February 11, 2009 Agenda

Report on Capital Infrastructure and Planning

Report on School Cost Structure

Overview

- 4 out of 6 reports released in draft form; 2 more due in March.
- Collective message:
  - Even if the full potential of recommended revenue increases and operating efficiencies is instantaneously achieved, Newton will still not able to close ***revenue-expenditure gap*** in the Operating Budget.
  - Neither will incremental revenue increases or cost savings be able to make a meaningful impact on the **investment gap** in the Capital Budget.
  - In attacking the twin gaps, Newton faces many choices pertaining to the scope, quality, and financing of municipal services.
  - These choices can only be systematically made and justified if the Mayor and the Board of Aldermen first identify what services residents value most—*i.e.,* what residents deem essential vs. peripheral.
  - The way these choices are reflected in the Operating and Capital Budgets will define the kind of City we want to be.

REPORT ON CAPITAL INFRASTRUCTURE AND PLANNING

Goals of the Report

- We sought to evaluate
  - –Condition of Newton's capital stock
  - –Process by which these capital assets are renewed, maintained and replaced

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We found serious causes for concern on both dimensions

Agenda

- Summary
- Status of Capital Infrastructure & Level of Required Funding
- Capital Investment Budgeting Process
- Conclusion

Methodology

- **Evaluated condition and capital needs of Newton's infrastructure**
  - Interviewed key municipal and school executives
  - Reviewed various capital budgets
  - Analyzed historical capital spending levels
  - Estimated replacement cost of City's infrastructure & required capital spending levels

- **Evaluated capital planning and budgeting process in Newton**
  - Interviewed key personnel
  - Reviewed capital planning and budgeting documents
  - Analyzed "case studies" of capital investment decisions
  - Studied best practices of other cities in prioritizing and rationing capital investment

Report on Capital Infrastructure and Planning

Summary of Newton's Capital Stock

Infrastructure	Description	Replacement Cost
Public Buildings	• 2.6 million square feet! – 22 educational buildings – 6 fire stations – Police HQ & garage – Main & branch libraries	• $950 million [a]
Vehicles & equipment	• Fire trucks • Ice & snow removal • Automobiles • IT infrastructure	• Up to $45 million
Roads & Traffic Signals	• 310 miles of streets • Concrete sidewalks	• Approximately $50 million [b]
Parks & Playgrounds	• Over 70 parks & play-grounds on over 1,100 acres • Basketball & tennis courts, swimming facilities	• $20 million [c]
Water & Sewer	• Sizable investment but generally not funded by tax revenues	• N/A
Total		• **Approximately $1.1 billion**

Newton has a large capital stock

- At new construction costs of $375 / sf or the present value of $35 / sf of rental rates.
- Estimates of resurfacing & reconstruction costs are approximately $150,000 / mile.
- The land itself is not depreciable / is assumed to have an infinite life. Represents the infrastructure & depreciable assets on the land only.

Summary Observations

Findings	Why?	Root Causes
• ***City's infrastructure in need of significant investment with a large "required" maintenance & replacement backlog***	• Significant historical under-funding • Convoluted budgeting process	• **Limited funds** • **Short-term bias** –Preference for program over maintenance –Short timeframe of elected officials –"Silent" nature of depreciation costs • **Lack of clear fact base** –Size & replacement needs of capital stock • **Self-imposed limitations** –e.g. "3% rule"
• ***Arcane and (sometimes) ineffective capital budgeting process***	• Not guided by long-term vision for City • No established prioritization criteria • Insulated from general public • "Rolling" budget process	

Root causes need to be addressed to "fix" capital backlog & budgeting process

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Current Annual Funding "Gap"

Current Spending (FY 2008)		Appropriate Spending	
		Replacement Cost of Infrastructure	$1,100,000,000
		÷ Useful Life	40 years
Capital Investment [a]	$13 M	Avg. Capital Investment	$27-28 M
Maintenance	$15 M	Appropriate Maintenance	±$20 M
Total Capital & Maintenance	**±$28 M**	**Total Capital & Maintenance (keep up with current needs)**	**±$48 M**

Newton has under-funded its capital investment by an estimated $20 million per year

(a) Excludes 2008 investment in Newton North High School as not representative of "typical capital spending level of the City.

