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2023 – 2024 Budget Update for January 23rd Selectboard Meeting

I wanted to provide a brief overview of the discussion for Monday night ahead of the meeting.

To start, I'd like to provide the high-level timeline of where we're at in the process:

Internal and Selectboard preliminary budget discussions	Fall 2022
Internal finance review, audit completion, and accounting updates	Fall – Winter 2022
Initiation of wage and compensation study	September 2022
Departments work on and submit revenue and expense requests	November/December 2022
Internal review and discussion and stakeholder updates	December 2022 – January 2023
Initiation of compensation discussion with collective bargaining units and staff	December/January 2023
Tax rate target and budget update discussion	January 23rd Selectboard Meeting
Initial materials made available to Finance Committee, Selectboard and public	5 – 10 days prior to meeting date
Department Budget Presentations, Feedback and Discussion	Late February/Early March* *Scheduled for February 27th, 28th, and March 1st but may move 1-2 weeks later as per prior discussion*
Internal review and updates from feedback	Early – Mid March
Selectboard final review and approval	March 20th or March 27th Selectboard Meeting
Preparation and distribution of materials for Town Meeting	March – May
Town Meeting	May 9th
Post-Town meeting budget implementation and FY beginning	July 1st

This is not exactly the timeline we set out for early on, and as we've discussed, we are running behind in the process largely due losing our Finance Director in the fall as we were beginning the budget. Our new Finance Director is starting full-time January 23rd, and alongside our finance staff and consultants, will help us finish our audit and prepare the necessary accounting and budget materials to take us through the remainder of the process.

Approach to this year's budget

As you may recall, we set out goals early in the process of performing a broader review of some of the ways in which we organize our budget. We've scaled back some of the proposed changes for this year due to a focus in several areas, including:

1. Getting caught up and re-organized in several accounting and finance areas where we fell behind due to staffing shortages and the current lack of institutional finance memory, to ensure that we have accurate, audited numbers on which to build a clear and transparent budget.
2. The Selectboard committed to beginning the first phase of a multi-phase review of our employment, wage, and compensation policies to help ensure we are paying our staff fair, competitive market values for the excellent work they do. As we've communicated to our collective bargaining units and staff, although we have not yet gotten what we needed out of the salary study we hired a consultant to perform, we have allocated significant time internally to review these policies and provide a set of short-term recommendations to ensure we are taking steps towards more competitive and fair wages. At the same time, we are completing the hiring a new HR Director, and then moving quickly this spring into a more thorough and interactive wage and compensation study that will provide us a more comprehensive set of recommendations for the 2024 – 2025 budget.
3. For me, getting up to speed on our departments budgets and needs, ensuring that even with major cost drivers this year challenging our budget's ability to balance the operational needs/burden to taxpayers, that key programs and needs were being met, and in a few areas that we'll highlight, creating some additional support.

This year's budget challenges

Over the last few months, we have encountered several specific challenges to this year's budget, which I'd like to summarize. They provide important context as to why we may want to look at our budget from a slightly different perspective this year. The primary (not exclusive) challenges that we face right now are:

1. Record 40-year high inflation and record rising costs in areas such as raw materials, health insurance and fuel.
2. Record labor shortages, especially in the public sector, and especially in our region (largely due to lack of housing availability and childcare services).
3. Several underbudgeted program areas, including for staff compensation, retirement accruals, and election expenses.
4. Likelihood of significant incoming debt service for existing major infrastructure repairs and upgrades, and a need for more holistic capital planning as part of the budgeting process
5. Overanticipated revenue in several areas
6. Somewhat high prior fund balance utilization that we may want to phase out, and discrepancy between Town and State definitions of fund balance.
7. Recommendation from the Trustees of the Trust Fund for significantly reduced new spending out of the Bresett fund this year, due to tight market conditions

We'll discuss these in a little more detail when we prepare the budget materials for the presentations (though I can answer questions at this point or before then of course about any of the above).

Basically, the short story is that we have more of a structural deficit in our budget than it may have seemed. Meaning we have more expenses than revenue (deficit), and that it is built in annually, not a one-time occurrence (structural). It was a little harder to see the existence of this over the past few years because of some of our accounting/reporting practices and how a handful of dynamics "netted out," such as needing to make payments for a retiring employee's accrued time off, but having vacancies in fulltime positions that provided additional budget availability. Largely because of the factors identified above, a number of those dynamics won't create a wash any longer, for example, as more departments have staffed up, or paid overtime or hiring bonuses, we don't have that same availability of funds (though should be noted some departments are still challenged with vacant positions and/or turnover). This all means it's time to look at the root causes of this budgetary imbalance, as well as explore what tools we have to access to so we can address it.

