be applied to a particular good or service, or to the population at large, as in the case of property taxes, is collected to raise general-purpose revenues. But taxes on sales of specific goods or services are not necessarily related to the cost of providing the goods or services taxed: Regulatory bodies such as health and safety inspectors rely on taxes for their funding, but serve only a minor fraction of Town constituents. Police, fire, and ambulance services charge

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wildly differing charges for their services, yet serve all citizens and visitors equally. Tax revenues are deposited into the General Fund, and the Town government, with Town voters' approval, spend tax revenues for basic services through the Town's budgetary process. Taxes are paid for government services that are intended to serve all residents of the community. The principle is that we pay taxes and those funds are appropriated from the General Fund to finance goods and services that directly or indirectly benefit all members of the community. A fee is intended to recoup all or some of the cost of providing a good or service from the individuals who benefit directly from that good or service. For example, the taxpayer who pays a fee for a clamming permit is getting the direct benefit of being able to harvest clams. A household pays a fee to the Town Water Department that is assessed based upon that household's water use.

Within the constraints established by federal law and regulation, Towns have the authority to decide whether to charge a fee for a service and how much to charge for that service. In Orleans, a number of municipal departments provide services for which users are charged a fee. Examples of those services include mooring and shellfish permits charged by the Harbormaster; recycling and dumping permits by the Transfer Station; beach access and Off Road permits by the Park & Beaches Department; and various fees that builders and contractors are charged by the Town Building Department for an array of services, such as permits and inspections. The amount of those fees appears to be set based upon an assessment of what the marketplace will bear, with that assessment largely based upon a comparison of fees charged by Orleans with those charged by other Cape Towns. But, in many cases, a fee charged bears no relationship to the Town's actual costs of delivering the service.

The Board of Selectmen has in place some policies with regard to how much of a Department's budget should be covered by fees charged. For example, the Town Water Department is self-funded by revenues from water usage receipts. Board policy directs the Transfer Station to seek to cover 75% of the direct costs of its operation from permit fees.

But should the Transfer Station be required to recoup of 100% of its direct costs? If we are successful in securing federal and state support for a proposed a plan to safeguard Piping Plovers on a portion of South Beach, should Off Road permit fees be raised to cover the cost of this program? If a contractor applies for a building permit that requires a certain number of onsite inspections, should the direct costs of those inspections be covered by permit fees charged by the Building Department, or should General Fund revenues be used to subsidize them?

The Finance Committee believes that Town fees across the board should be established based upon 100% of the direct costs of providing those services and that, as a rule, fees charged should cover 100% of the direct costs of providing those services. If there is a decision not to seek to cover 100% of the direct costs of a service through a permit fee, the reasoning behind that decision should be evident to the taxpayer and documented in a policy voted by the Board of Selectmen.

Lease vs. Purchase . . .

As is clearly reflected in both the Town operating budget and the 5-year CIP that voters will take up this year, the Town of Orleans will be making significant investments in capital items in the coming years. We believe that the Town leadership should be open to considering leasing of many capital items and undertake a study to look at whether or not the town should pursue leasing over purchasing for many capital-intensive investments.

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Leasing can have significant benefits over purchasing. It lowers the up-front cost of acquisition; spreads the payment for capital-intensive items out over a longer period; eliminates the need to depreciate capital items (where applicable); and eliminates the cost of disposing of capital-intensive property, plants, and equipment.

The Finance Committee appreciates that there may be factors other than cost that must be considered in deciding the appropriateness of leasing rather than purchasing capital items. However, the Committee believes that a study of the potential for leasing certain capital items should be an integral component of planning for the financing of investments in equipment and other capital items.

Technology . . .

The Finance Committee believes that technology should be applied in all aspects of Town activities. Technology holds the potential for producing numerous direct benefits, among these:

- cost savings and improved efficiency;
- increased transparency;
- enhanced data access and security;
- elimination of unnecessary services; and
- addition of new services at little to no marginal cost.

In addition, boosting the town's image as a leader in applying contemporary technology solutions to managing government operations and delivering services to constituents potentially would have the indirect benefits of:

- attracting new businesses to the town;
- attracting more tourists to the town;
- improving technology education opportunities at the Orleans Elementary School; and
- shrinking the technology gap for seniors.