Newton Capital Investment Backlog

- Sustained under-funding of repair & maintenance has led to a sizable backlog of desired capital spending

  – $220 million for schools
  – $76 million for municipal sector
  – up to $300 million total

If accurate, this backlog represents approximately 30% of the $1.1 billion replacement cost of all of Newton's capital infrastructure!

What This Backlog Means for You

Newton Capital Investment Backlog	Up to $300,000,000
Residential Property Tax as % of Revenue	72.4%
Newton Residents' Share of Backlog	Up to $217,200,000
Assessed Value of Newton Residents' Property	$19.4 billion
Liability per $100,000 of Assessed Value	Up to $1,121

Single Family Home Assessed Value	**Household Share of Liability**
$400,000	$4,484
$500,000	$5,605
$600,000	$6,726
$700,000	**$7,847**
$800,000	$8,968
$900,000	$10,089
$1,000,000	$11,210

Equivalent to a one-time ~$8,000 liability for the median single family household in Newton!

Increase Annual Spending on Capital Maintenance & Renewal Substantially

Current Spending (FY 2008)	
Capital Investment [a]	$13 M
Maintenance	$15 M
Total Capital & Maintenance	**±$28 M**

Appropriate Spending	
Replacement Cost of Infrastructure	$1,100,000,000
÷ Useful Life	40 years
Avg. Capital Investment	$27-28 M
Appropriate Maintenance	±$20 M
Total Capital & Maintenance (keep up with current needs)	**±$48 M**
Additional annual spending to work off existing backlog	±$14 M
Total Recommended Capital & Maintenance	**±$60 M**

A ~doubling of capital & maintenance spending is necessary to work off the backlog

(a) Excludes 2008 investment in Newton North High School as not representative of "typical capital spending level of the City.

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Capital Investment Process Context

- **Three investment guidelines established after passage of Proposition 2½ in 1981**
  - Free Cash (end of year budget surplus) would only be used for capital projects
  - Capital projects > $500,000 financed by debt; < $500,000 out of operating budget
  - Debt service (interest + principal) = 3% of Revenue
- **Good intentions, but some unintended consequences**
  - Incentive to overestimate expenses and underestimate revenues to create “Free Cash”
  - Artificial “3% rule” constrained replacement of infrastructure
  - Limited budgeting of “small” (<$500,000) capital projects
  - “Pay as you go” method inhibits systematic budget analysis

Current Capital Investment Process

- **Budgeting process has several procedural complications**
  - Only the Mayor can propose a Capital Budget
  - Rolling 9 month process
  - Four different capital planning processes (CIP, Supplemental Capital Budget, Mayor's submissions, Capital Stabilization Fund)

- **There are several barriers to simplifying and improving this process**
  - Plan is not grounded in long-term vision for City
  - No up-to-date inventory of City's infrastructure (replacement cost & useful life)
  - No asset management plan or single "manager"
  - Capital budgeting process is insulated from the general public
  - Poor linkage with the operating plan

Capital budgeting process needs re-engineering

Recommendation #2

Institute a New "Capital Investment Rule"

– Determine annually the replacement cost and useful life of Newton's infrastructure

– Each year, set aside in the budget an amount equal to the replacement cost of Newton's infrastructure ÷ its useful life in the "Capital Investment Reserve" account

– Draw annual capital investments from this Capital Investment Reserve

– The Capital Investment Reserve cannot be used for anything other than capital investment in existing infrastructure

– Any repayments or amortization of principal of the City's debt are to be "counted" as if invested in the Capital Investment Reserve

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Capital Investment Rule will be a forcing mechanism for the City to "save" adequately for future capital repair, replacement & maintenance

Recommendation #3

Introduce New Processes for Prioritizing Capital Investments

– Consider adoption of Integrated Operating and Capital Budget

– Elevate importance of a formal Capital Improvement Plan process

– Establish a consistent and measurable set of criteria for prioritizing specific projects

– Budget for both planned and an average level of “unanticipated” capital maintenance

– Consider more decentralized process for developing and vetting annual investment priorities

Several additional changes are necessary to improve the capital budgeting process

Supporting Recommendations

#4 - Complete Detailed Inventory of the City's Stock of Capital Assets

#5 - Create and Fully Support a New "Capital Asset Manager" Position

#6 - Adopt Life Cycle Costing for All Significant Capital Projects

#7 - Harvest Short-Term Savings

#8 - Consolidate Municipal & School Maintenance in the Public Buildings Dept.