Available tools and options

When faced with dynamics such as those that challenge our ability to match our revenues to our expenses, we want to expand our perspective and include a broader context when looking at this year's budget. But before we do that, there are a limited number of tangible options that are available to address a budget imbalance. These aren't the tactics (which is a different conversation), but rather the broad strategy or tools available:

1. Cut costs or reduce/eliminate services
2. Increase non-tax revenue
3. Borrow money
4. Raise taxes on existing taxpayers
5. Intentionally create new taxpayers

Let's look at each of these one by one.

1. **Cut costs or eliminate services**. For simplicity's sake, we can break those into two different pieces.
    a. **Eliminate services.** Based on the feedback and guidance from the Selectboard and the community's expectations, we are not in an "eliminate services" mindset. In fact, we have guidance for not just maintaining the level of services we currently provide, but expanding in certain key areas, such as identifying ways to build additional workforce housing, and expanding funding for certain programs or increase of hours. So unless we get guidance otherwise, we aren't examining eliminating entire service offerings as a cost saving mechanism.
    b. **Cut costs**. Cutting costs can feel like a compelling mechanism, but it's not as easy or impactful as one might hope, especially in an organization that is already impressively and sometimes surprisingly lean in certain areas. Much (though not all) of the "low hanging fruit" has already been addressed in how the organization functions and there isn't easy waste to just cut. Next, because the majority of the budget is staff compensation, and that is an area we have identified as needing additional support, not less, that takes that off the table. And many of the areas where we might be able to find more competitive pricing such as large or ongoing purchases, those markets are not in the consumer's favor right now where costs are rising significantly well beyond our control, such as for raw materials or fuel, or our fixed costs for things such as insurance. We're left with a small piece of the pie in areas where we should absolutely focus and make improvements, but they won't make such large impacts as to noticeably reduce tax burdens or help open up costs in other areas. Meaning, we may upgrade a phone system, get a better deal by doing joint purchasing, or save money by reducing paper with a new software program, and these are valuable changes, but they won't make a major impact tax burden wise.

2. **Increase non-tax revenue.** Non-tax revenue (versus tax revenue) is all the money that comes in through permits, fees, rates, fines, etc. This might include parking meter or tickets, motor vehicle registrations, or building permits. Those fees are required to be set based on the costs of providing the service , rather than based on a budgetary need. Meaning, you can't decide you'd like to have more money because you need to pay for something unrelated, and just increase the cost of a different permit to pay for it. Additionally, those payments are made by a subset of people, not all taxpayers, (which is what a government "fee" really is) meaning it places an outsized burden on a specific group of people, which although can be good sometimes by doing something like having visitors contribute to the cost of maintaining parking lots by paying for parking, but it could also be bad, for example asking people who are renovating their house to pay for expanded hours at the library. So we can't just turn a dial and increase rates to generate more revenue – they have to be matched to the direct cost of the services provided.
3. **Borrow money.** Using debt to pay for a structural deficit is a financial practice that I don't believe any stakeholder in Hanover would support. This 'kicks the can down the road' and it's basically the equivalent of using a credit card to pay for monthly expenses beyond what one can afford with no end in sight. In certain rare cases where you need credit to act as a short-term, temporary bridge between two points in time, and as part of a transparent plan, it may be appropriate or valuable, but more often it can be used to just kick the can down the road. It also may be necessary, and appropriate, on large scale, planned capital expenses, such as major infrastructure upgrades, where not only does the cost need to be spread out, but that the cost is going towards a hard asset that will be used by people for years or decades into the future, and as such, should have its cost shared by those people. But again, it's not a tool for managing annual, ongoing operating expenses.
4. **Raise taxes**. This is one we are all too familiar with – one's tax bill going up in one year from the last year. And there can often be a reasonable justification, for example, if there is inflation every year, which there is most years in how the economy is built to work in the US, then with all other things being equal (not cutting services, etc), you'd need to raise taxes, on average, along with that number to keep the budget flat at its prior level. Keeping taxes flat, or making increases below inflation, without making other changes, can actually undercut the spending power of the budget over time. Raising taxes is also not inappropriate when there is a new service requested or demanded by the community and additional money is needed to pay for that service or program. However, raising taxes can be used as a crutch in some governments because it can be seen as a dial that can be easily turned to just create additional money, further burdening existing taxpayers and ultimately harming long-term viability. In Hanover, this is not the case, and the Selectboard has not used its tax base in that way, being mindful of the burden each increase may impose on already high cost of living in our region. So this is part of the mix, but it cannot be the only mechanism for "raising new funds" otherwise existing taxpayers will bear to large of a financial burden and that can cascade into other consequences down the road.
5. **Create new taxpayers**. Outside of being the federal government which can "print" additional money if it needs more money, creating new taxpayers tends to be a state or local government's biggest dial to play with that can have the largest impact on the budget. What creating taxpayers means is not to just anticipate growth in the grand list, which may come from growth in value of existing taxpayers as well as the creation of new taxpayers, but rather to be intentional about adding *new entities* into the tax base who weren't previously there. How this plays out is heavily connected to local zoning laws and other related policies. For example, higher density of housing or commercial spaces tends to not only encourage the increasing of value of a property, but in doing so, the addition of new taxpayers, who contributes to grand list growth, expand the total pool of who is paying into our budget, and thus are a source of new revenue. In rough terms, on average, a building that contains 25 units will generate (approximately) $66,713 in tax revenue towards the town budget. If that building contained 50 units, it

