



CITY OF SOMERVILLE, MASSACHUSETTS
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MAYOR

FINANCIAL ADVISORY COMMITTEE
February 17, 2009

CITY OF SOMERVILLE OVERVIEW



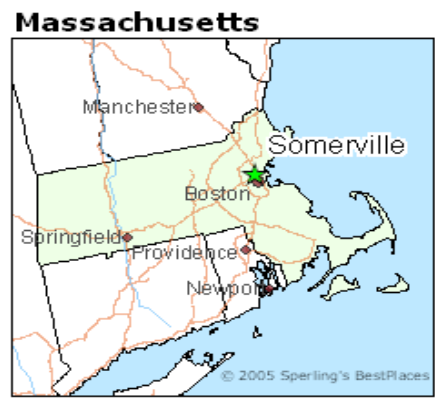
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1. CITY OVERVIEW

Located in Middlesex County, Massachusetts, the City of Somerville occupies slightly over 4 square miles just two miles north of the City of Boston. With a population of around 80,000 residents and a myriad of immigrants from around the globe, Somerville is the most densely populated community in all of New England, and one of the most ethnically diverse cities in the entire nation. Rich in both history and culture, Somerville houses numerous intriguing historical sites, small and large businesses, Tufts University, and hundreds of shops and restaurants for every style and taste.



Today, Somerville is an eclectic mix of blue-collar families, young professionals, college students and recent immigrants from countries as diverse as El Salvador, Haiti, and Brazil among others. One-third of Somerville residents are foreign born, with more than 50 spoken languages in the award winning Somerville schools.

Somerville is defined by city-squares of robust economic and community activity. These squares, which help mark neighborhood boundaries, feature bustling business and entertainment centers for residents. Among the most active are Davis Square, Union Square, Ball Square, Teele Square, and Magoun Square. Each square offers its own assorted mix of ethnic restaurants, bars and shops, and businesses.



Tufts University is partially located in the City of Somerville, and enjoys a global reputation for academic excellence and research innovation. Tufts student body and faculty members add a rich component to Somerville's character and economy, with over 8,500 students and faculty from more than 100 countries.

Somerville also is known as the Arts Center of New England: only New York City has more artists per capita than the City of Somerville. Local artists make Somerville one of the most vibrant and exciting arts centers in the entire country.

Somerville also has received national recognition as a model of management innovation and efficiency for its 311 customer service helpline and SomerStat program, a data-driven style of managing public services. Today, Somerville is the only community in Massachusetts to employ 311, and the only city in the country to employ both a 311 customer service help-line *and* a Connect-CTY massive outreach (reverse 911) program.

In addition to recognition for management innovation, the City of Somerville has become a beacon of smart economic development, featuring some of the regions largest new, mixed-use and transit oriented development projects. Projects include:

- Assembly Square;
- MBTA Green and Orange Line Extensions;
- Inner Belt/Brick Bottom; and
- Union Square

These projects are among the most promising and watched on the entire Eastern Seaboard.

LARGEST EMPLOYERS

The following table provides a listing of the largest employers in the City of Somerville with 100 employees or more.

Tufts University*	Educational Institution 2,193
Somerville School Department	Municipal 1,100
Cambridge Health Alliance	Health Care 771
City of Somerville	Municipal 700
Angelica Textiles	Laundry 546
Ames Safety Envelope	Envelopes/ Printing 400
Star Market/ Shaw's	Grocery 400
Market Basket	Grocery 275
MBTA Commuter Rail Maintenance	Facility Railroad Maintenance 250-400
Gentle Giant	Local Trucking 250-375
Target	Retail 200
Share Group	Non-Profit Telemarketing 196
United Parcel Service	Package Delivery Service 180
Stop & Shop	Grocery 178
Home Depot	Retail 160
Rogers Foam Corporation	Foam Products 150
Arrowstreet Architecture	Design Firm 150
Grossman Marketing	Hotel 114-154
Somerville Housing Authority	Development/Management 105