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Conclusion

- **Limited funds, a short-term bias, lack of a clear fact base and some self-imposed limitations have led to:**
  - Under-funded capital investment and maintenance by up to $20 million per year
  - Deterioration of infrastructure and a sizeable backlog of required investment
  - Arcane and complex decision-making process
- **We must increase level of annual capital spending and maintenance just to ensure that investment backlog doesn't continue to *grow*.**
  - On average, about $48 million per year just to maintain capital stock—assuming no backlog
  - Substantially greater investment required to attack deferred maintenance
  - This represents a big increase over the $28 million spent in FY 2008.

Conclusion

- **Newton has two choices on how to deal with the current capital investment backlog:**
  - Either reduce the amount of capital stock in the City and then live with the consequences (a reduction in services that utilize significant capital assets)
  - Or increase capital spending to "catch up" for historical underfunding"
  - Ask the question: What will happen if the City chooses not to increase capital spending and allows its buildings and infrastructure to continue to deteriorate?
- **Newton's silent de-capitalization is reversible and fixable if we face the music**
  - Increase capital spending to maintain current capital stock and "catch up" on backlog
  - Establish Capital Investment Rule to make sure we "keep up" in the future
  - Amend (and simplify) decision-making process

Report on School Cost Structure

Goals of the Report

We sought to:

- Define the choices facing Newton with respect to educational service levels and their long-term funding requirement,
- Identify within this context innovative ways of increasing short- and long-term operational efficiency and effectiveness of Newton's school operations,
- Identify new or enhanced sources of funding for the Newton school system.