In recent years, Orleans has made important investments in the Town's technology infrastructure that hold promise for reducing costs, increasing efficiencies, and improving the quality of service delivery. Most notably, the Town's Water Department currently is engaged in integrating utility mapping, cloud computing, and the use of handheld devices into its operations and is looking forward to fully implementing communications technology that will permit the automatic reading of water meters. These initiatives open the door to adaptation of other software solutions to Department operations and the potential for expansion of use of these technologies to other Town Departments.

The Finance Committee believes that the Town should explore aggressively other opportunities to apply technology solutions to government operations and services delivery. We recognize that some of these opportunities may require increases in annual outlays for technology services. However, we believe that each of these opportunities should be subjected to a cost benefit analysis that takes into account both financial and non-financial cost and benefits to the Town. Over time a project that would require an increase in a Department's annual outlay for technology may yield an array of both quantifiable benefits (e.g., reduced personnel, equipment, and maintenance costs) and unquantifiable benefits (e.g., customer satisfaction) that in the end may more than justify increased spending for that purchase.

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The Finance Committee would urge the Board of Selectmen to consider convening a Town committee made up of volunteers who have experience in developing technology deployment at the institutional level (e.g. business and industry and government) to assist the Town Director of Finance and Town MIS Director in identifying, evaluating, and making recommendations to Town leadership on opportunities for expanding the use of technology in support of Town activities.

The Challenges

In this report we've talked about financing and shared our thoughts on what we have learned from our look into that topic. We now will turn to three topics that we continue to believe are among the most urgent challenges facing the Town of Orleans.

Demographics . . .

In last year's report to Town voters, the Finance Committee asserted that the changing demographics of our Town is the number one risk to the long-term economic health of Orleans and its viability as a community. And we continue to maintain that position today. This year, the Finance Committee began to look at how to go about developing a better understanding of the fiscal implications of demographic changes on the Town of Orleans.

We believe that addressing the implications of our Town's changing demographics involves a thorough analysis of what has changed in our community, where it has changed, and how it has changed. But that analysis needs to go deeper than the data, and it must be carried out against the backdrop of a clear picture of where we hope to be in the future. A number of positive steps have been taken to date that bode well for Orleans' future, among these, significant advances in managing and controlling debt; downtown improvement initiatives; implementation of a building and facilities master plan; and capital planning for the schools. But these initiatives and others have been based largely on our knowledge of needs as they stand today.

We must begin our efforts to address the issue of changing demographics with a look at what the desired outcome is 10 to 20 years down the road, and then consider how we go about getting there. We need to think in terms of potential outcomes: If we go along the current path, the outcome will be one scenario; if we somehow change the demographics, then the more likely total outcome is another scenario. And we need to analyze in depth each area in which we are seeing changes in our demographics. For example: The population is shrinking, but why? The analysis of why in this case needs to go a lot deeper than saying, for example, "we're aging." Aging itself would seem to be insufficient as a reason. People are getting older in general; living longer; staying in places longer. Houses don't disappear as residents age; houses are sold and continue to generate tax revenue. And, the tax rate itself probably is not the reason people are leaving.

It is easy to say, "yes we are getting older and the tax base is changing," but it is difficult to project how you want to change circumstances to achieve a different outcome. Moreover, the criteria and actions that can be explored to generate various outcomes are very subjective.

We need to explore options for changing outcomes. But, we must temper this search with an evaluation of what is realistic for Orleans, and what is not. In particular, we need to explore:

- What we want/need;
- Where we are in relationship to what we want/need;
- Long term risks of staying where we are;
- Conditions that are keeping us from what we want/need; and

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- Realistic options for changing conditions to achieving what we want/need, e.g., futuristic or forward looking infrastructure projects, such as town-wide Wi-Fi.

In September 2013, the Orleans Finance Committee Chairman had the opportunity to meet with the Orleans Planning Board to discuss the Finance Committee's concerns regarding the Town's demographic changes. Since that time, the Planning Board has begun to look at indicators that may inform the discussion of demographic changes and discuss tracking indicators in areas that may have implications for goals set out in the Orleans Comprehensive Plan (OCP). The OCP, last amended in 2006, provides a vision statement of what the Plan is intended to achieve over a 20-year period and provides goals and policies to guide decision-making to realize that vision.