2. GOVERNMENT STRUCTURE

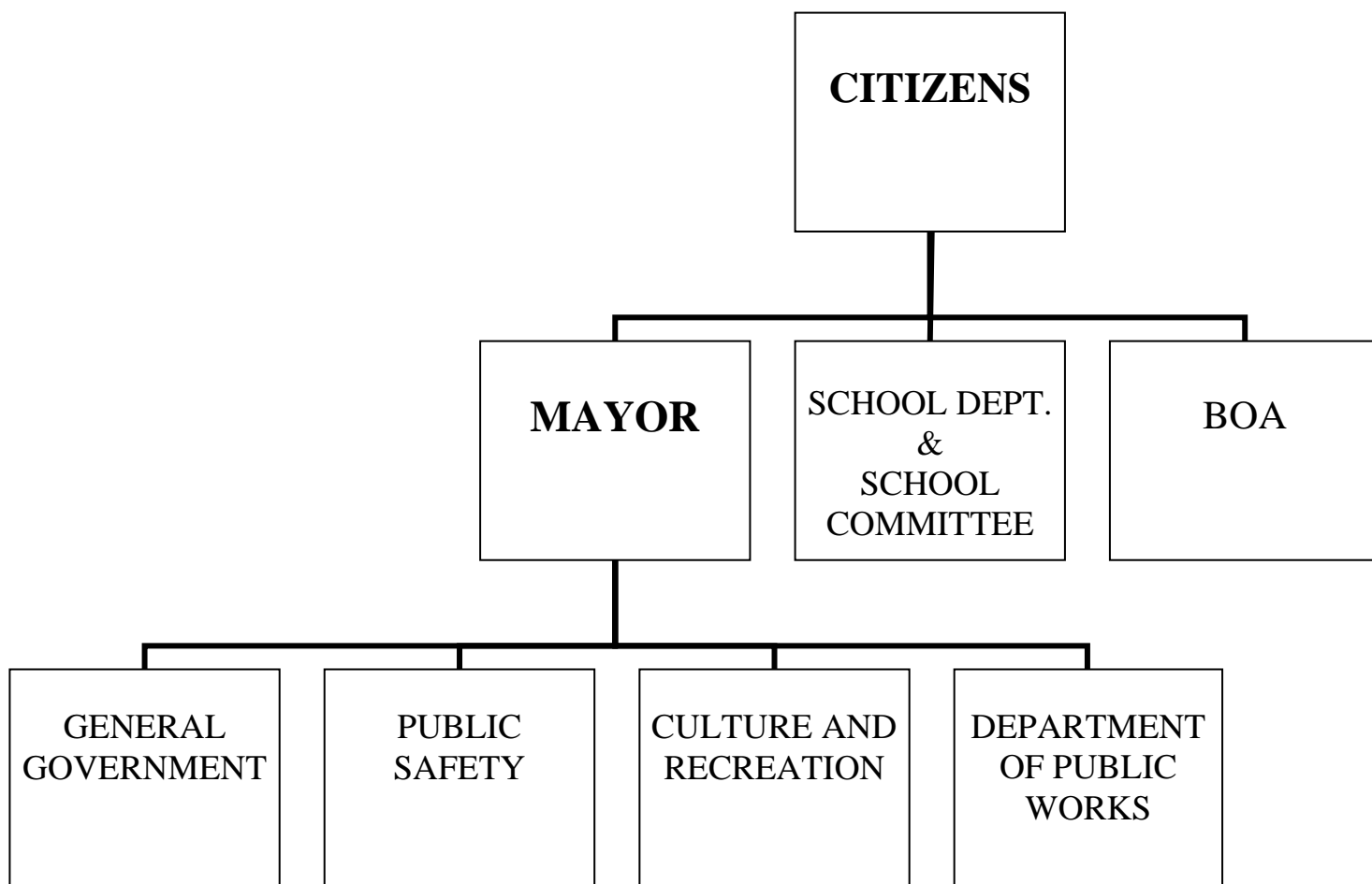
The City of Somerville operates under a Strong Mayor – Aldermen form of government. The Board of Aldermen (BOA) is the legislative branch, with four members serving at-large, and seven members representing individual wards. The Board passes ordinances on a broad range of issues, from zoning laws to creating boards and commissions. It also has the power to approve or disapprove the Mayor's annual budget appropriations.

Both the Mayor and BOA hold coterminous two-year terms.

The Mayor is the chief executive officer, responsible for day-to-day operations, submitting annual budgets, and appointing all department directors.

Other areas of government include: the School Committee; appointed boards and commissions; and a number of executive departments, such as the Department of Public Works, Public Safety, SomerStat, Finance, and the Traffic and Parking Department.

Organization Chart:



3. MUNICIPAL WORKFORCE

Like most Massachusetts municipalities, Somerville’s municipal workforce consists of both union and non-union employees, filling both full- and part-time positions. There are approximately 1,800 City employees. Of this amount, approximately 900 work in the Somerville schools.

Union membership and representation is very strong across almost all City departments. Below is a brief illustration of the workforce, not including the School Department:

CITY OF SOMERVILLE WORKFORCE ANALYSIS JANUARY 2009*		
Workforce Group	Number of City Employees	Percentage of City workforce
NON-UNION	281	32%
Somerville Municipal Employees Association Unit B (SMEA B)	206	23%
Fire Suppression (FFA)	151	17%
Somerville Police Employees Association (SPEA)	97	11%
School Custodians (Local 3)	51	6%
Somerville Police Superior Officers Association	28	3%
Somerville Municipal Employees Association Unit A (SMEA A)	27	3%
Somerville Municipal Employees Association Unit D (SMEA D)	15	2%
Service Employees International Union Local (NAGE)	14	2%
FAO Fire Alarm Operators	10	1%
Total City Workforce	880	100%
<i>* Does not include school employees or crossing guards.</i>		
<i>NOTE: Union employees account for approximately 65% of the City workforce (much higher if you include School Employees).</i>		

4. COLLECTIVE BARGAINING

Chapter 150E of the Massachusetts General Laws requires “collective bargaining” between management and workers’ representatives. Collective bargaining is the mutual obligation of employers’ and employees’ representatives to meet at reasonable times and confer in good faith with respect to wages, health insurance, work hours, standards of productivity and performance, and other terms and conditions of employment. The final contract is called a collective bargaining agreement.