Methodology

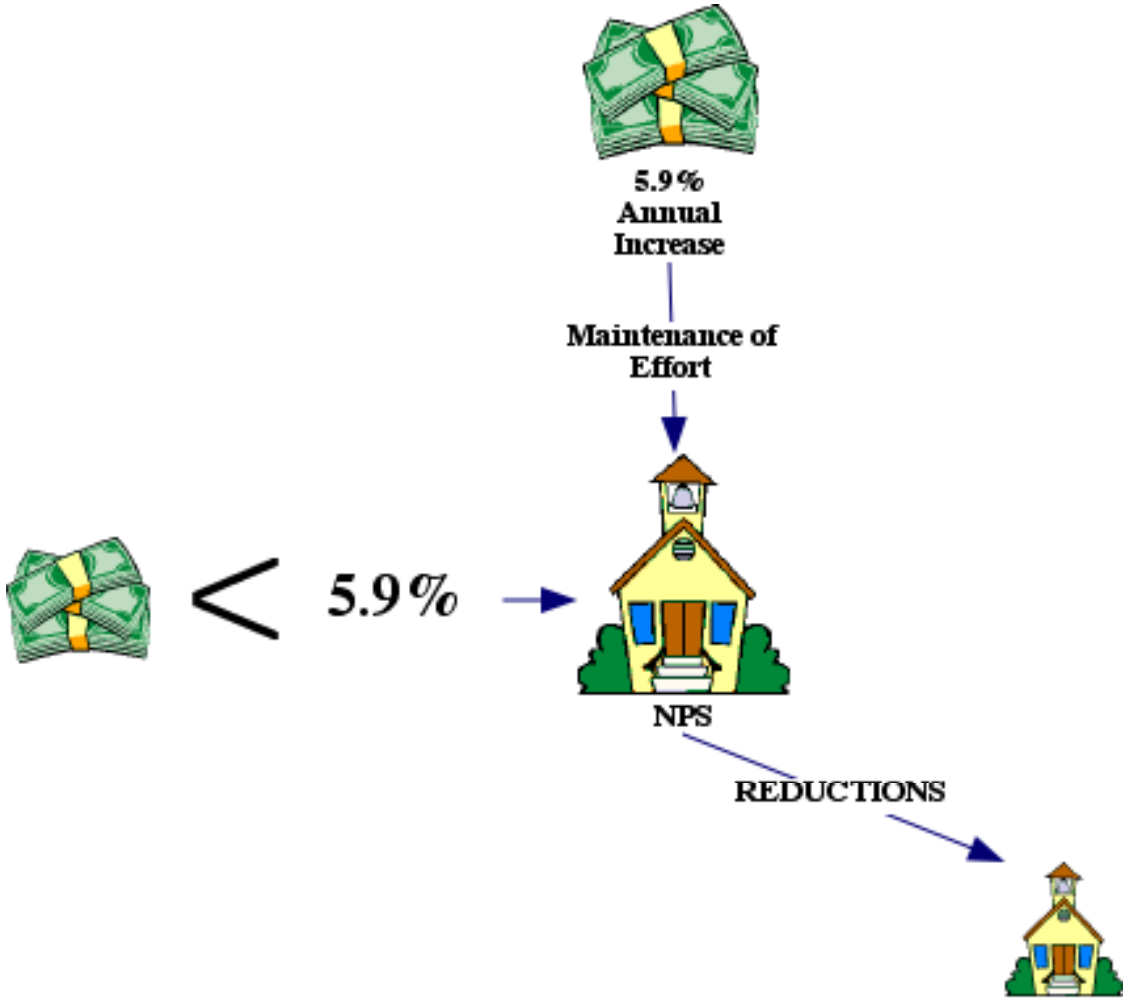
- Six months of interviews with school administrators, School Committee members, parents, citizens, and input from several open forums
- Analysis of reports by the Newton Public Schools and other sources of data, including information from a Citizen Advisory Group benchmarking report
- Given our limited resources and time period, we had to select a few, critical areas of the Newton Public Schools to study.
- We chose:
  - Administrative Practices
  - Budgeting & Compensation
  - Special Education
  - METCO
  - Transportation
  - Food Services

Finding

In the course of our work, we became *deeply concerned* that, in the absence of new revenues, the Newton Public School will be unable to maintain its current level of services and programs or to continuously improve—one of the essential elements of excellence in the field of education.

Related to this major concern, we found evidence of a long-standing gap between the funding of the Newton Public Schools and what it costs to run the system under the current educational model.

Finding



If funding to the Newton Public Schools only increases by 4.3% annually in the future, a cumulative deficit (i.e., cuts that will have to be made) in the next six years will total $60 million.

Finding

Key costs are rising faster than the overall budget's rate of growth (4.3%)

- Benefits

(growing 9.3% over the past 6 years)

- Special Education

(mandated costs projected to grow at 8.7% per year)

- Utilities

(compound annual growth 10.9% ('04-'09))

Report of School Cost Structure

Special Education Students

Primary Disability	2003	2004	2005	2006	2007	2008	Increase 03-08
Autism	94	113	119	139	161	185	96.81%
Communication	169	201	230	275	254	262	55.03%
Dev. Delay	216	234	231	236	227	222	2.78%
Emotional	178	176	191	174	170	161	-9.55%
Health	134	158	179	211	220	236	76.12%
Intellectual	51	54	52	52	50	45	-11.76%
Multiple Disabilities	32	31	30	30	32	32	0.00%
Neurological	58	59	67	71	88	113	94.83%
Physical	12	13	20	20	16	13	8.33%
Sensory/Deaf Blind	2	1	1	3	2	2	0.00%
Sensory/Hearing	16	18	18	18	16	15	-6.25%
Sensory/Vision	5	5	8	9	7	6	20.00%
Specific Learning	1151	1158	1121	1078	1006	995	-13.55%
None Specified						2	
Grand Total	2118	2221	2267	2316	2249	2289	8.07%