would generate approximately $133,425. That additional ~ $66,000 is in large part being borne by the 25 new people (or so) paying new rent that didn't previously exist, and which flows up to their property owner and then to the Town. Just the same way that adding more people, on average, into an insurance pool, reduces the risk and cost for everyone, so is the same for a tax base. But a challenge, is that without an up to date master plan and a commitment to a community-first process that ensures growth happens in line with community values, this can play out in non-ideal ways where buildings come online too fast and they aren't done in a way that benefits the community or are part of a intentional plan. But now, for the first time in many years, Hanover is just about at that point of having updated guiding principles and the necessary zoning to support its goals, which helps unlock this as a new and reasonable, an in fact highly impactful and potentially beneficial, option to consider.

This might mean creating higher density housing (that is safer and more energy efficient, too), for example new higher density housing that is geared towards students on West Wheelock, or allowing mixed-used development to bring more residential above commercial in our downtown, or turning undervalued assets such as a parking lot, into covered parking plus residential or commercial uses above, and/or addition of green space. Although there is significant work that goes into these processes currently through the Town's various planning stakeholders (Our Planning and Zoning Office, land use boards, etc), we'd like to integrate that planning more so with the budget process, so that the Town itself can dial in pursuit or facilitation of redevelopment in aways that are done with an understanding of future budgetary needs, and vice versa, where the budgetary conversations can have the context, opportunities, and constraints from the planning side. Integrating these areas will allow for much more accurate future forecasting, as well as give the community much more agency in being proactive about how much pressure, and where, and how, is applied to the "gas pedal" of redevelopment and how that may impact the budget, and subsequently, the future plans, programs, policies, and services offered or anticipated to the community. These conversations should be, and are beginning to be integrated on the staff side, and we may want to consider additional board integrations between Selectboard and Planning Board, too, in addition to broader community engagement and input.

Takeaways: There are a number of elements that are challenging and changing our budget this year which has uncovered the existence of more of a structural imbalance than may have been understood previously. Because of that, we are zooming out in our budget analysis, and intending to frame a conversation that includes a discussion of the tools and options available to address how we address this and future year's budgets. And because we will shortly have a newly created set of guiding values, principles, and goals from a comprehensive year-long master plan update, and based on the zoning changes that have already been made and are being recommended for Town Meeting this year, we have recently created the ability to use the option of creating additional tax base growth in ways that are in line, and actually help forward our community's values, and which help balance future years' budgets, and potentially support our community even more into the future.

The budget presentations, and materials provided ahead of time, will not only provide an accurate and clear accounting of our budget, prior year's activity, upcoming goals, and highlights of some changes, but it will begin to provide some of the additional context above. This will help speak to the question – how do we look multiple years ahead, in an interdisciplinary fashion, to ensure various policy and program areas are integrated and working together towards our short, medium, and long term goals as a community. Or more succinctly – how do we pay for things in the future that we don't currently have funded or which we expect costs to rise on without overly burdening existing taxpayers in Hanover?