COLLECTIVE BARGAINING AGREEMENTS

Effective Dates of the City of Somerville’s Nine Certified Collective Bargaining Units as of February 11, 2009

Bargaining Unit	Dates of Most Current Contract	
	Effective Date	Expiration Date
SMEA Unit A	July 1, 2005	June 30, 2008
SMEA Unit B	July 1, 2005	June 30, 2006
SMEA Unit D	July 1, 2007	June 30, 2010
Local 76, Fire Suppression	July 1, 2004	June 30, 2007
Local 76, Fire Alarm	July 1, 2004	June 30, 2007
SPEA (NOTE: 2 CBAs were executed simultaneously)	July 1, 2004	June 30, 2008
SPSOA	July 1, 2004	June 30, 2006
SEIU, Local 888 (E-911 Call Taker/ Dispatchers)	July 1, 2005	June 30, 2008
NCFO / SEIU, Local 3 (School Custodians)	July 1, 2004	June 30, 2006

NOTE: Only SMEA Unit “D” has a current contract which is set to expire on June 30, 2010. Currently, the following bargaining units are at some stage of negotiation:

- SMEA Unit “A”
- SMEA Unit “B”
- SPEA (Patrol)
- SPSAO (Superiors)
- SEIU Local 888
- NCFO / SEIU Local 3

5. FINANCIAL PRIMER

The City of Somerville's financial practice centers on the planning and management of two major activities: collection of revenues and controlling expenditures. In order to do this, Somerville follows annual financial practices and procedures comprised of:

Budget Formulation and the Budget Process

The Budget process: following Mayoral guidelines, department heads formulate their annual budget plans for personnel compensation and other expenditures, such as supplies, equipment, contractual obligations, and administrative costs. The budgeting of capital and infrastructure projects must conform to the overall capital improvement plans of the City.

Recently, with the assistance of the John F. Kennedy Harvard School of Government, Somerville put in place a performance-based budget, comprised of performance metrics and efficiency measures to monitor each department throughout the fiscal year.



Budget Execution and the Tracking of Revenues and Expenditures

Once the annual operating budget is passed in the form of an Appropriation Order (appropriations) by the Board, the City can begin expending funds (paying staff, formalizing contracts, etc) and collecting revenues (taxes, fees, fines, permits, and other charges) as specified by the approved budget.

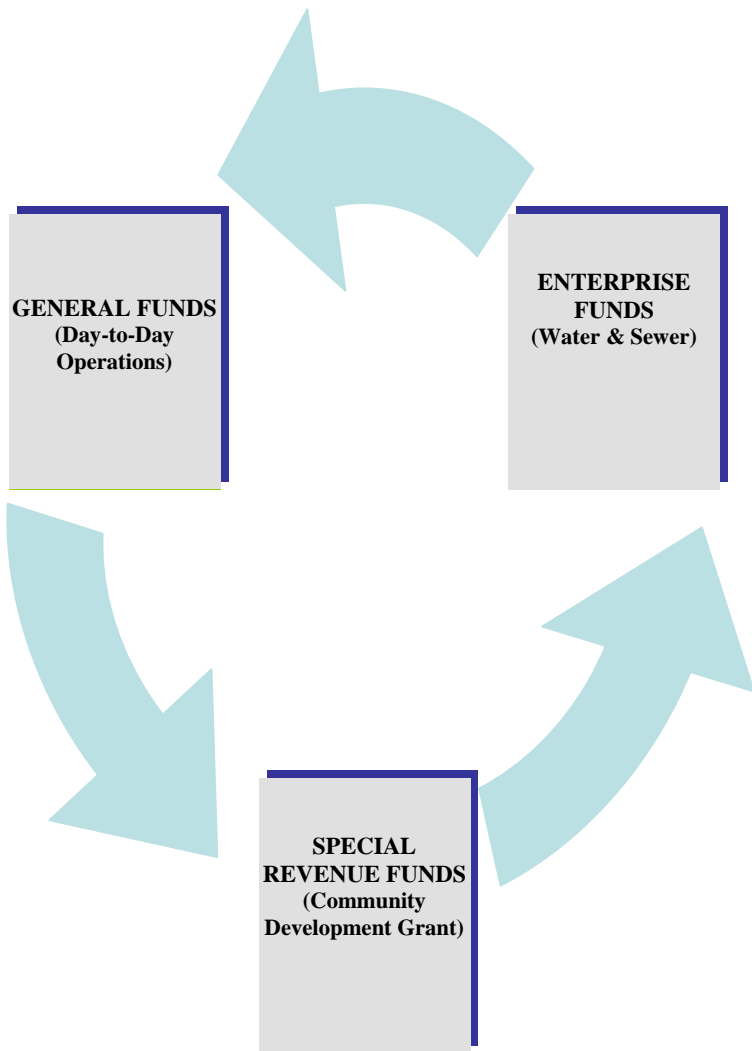
Throughout the fiscal year, Somerville may issue bonds or short term notes to finance capital and infrastructure projects.