Current Growth Rate for Teacher Salaries

	Unit A (Teachers)	Unit C (Aides)
FY ’09 Salaries (millions)	$74.3	$13.7
Overall salary growth due to STEPS and Lanes	2.6%	5.4%
COLA increase (FY’09)	3.0%	3.0%
Net increase before turnover savings	5.6%	8.4%
Turnover savings	1.6%	-
Net annual salary growth (projected)	4.0%	8.4%

Finding

Newton's teachers salary and growth is consistent with similar communities

- Compared to demographically similar communities, Newton's average teacher salary of $67,080 (MA DOE FY07) is 8.4% above the average of $61,881.
- Among the 6 communities with a similar commitment to education, Newton's average salary ranked fifth, although 0.4% above the average.
- For Master's level teachers, Newton's highest step level was 1.8% above the average of that group, second to Wayland.

Report on School Cost Structure

Growth Drivers for the NPS Budget

	Base Year (FY 2009)	% growth	% of budget	Contribution to growth above 4.3% $	Contribution to growth above 4.3% %
Instructional salary less offsets (not including SPED)	$62,707,400	4.3%	39%	7,354	0%
Other salary (principals, custodians, admin, etc.)	24,622,423	3.8%	15%	(123,287)	-5%
Benefits (total, including SPED)	23,190,989	8.9%	14%	1,061,414	42%
SPED (less benefits)	33,596,828	8.4%	21%	1,384,487	55%
Utilities	6,384,408	6.0%	4%	108,535	4%
Charter maintenance	1,914,100	15.0%	1%	204,809	8%
All other	7,669,020	2.5%	5%	(137,691)	-5%
TOTAL	160,085,168	5.9%	100%	2,505,621	100%

Finding

In order to close the gap between ongoing costs growing faster than revenues, the Newton Public Schools has had to make decisions that have produced a *gradual and cumulative erosion* in most instances in arenas that can be best described as *educational infrastructure.*

Finding

A number of factors are contributing to the erosion in quality as financial resources have become more constrained:

- Diminished administrative and leadership support
- Reduced capacity to supervise of teachers
- Shrinking professional development opportunities
- Insufficient technology
- Inadequate building maintenance
- Increases in class size

Finding

Near-term opportunities to save money, perhaps as much as $1 to $2 million, in two areas:

Transportation - by increasing user fees and reducing service

Food Services - through outsourcing

Recommendation: Transportation

1. Reducing the costs by reducing the number of buses by either/or

    - Providing bus service to only those students mandated by law and/or
    - Hiring more crossing guards to reduce the number of elementary school students who need bus service for safety reasons

2. Increasing fee revenues by either/or

    - Increasing the fee level and/or
    - Having more students pay the fee (K-5 students who live between 1 – 2 miles from school, presumably in non-safety areas)
    - Asking private schools to contribute to the cost of transportation

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Recommendation: Food Services

Consider outsourcing management *and* labor:

- Losing $1.2 million on expenses of $4.2 million.
- Losses have been rising on a rather consistent basis.
- Prices are the highest of any benchmark schools.
- Sales of paid lunches have been falling consistently.
- The nature of the elementary school facilities make changes in food choices more difficult and require unusual and thus higher labor costs.

Recommendation: Special Education

1. Conduct an outside evaluation to determine how well and how efficiently special education services are delivered; this type of evaluation is needed on a periodic basis, perhaps every ten years.

- Establish its own set of metrics to measure the effectiveness of its special education programs.

3. Capture and report systematically special education costs and revenues in a more reader friendly manner.

- Partner with the Special Education PAC to continually evaluate and improve upon programs and practices.

5. Improve communication, transparency and public understanding of Newton's special education programs by continuing to work with the Special Education PAC.

Recommendation: METCO

Just like other school programs, we see the need to periodically assess and communicate how this program supports our core values and how effectively it is achieving our educational goals.

Recommendation: CFO

Long-term planning, budgeting, and scenario planning should be bolstered under the direction of a NPS Chief Financial Officer.

- As the ninth largest school system in Massachusetts and with responsibility for managing a $160 million enterprise, comprising 55% of Newton's total expenditures, this is a good investment.

Recommendation: Communication

As a means of regaining trust and fostering the necessary dialogue about the future of the school system, there is an urgent need

- to increase the quality of and
- to consider new vehicles for

communication about the financial condition of Newton Public Schools and the programmatic choices it faces.