Last year, the Finance Committee urged Town leadership to engage in a concerted effort to understand and address the implications of these demographic changes on our community. This year we would reassert that position and suggest that the OCP would provide an appropriate platform on which to begin that concerted effort. As such, the OCP in our view would provide an excellent framework for analyzing indicators of demographic change; identifying areas wherein these changes may threaten our vision of an Orleans of 20 years from now; and shaping a strategy for addressing the implications of demographic changes for our Town's future.

In sum, we believe that Orleans' changing demographics create fundamental risks to the long term economic health of our community; that these risks must be evaluated and understood; and that the knowledge gained from the examination of the implications of these demographics should inform and shape strategic planning and spending decisions that we make going forward. Unless we are willing to address directly the issue of our changing demographics and the implications of these changes for our future, we cannot be certain that we will have the resources in place to meet future needs.

Wastewater . . .

At Town Meeting this year, voters will be presented with a comprehensive wastewater Article that encompasses several projects whose collective purpose is to produce information for use in shaping water quality improvement projects in the Town of Orleans. Town voters also will be asked to consider two Articles concerned with the future use of the existing Tri-Town Septage Treatment Plant in both the near-term and into the future. These Articles -- neither individually nor collectively -- advance a specific plan for implementation of wastewater management solutions in Orleans, but, if adopted by Town voters, instead, would inform our development of a course of action to meet our water quality improvement needs.

As we observed last year, the Town has engaged in a healthy and productive, if oftentimes contentious, second look at the draft Comprehensive Wastewater Management Plan that was released in April 2009 in which several significant issues emerged that have remained unresolved to date. Those issues include the amount of water quality remediation required in Orleans water bodies; the use of alternative technologies that may provide more efficient and less costly strategies for meeting wastewater management needs than conventional sewerage; the potentially deleterious effects of increasing the discharge of water into Namskaket Marsh; the feasibility of employing directional drilling in plan implementation; and the potential cost, and financial implications for Town homeowners, of what will prove to be the largest capital investment the Town will ever make. The lack of definitive information to answer questions and concerns surrounding these and other

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unresolved issues in our view were major factors in the defeat of the two wastewater Articles that were put before voters last May.

Over the past year, the Board of Selectmen has engaged in a dialogue that the Finance Committee believes has helped to focus Town leadership's attention on developing strategies to address and resolve those issues. Following last year's Town meeting, the members of the Board of Selectmen committed themselves to seeking out answers to outstanding wastewater issues; held a series of special meetings to explore these issues; with monies from the Finance Committee's reserve fund, hired an experienced professional to guide them in this process and develop a plan for gathering the information to address these issues; and now has put forward for Town voters' consideration of a sound strategy that, once completed, will position our Town to develop a plan and generate the support needed to proceed with that plan.

In that same timeframe, the Cape Cod Commission (CCC) initiated its project to update the county's regional wastewater plan -- the so-called "208 plan". With \$3.5 million in funding from the Commonwealth, the CCC began a 12-month study to produce a mandated update of the existing 1978 Water Quality Management Plan for Cape Cod. The 208 plan takes its name from Section 208 of the Federal Clean Water Act, which requires the development and implementation of regional wastewater management plans. A key feature of the 208 plan study process was the creation of various working groups comprised of individuals from town government and administration, town wastewater committees, business and civic organizations, and regional and other stakeholder groups, many of who were from Orleans. These working groups provided invaluable input into, and support for, the 208 process, allowing the CCC to build strong consensus on wastewater management issues on Cape Cod.

In the past, with the Federal, State, and County governments locked onto conventional sewerage as the optimal approach to wastewater management, Towns de facto have been constrained from doing anything but produce sewer-centric wastewater management strategies, and discouraged from exploring alternative strategies for water quality in their watersheds. But the 208 planning process has changed all that.

In February of this year, the CCC Executive Director announced that the 208 study had concluded that abandoning reliance on a conventional sewerage solution to wastewater management and instead, looking to alternative technologies and strategies could meet Cape Cod's water quality remediation goals while saving Cape Towns millions of dollars.