Analysis: ongoing analysis of revenues and expenditures allows the City to make mid-year adjustments, identify surpluses and deficits, and reprogram funds when and if necessary.

Standard accounting procedures are carried out internally on a day-to-day basis in accordance with all relevant Massachusetts General Laws and Generally Accepted Accounting Principles for Government. An external audit of City finances is carried out at the end of each fiscal year.

A common misconception is that cities and towns have unlimited funds to spend when providing basic services. In fact, the Mayor and the BOA are limited by revenues collected and laws to spend funds in a specific manner, depending upon the funding source. Fund accounting is the way the City of Somerville segregates monies according to their intended purpose. Each fund is an independent set of self-balancing accounts.

There are several types of funds in Somerville that follow the guidelines of governmental accounting. The manner in which these funds can be spent is dependent upon a number of factors (i.e. the fund “type” and State/Federal law).



The **General Fund** is the City’s primary operating fund, providing for most of the daily operations with very few restrictions on expenditures. Examples of general fund expenditures include Police, Fire, Public Works, and Finance and Law.

Special Revenue Funds account for revenue sources that are legally restricted to expenditures for specific purposes. Expenditures are usually restricted by State or Federal law. An example of a special revenue fund is the Community Development Block Grant fund.

Enterprise Funds are used to account for operations that are financed and operated in a manner similar to private business. By law, enterprise funds can only be used to provide the services associated with the service fee. The City’s water and sewer funds are examples of enterprise funds.

6. EXPENDITURE SUMMARY

The City of Somerville provides a wide variety of services to its residents. Among these services, education, public works, and public safety take up the greatest majority of resources. In recent year, the City of Somerville has experienced drastic increases in the amount it pays for health care and insurance for employees.

Major Budget Expenditure Categories*	
Category	Percentage of Budget
Education	30%
Public Safety	19%
Health Insurance	15%
Public Works	12%
Pensions	8%
All Other	16%

* In FY 2009, salaries and expenses accounted for over 77% of all budget expenditures.

Except for the School Department, the annual appropriations order specifies departmental expenditure authorizations by (A) salaries and wages, (B) expenses, (C) debt service and capital outlay, (D) fringe benefits, and (E) intergovernmental charges.

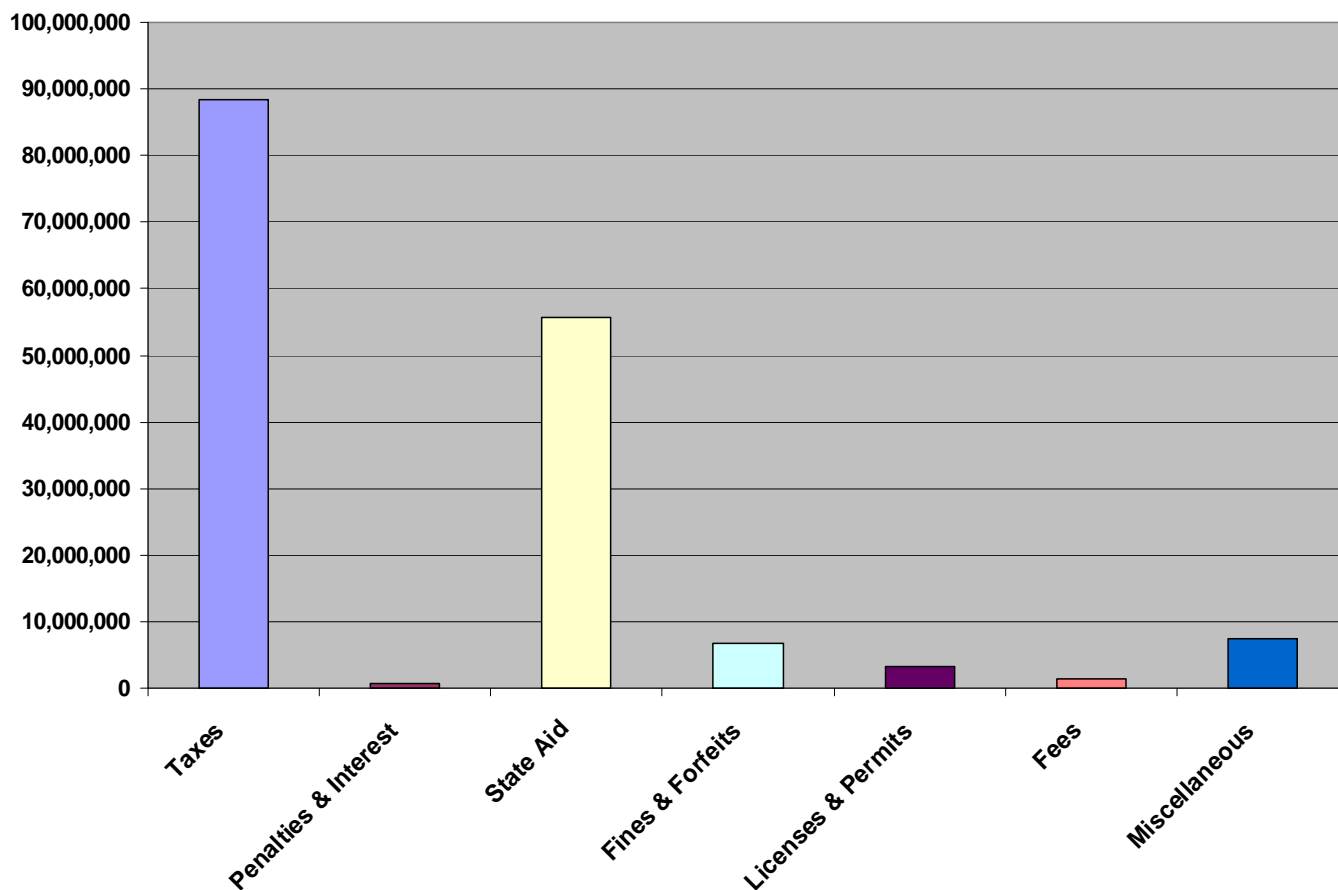
The School Department appropriations are adopted at a single line level for the entire system in the categories of (A) salaries and wages, (B) expenses, and (C) capital outlays.