Observation

In the eyes of the public, it is not clear how much the quality of education has been negatively impacted by the economics of the past few years.

Last spring, the Override Budget and the Allocation Budget in some ways defined a difference in quality. But, we believe there is a sense in the community that, regardless of what budget passed, Newton is and will continue to be an excellent school system.

Recommendation: Addressing Choices

We see the necessity for the Newton Public Schools to distinguish between the *essential* and the *desirable* qualities of an excellent school system.

In particular, in the absence of new revenues, Newton Public Schools will very likely need to reevaluate some of its past practices and choices that significantly affect the economics and performance of the school system, including:

- Class size
- Teaching loads
- Compensation
- Teacher development

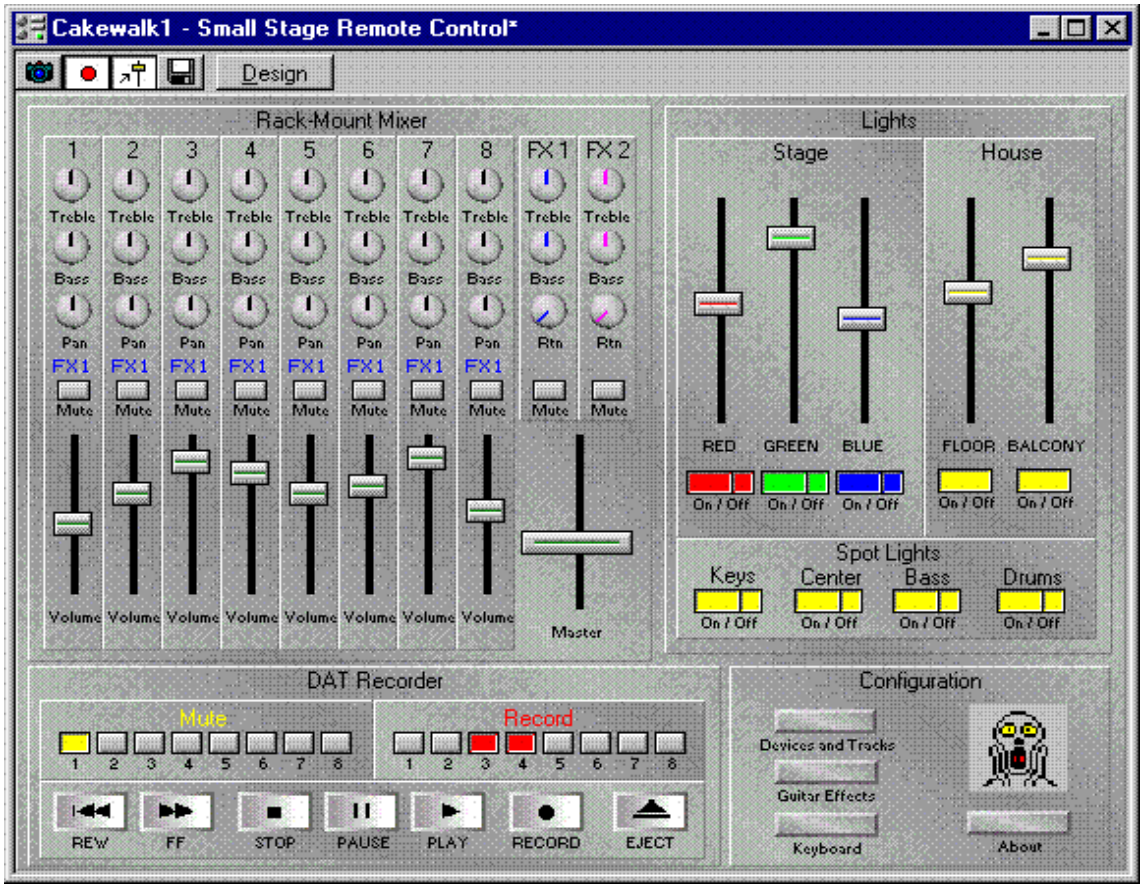
Recommendation: Teacher Compensation

- Develop and Articulate a Philosophy of Teacher Compensation
- Review Compensation Structure of Special Education Aides
- Conduct Regular Teacher Surveys
- Consider Joining the Commonwealth's Group Insurance Commission

Observation

The current budget and decision making process does not lend itself necessarily to tackling cost reduction issues comprehensively. The individual elements each need to be considered one by one, but, more importantly, they must be considered as a group. There are important relationships between individual cost items.