More recently, the CCC Executive Director told Orleans Selectmen that the 208 study finding will allow a community to pursue the development of "something less than a comprehensive wastewater plan" and to develop instead a "targeted plan" to take on initiatives in areas where there is consensus in the community that work needs to be done.

The announcement of the 208 plan's finding marked a sea change in the debate on water quality improvement solutions. The groundwork that would be done under the projects included in the Article that Orleans voters will take up this year would produce information that will permit the Town to take full advantage of 208 planning process products and any Commission resources that may be available to assist us in developing plans to meet our wastewater management needs, projecting potential costs of various technologies, and evaluating options for the Tri-Town site.

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We are aware that there are individuals in our community who believe that the wastewater Article that will be before us this year is an effort to resurrect the Plan 1A initiative that was defeated at Town Meeting last year. These individuals have been very vocal in arguing that position, which, in turn, has caused confusion and concern among other Orleans citizens who are uncertain what to conclude from this perception. The Finance Committee has followed closely the Board of Selectmen's discussions with its wastewater consultant which shaped this Article. We do not see any evidence of an effort to revisit Plan 1A, nor do we believe that is the intent underlying any action taken by the Board of Selectmen. Instead we believe that this kind of thinking is a distraction and disruptive of an extremely thoughtful and productive dialogue that has positioned us to move forward with water quality remediation initiatives in this Town. We are hopeful that the Board of Selectmen will engage in a concerted effort to communicate the intent, scope, purpose and importance of the wastewater Article that Town voters will be asked to act on in May.

What we do this year will serve as the prologue to framing this Town's approach to wastewater management for the long-term. We therefore believe that it is critical that the Town be successful in developing the information that is needed to make informed decisions on the selection of solutions for water quality improvement in Orleans watersheds. We are hopeful that Town voters will come together in support of funding of the initiatives that we believe will provide us with that information.

Unfunded OPEB Liabilities . . .

Currently, the Town of Orleans' unfunded pension liability is \$17,000,000 and our retirees' other post employment benefits (OPEB) have an accrued liability of \$22,000,000 for a total obligation of \$39,000,000. The pension liability currently is being funded by the Town at a level and on a schedule to meet the 2038 State deadline for full funding of each pension system. By contrast, at present there is no requirement that municipalities make payments against their OPEB liabilities or any deadline for fully funding that obligation.

In 2012, Town voters approved the establishment of an OPEB stabilization Fund so that funds may begin to be set aside as a reserve for payments against the Town's future liability. The Finance Committee fully supported establishment of the OPEB and believes that payments against that funds must be accelerated.

In accordance with the Board of Selectmen's policy, Free Cash is maintained in amount equal to 4.5% of the Town's annual budget each year, with an additional .5% set aside for the OPEB and General Stabilization funds. As we did last year, the Finance Committee would encourage the Board of Selectmen to consider reducing the percentage set aside for Free Cash to 4% and authorizing a total of 1% to be set aside each fiscal year for the OPEB and General Stabilization Funds.

Conclusion

For the past several years, the Finance Committee's consideration of the financial matters of the Town have been strongly influenced by the Committee's belief that sustaining the Town's fiscal health requires long-term planning to meet future challenges and near-term actions to address immediate priorities and improve Town government services. This year's budget and CIP reflect substantial progress on both those fronts.

With the hiring a Department of Public Works & Natural Resources director and a full time project manager, the pace of scheduled building and facilities maintenance and repair projects has been accelerated. The CIP includes projects to address several significant infrastructure projects that have

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languished for years. Both the Orleans Elementary School and the Nauset Regional School District for the first time have completed capital improvements plans, and Town leadership now has a handle on, and can begin to plan for, outlays to meet the capital needs of our schools. Town voters' approval of the wastewater Article this year will provide the Town cost-related and other information that it will need to move forward with water quality improvement plans.

How we finance our spending is as significant a consideration as what we elect to spend our money on. We believe that in the process of developing plans for financing town projects Town leadership should look beyond the question of whether to bond or pay cash for these initiatives to consider as well where and how we might change the way we do business to reduce costs and improve efficiency and transparency.

Respectfully submitted,

Gwen A. Holden Kelly, Chair

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