7. REVENUE SUMMARY

The City of Somerville relies on three main sources of income to support the services it provides to residents:

1. Taxes
 - a. Real Estate & Personal Property
 - b. Motor Vehicle Excise
 - c. Payment in lieu of taxes (PILOT)
2. State Aid
3. Local Receipts (fines, licenses, permits, fees)

REVENUE BY SOURCE



8. BONDS AND BORROWING

Each year, Somerville issues a series of debt obligations (municipal bonds) to help raise money to finance operating costs and capital projects, such as water and sewer infrastructure, road, parks, buildings and school construction, and other infrastructure projects.

Somerville issues both short- and long-term debt:

Short-term debt is issued to fund capital project costs incurred prior to obtaining permanent financing through issuance of bond anticipation notes (BANS). Short term loans are general obligations and carry maturity dates that are limited by statute. Interest expenditures and expenses for short-term borrowings are accounted for in the general fund and the capital projects fund, respectively.

Long-term debt is used to fund capital and infrastructure projects that are too expensive to be financed from current revenues. In general terms, this refers to projects larger than \$250,000.

Long-term obligations are expected to be paid back within a period not to exceed the expected useful life of the project. Pay back periods are stipulated by statute. To the extent possible, user fees are set to cover the capital cost of enterprise type services or activities (water/sewer charges).

Bond Ratings

The City of Somerville's general obligation bonds are rated extremely favorably by the credit rating agencies; considered "High Quality."

Financing Type	Moody's	Standard and Poor's
General obligation bonds	Aa3*	A+

*In FY 2008, Moody's upgraded the City's credit rating to Aa3, the highest rating in the City's history.

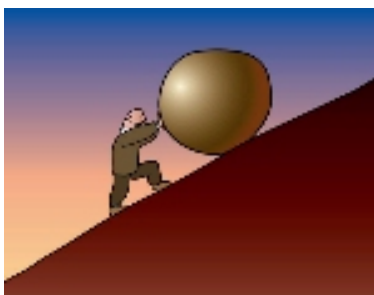
"The city's already large, \$8.7 billion tax base will continue to expand and diversify given the city's favorable location and a number of substantial projects expected in the near- to medium-term."
- Moody's.

"The positive outlook recognizes recent and ongoing significant tax base growth occurring from strong redevelopment activities and the city's successful management of that growth to date."
- Standard & Poor's

For detailed information related to Somerville's short- and long-term debt obligations, please see attached.

9. FINANCIAL CHALLENGES

Virtually all Massachusetts cities and towns face a series of long- and short-term financial challenges on an annual basis. Many costs, particularly health insurance, utilities, and pension costs, are rising faster than the revenues collected to pay for them. Massachusetts also is restricted in its ability to tap new sources of local revenues, such as local options taxes (meals or hotel/motel tax). In addition, State aid for Massachusetts cities and towns was dramatically reduced during the period of FY 2002-2004 and has never recovered to its previous levels.



Specifically, Somerville is hampered by the convergence of four major forces:

Proposition 2½ and over-reliance on property taxes:

Proposition 2½ subjects Massachusetts cities and towns to two distinct property tax limits:

1. **Ceiling:** The total annual property tax revenue raised by a municipality shall not exceed 2.5% of the assessed value of all taxable property contained in it.
2. **Increase limit:** The annual increase of property tax cannot exceed 2.5%, plus the amount attributable to taxes that are from new development.

These limits refer to the entire amount of the annual tax levy raised by a municipality. The property taxes are the sum of: (a) residential real property; (b) commercial real property; (c) industrial real property; and (d) business-owned personal property. In practice, Proposition 2½ usually limits the tax bills of individual taxpayers, but only indirectly.