Recommendation: Scenario Planning



The individual items – number of employees, teacher compensation, class size, teacher load, teacher development, investments in technology, etc. – need to be linked to a comprehensive, strategic, and long-term plan for the Newton Public Schools.

We recommend scenario planning as one powerful tool for doing this.

General Recommendation

The School Committee and Newton educational leaders must re-engage in a discussion about the future of the Newton Public Schools

- What are the choices we need to make?
- How can we most effectively and efficiently meet the needs of all our students, including the 20% of students requiring special education?
- How do we maintain the high quality of our teachers?
- How can we control expenses, including benefits and utilities?

General Recommendation

The School Committee and Newton educational leaders must re-engage in a discussion about the future of the Newton Public Schools

5. Most importantly, what are our priorities? What as a community are we willing to pay for? What are we willing to sacrifice?

6. What is essential? What is desirable?

CONCLUSIONS

Newton Faces a Major Financial Challenge: Twin Budget Gaps

- These gaps are persistent
  - Capped revenues and uncapped costs
  - Underfunded obligations (e.g., post-retirement health care obligations, underfunded by as much as $22 million annually)
  - Unfunded mandates in the schools (special education)
  - Substantial underfunding of capital assets

Four Conclusions

- Conclusion #1: The current economic model is not sustainable—for both Municipal and School Operations
- Conclusion #2: The need for change exists before it becomes obvious to everyone. When it becomes obvious to everyone, it's too late.
- Conclusion #3: Run the financial scenarios to help make the difficult choices.
- Conclusion #4: Employee involvement is critical in two "value engineering" initiatives:
  - ***Innovation in Learning***
  - ***Operation Simplification***

BACKUP

Newton Public Schools – 6 Year Scenario Planning

BASE CASE – Growth rate	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015
NPS budget requirement: 5.9%	169,530	179,532	190,125	201,342	213,221	225,801
NPS budget allocation: 4.3%	166,969	174,148	181,637	189,447	197,593	206,090
Surplus/deficit	2,561	5,384	8,488	11,895	15,628	19,711
Cumulative surplus/deficit	2,561	7,945	16,433	28,238	43,956	63,668

SCENARIO A-1

Cost improvement	New Growth Rate
Reduce COLA for teachers/aides to 2.0% per year:	5.4%
Reduce Aide step growth to 4.0% per year:	5.3%
Improve growth in benefits to 7.4% per year:	5.1%

Report on School Cost Structure

Newton Public Schools – 6 Year Scenario Planning

SCENARIO A-1 – Growth rate	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015
NPS budget requirement: 5.1%	168,249	176,830	185,848	195,327	205,288	215,758
NPS budget allocation: 4.3%	166,969	174,148	181,637	189,447	197,593	206,090
Surplus/deficit	1,281	2,682	4,212	5,880	7,695	9,668
Cumulative surplus/deficit	1,281	3,962	8,174	14,054	21,749	31,417
Additional efficiencies/investments						
Outsourcing school lunch	1,188	1,247	1,310	1,375	1,444	1,516
Transportation savings	800	832	865	900	936	973
Benefits savings from GIC	-	500	537	577	619	665
Ins. Trust Fund distribution (GIC)	-	2,925	2,925	-	-	-
Technology investment		500	500		-	-
Subtotal efficiencies	1,988	5,004	5,137	2,852	2,999	3,155
Surplus/deficit	707	2,323	925	3,028	4,696	6,513
Cumulative surplus/deficit	707	3,030	3,955	928	3,768	10,281
Operational override (FY2013)	-	-	-	3,427	3,427	3,427
Cumulative surplus/deficit	707	3,030	3,955	4,355	3,086	-