The property tax levy in Somerville currently is \$91,871,710, approximately 4% higher than the previous year. Somerville only is \$35,000 under its Proposition 2½ levy limit, and may only raise taxes based on the 2.5% factor plus new growth. Fortunately, Somerville has historically relied on new economic growth and development to bring about new levy growth. Other Massachusetts cities and towns have not been so lucky.

In FY 2009, new growth allowed an increase of \$2,062,000.

In addition, a side effect of Proposition 2½ is that municipal income declines in real terms whenever inflation rises above 2.5%. Historically, inflation has been well above 2.5% for a majority of years since 1980, resulting in a real decline in local tax rates and local spending ability.

The over reliance on the regressive property tax also has increased to historic levels, as they now pay for a higher portion of local budgets (53%) than at any time since FY 1982. A dramatic shift can be seen in Somerville since FY 2001:

- FY 2001 property taxes funded 41% of the budget
- FY 2009 property taxes funded 52% of the budget

In 2007, 76 Massachusetts cities and towns held override votes. With the current economic conditions, it is unknown how many more communities will be forced to hold override votes during the next fiscal year.

Rising costs: health, energy, utilities, and pensions:

Health care is the fastest growing cost for all municipal employers. Somerville's costs are expected to increase, on average, by 12% per fiscal year. Currently, health insurance costs the City around 15% of all expenditures in FY 2009. As costs continue to escalate, Somerville has less and less capacity to meet its health care obligations to employees.

One solution to mitigating rising health insurance costs is to renegotiate health plan design and contribution rates. Recently, towns and cities across Massachusetts have turned to increasing the ratio of employee and retiree contributions for health insurance. Somerville recently increased the contribution percentage for all non-union employees from 90/10 to 80/20. The School Department non-union employees remain at 85/15, and the School Department's bargaining units all remain at 90/10.

Energy costs, such as fuel, gasoline, and other utility increases, continue to negatively impact the City's bottom line, just as they do residential and commercial customers. Somerville is taking aggressive action to reduce consumption and be more efficient. The City currently participates in a regional purchasing consortium for gasoline and heating oil, providing competitive prices due to bulk purchasing power (the City pays roughly $\frac{3}{4}$ of the price consumers pay at the pump).

Other escalating costs include the price of liquid asphalt (rose from \$394 per ton to \$600 per ton in less than a year), heating oil, natural gas, and electricity. As a result, Somerville intends to competitively bid out electricity and natural gas.

The Somerville Retirement System Pension costs continue to escalate. Costs went up by \$590,015 in FY 2009 – which makes up 8% of the budget. In addition, sizeable increases are projected for the foreseeable future.

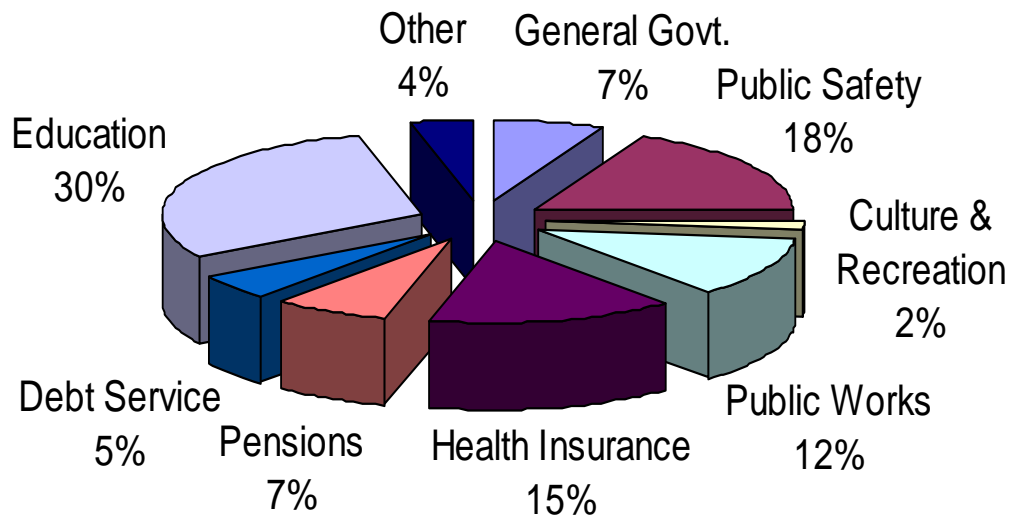
10. BUDGET OVERVIEW

The FY 2008 Proposed Budget Appropriation was \$158 million, which was about \$4 million (2.8% increase) more than FY 2007.

FY 2008 was an extremely positive operating year. Highlights included:

- The highest credit rating in City history (Moody's Aa3)
- The 6th consecutive year of budgetary surplus
- Property taxes, motor vehicle excise, and investment earnings continued to outperform targets; yet shrinking over time; and
- Continued robust economic and commercial development:
 - Assembly Square development and Orange Line Station
 - Somerville Avenue/Union Square Project and Green Line Extension
 - Davis Square hotel

FY 2008 General Fund Pie Chart:

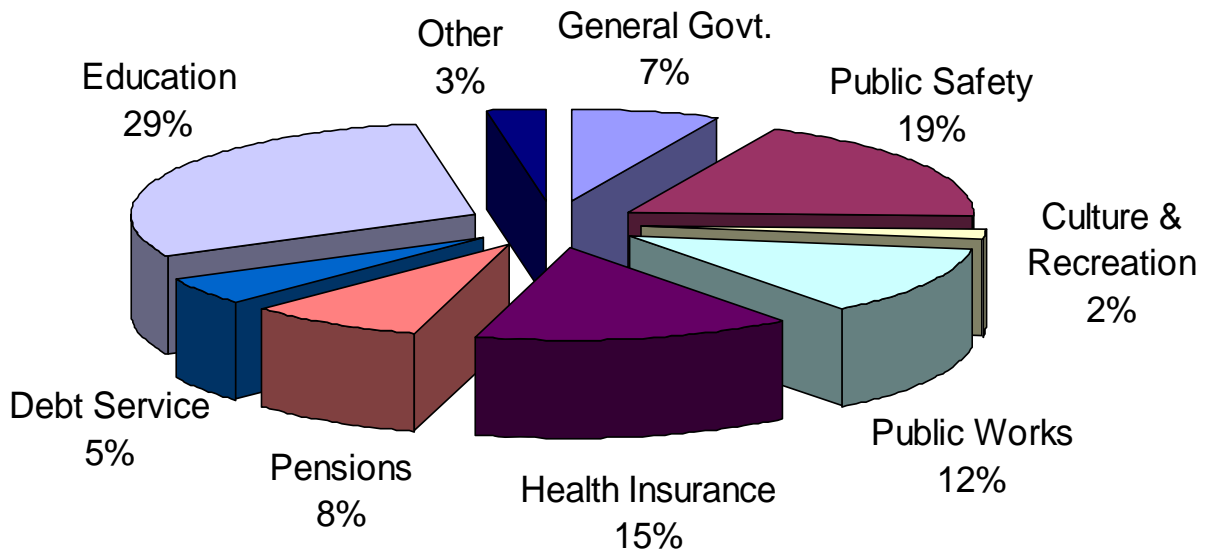


The FY 2009 Proposed Budget Appropriation was \$165 million, which was about \$7 million (4.5% increase) more than FY 2008.

FY 2009 operating results still are a work in progress. Challenges include:

- Salaries and expenses are climbing = 78% of overall budget
- Local Aid was anticipated to support 32% of the FY 2009 operating budget. HOWEVER, mid-year reductions of approximately \$3 million in local aid drastically changed the financial outlook
- Extremely difficult to adjust to mid-fiscal year cuts
- Several initiatives currently underway to reduce expenditures and raise additional revenues by the Mayor and Administration
- Financial Advisory Committee recently formed to help with long-term budget recommendations and suggestions

FY 2009 General Fund Pie Chart:



11. FY 2009 & FY 2010 BUDGET CUTS

FY 2009 Budget Cuts

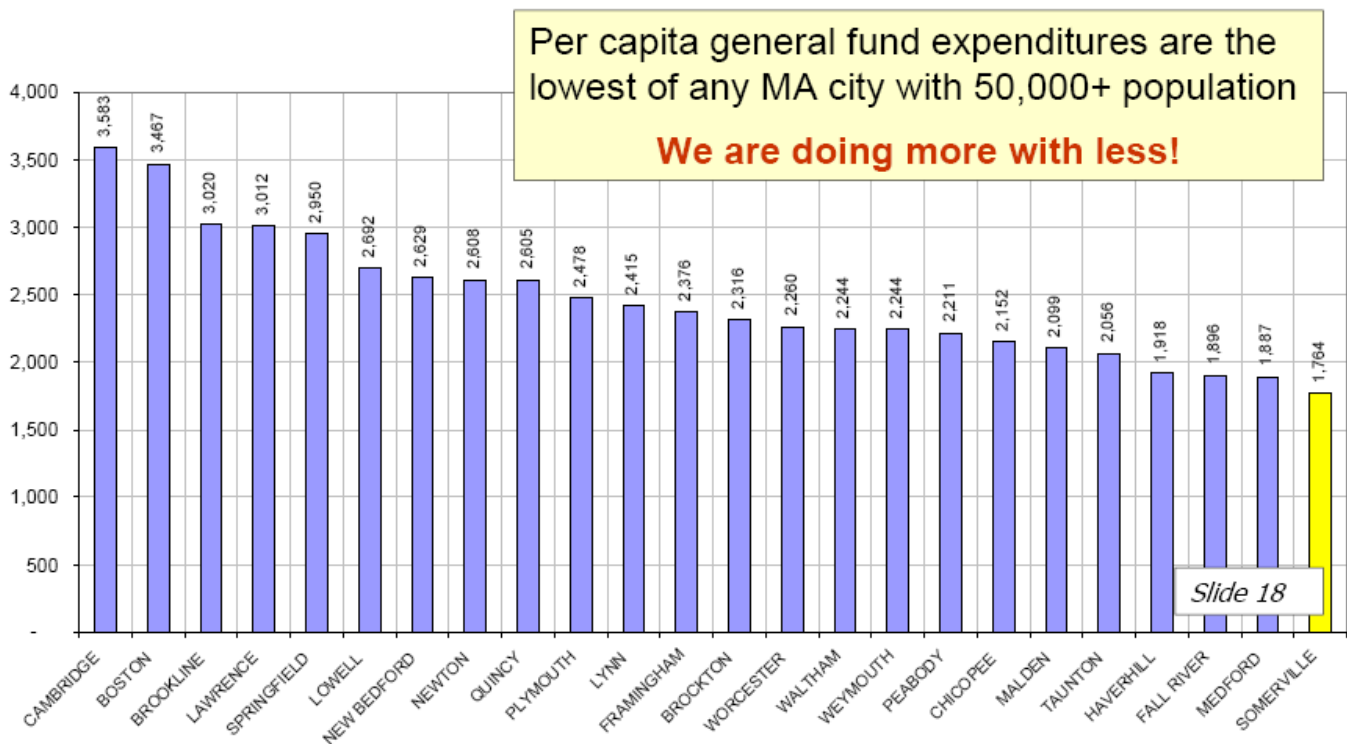
In January 2009, Governor Patrick announced that he would cut local aid to Massachusetts cities and towns by 9.7% or \$128 million for FY 2009, and an additional \$220 million in FY 2010. As a result, **Somerville must find a way to make up an unanticipated \$3 million shortfall before June 30, 2009.**

In order to do this, the Administration has implemented a series of short-term strategies to reduce expenditures and increase revenues. Although ending FY 2009 on a positive note will be extremely challenging, Somerville is poised to reap the benefits of historically sound financial management practices, as well as its proven ability to do more with less.

FY07 General Fund Expenditures Per Capita for 50,000+ Population Cities

Source: Massachusetts Department of Revenue Municipal Databank/Local Aid Section

<http://www.dls.state.ma.us/Allfiles.htm>



A few examples of short-term budget strategies currently being implemented include:

- Re-evaluating all revenue sources (fees, fines, permits, and all other charges)
- Achieving savings via attrition and wage freezes
- Reducing consumption and expenditures
- Increased reliance on technology

FY 2010 Budget Cuts

The proposed FY 2010 budget cuts pose a much more serious and complicated set of budgetary constraints. As proposed, the Governor's plan relies on a host of tentative and one-time sources of revenues to help close a three billion dollar State budget gap. The plans calls for over \$590 million in new taxes and driving-related fees, draws heavily on expected Federal relief funds, and contains a slew of one-time revenues from cash reserve accounts.

The two biggest issues with the Governor's plan are that it requires legislative action and the new revenue sources are susceptible to prevailing economic conditions. Taken together (an economic recession and new Leadership in the State Legislature), the outlook for a balanced FY 2010 budget.

It should be noted that the City of Somerville enjoys a very solid relationship with the Patrick Administration, its Legislative Delegation, and Legislative Leadership. The Mayor strongly supports the Governor's efforts to diversify revenue options for Massachusetts municipalities. While we remain confident in the Governor and Legislature, the City of Somerville must plan conservatively to continue meet the needs of our residents in these difficult economic times.

Some of the Governor's FY 2010 new revenue proposals include:

- Meals and Hotel Taxes: \$150 million from a 1-cent Statewide increase dedicated to reducing local aid cuts; and \$200 million for an additional 1-cent increase at local option.
- Commonwealth Wellness Fund: \$121.5 million from eliminating sales tax exemption on alcohol, candy and sweetened beverages dedicated to public health programs.
- Bottle Bill: \$20 million from expanding the 5-cent recycle deposit to include plain and flavored water, coffee-based drinks, juices and sports drinks.
- RMV fees: \$74.5 million from updated and consolidated Registry of Motor Vehicle (RMV) fees dedicated to the state Highway Fund.

As it stands, however, Somerville stands to lose over \$6.2 million from its local aid base in FY 2010. (FY 2009 Cherry Sheet Estimate = \$53,411,710; FY 2010 Governor's Budget = \$47,190,208.)

The Local Option 1% meals tax initiative would yield an additional \$988,870 in revenue; the local option hotel/motel increase yields an additional \$98,943; and the closure of the telecommunications property tax loophole brings in an additional \$105,342. The net loss in state aid revenue for the City of Somerville under the current plan is \$5,028,347.

Many of the City's Local Receipts also are sensitive to changes in the economy, most notably Motor Vehicle Excise, Investment Incomes, Building Permits, and Condo Application Fees. It is expected that local receipts will drop by at least \$2 million in FY 2010.

When combined with state aid cutbacks, Somerville could well face more than a \$7 million dollar revenue shortfall in FY 2010.