

## Budget Guidelines

This section contains budget guidelines, which the Committee expects to be an integral part of the annual budget process. The guidelines are intended to provide on-going guidance to the Borough Council and administration as they work to achieve the mission of the budget:

*The Borough's annual municipal budget shall be established to provide and support the services desired by the residents. The principles employed in its formulation shall include financial prudence, consistency, stability and predictability. The realities of inflation and compliance with New Jersey legal requirements must be considered.*

The guidelines should not be considered as hard and fast rules that cannot tolerate exceptions. Rather, they should be seen as a firm, but flexible rubric that needs to be complied with over the long term, with any material deviations publicly disclosed and explained as part of the budget process.

The percentages and ranges used in the proposed guidelines are based on the Borough services and the available revenue mix used to fund those services for the 20-year period of 1994-2014. If unanticipated changes occur to services or their funding, numbers embedded in the guidelines will need to be re-examined and possibly changed. In extreme cases, such as a natural disaster or suspension of a major funding source, the guidelines may have to be temporarily suspended.

## Municipal Surplus

**GUIDELINE 1A:** Surplus included as revenue in any annual budget should not exceed the amount of surplus generated in the prior calendar year.

*Surplus included as revenue is essentially a contingency reserve or cushion within the budget, intended to protect the Borough against revenue shortfalls and to provide funds should additional spending be needed for operations. The intent of this guideline is to smooth or stabilize the amount of surplus used in the annual budget (and avoid the swings of history) while allowing modest increases over time. The prior year constraint helps prevent surplus from falling below desired levels. The use of such a constraint is a practice rating agencies prefer to see.*

Shown on the next page is a 6-year historical view of budgeted surplus in revenue vs. the guideline ("maximum allowed" in the table). Because surplus in revenue is essentially a "budget cushion," it may be helpful when applying this guideline to see this cushion as the sum of (a) the reserve for uncollected taxes plus (b) 8-12% of operating appropriations other than the tax reserve ("upper bound").

\$000s	Budgeted Amounts		Surplus in Revenue		PY Surplus Generated	Tot. Surplus less Surplus in Revenue
	Tax Reserve	Operating Appropri.	Tax + 12% Opn. App.	Budget		
2014	1,600	22,109	4,253	3,597	4,246	3,628
2013	1,560	20,771	4,053	2,975	4,027	2,619
2012	1,500	20,551	3,966	2,800	3,591	1,528
2011	1,500	20,690	3,983	3,635	3,638	758
2010	1,497	20,536	3,961	5,227	3,416	780
2009	1,497	20,942	4,010	5,200	3,854	2,574
			<i>Upper Bound(b)</i>		<i>Maximum Allowed(a)</i>	

(a) The \$4,246K shown as surplus generated in 2013 excludes FEMA recoveries.

(b) "Tax + 8% Opn. App." would be \$3,369K in 2014; \$3,222K in 2013; \$3,144K in 2012; \$3,155K in 2011; \$3,140K in 2010; and \$3,172K in 2009.

**GUIDELINE 1B:** Surplus at the end of any calendar year should be 20-25% of total appropriations for the coming year.

*The guideline range (a) provides a prudent amount of "surplus as revenue" for inclusion in the annual budget while (b) maintaining an ample balance sheet reserve for emergency situations, unique, one-time developments and contingent liabilities. The range is also consistent with best municipal practices, third-party analyses<sup>1</sup> and rating agency criteria for the most highly rated municipalities.*

**GUIDELINE 1C:** Surplus in excess of the upper end of the Guideline 1B range (i.e., >25%) may only be used for the capital improvement fund or to pay down debt (including the pre-funding of obligations).

*The intent is for "excess surplus" to be used for improving the long-term financial condition of the Borough, not for near term or operating appropriations.*

*NOTE: Guidelines 1A and 1C operate independently. It is therefore possible that (i) surplus transferred to the municipal budget could be constrained by 1A (i.e., no more than the surplus generated in the prior year) AND (ii) there might be excess surplus available for further transfer under 1C (depending on the absolute amounts of year-end surplus and the coming year's appropriations).*

<sup>1</sup> See, for example, "Benchmarking and Municipal Reserve Funds: Theory versus Practice," by Michael Shelton and Charlie Tyer with the Assistance of Holly Hembree, available online at [http://www.ipspr.sc.edu/publication/Municipal\\_Reserves.htm](http://www.ipspr.sc.edu/publication/Municipal_Reserves.htm).

## Operating Revenues and Appropriations

**GUIDELINE 2:** For the current level of municipal services, the budgeted operating shortfall (as defined and explained in the "Observations" section above) should not exceed 7% of total appropriations.

*Operating shortfalls result from historical decisions regarding: (a) the type and level of services provided by the Borough, b) how those services are paid for by Borough taxpayers and service users, and (c) a conservative budgeting practices. To the extent that future service levels or costs cause the operating shortfall to increase, any incremental shortfall beyond the 7% threshold should be funded by additional operating revenue rather than higher utility transfers.*

## Utility Transfers

**GUIDELINE 3A:** Utility budgets should recognize that future municipal budgets will likely require utility transfers up to 22% of total municipal appropriations.

*The 22% figure is the average for the 1994-2014 budgets. It can be viewed as the sum of 7% for operations (per guideline 2 above) and 15% for capital (debt service and CIF).*

**GUIDELINE 3B:** Surplus from any utility should only be transferred to the extent that the utility's surplus remaining after transfer is at a level considered sufficient for (a) working capital, (b) capital expenditures and (c) a reasonable cushion for contingencies.

*The two utility guidelines reflect the historical role of the two utilities in providing funds for the Borough's budget. As a result, they create a priority of uses for the utilities' Fund Balances. For the foreseeable future, the Borough will require \$1.5 million of utility transfers for operations, and that need has top priority. After that, the two utilities should have ready and immediate access to back-up and emergency funds (i.e., "retained surplus") consistent with the scope of their operations and expected service levels before transferring any surplus to municipal capital projects (i.e., enough for working capital, capital expenditures and contingencies).*

*The level of "retained surplus" requires further analysis, which is pending until reports are received from consultants engaged by the Borough to examine utility operations. It is possible that surplus retained by the utilities may reduce the amount available for transfer to the municipal budget in any given year. As a result, the Borough Council may have to consider raising utility rates, municipal fees and/or property taxes to balance the municipal budget. Such actions would require the Council and administration to weigh the impact of various options and to communicate to the public the rationale for the option ultimately selected.*

## Debt Service and Incurrence

**GUIDELINE 4A:** Debt service (interest and principal) within the municipal budget should not exceed 10% of total appropriations.

**GUIDELINE 4B:** New borrowing should generally be limited to capital assets having a useful life of at least 15 years. Exceptions can be made for a capital asset, which generates revenue resulting in a reasonably attractive return on the investment required for the asset.

*The two debt guidelines are prudent limits on "mortgaging the Borough's future" and are consistent with rating agency thresholds for the most highly rated municipalities.*

## Capital Funding

**GUIDELINE 5:** The Capital Improvement Fund (CIF) line item in each municipal budget should be no less than 10% of total budgeted appropriations.<sup>2</sup>

*Ideally, the annual CIF amount should be based on a multi-year capital improvement schedule, which would show year-by-year capital expenditures for the Borough and its utilities and would be updated annually. We encourage the Borough to prepare such a schedule, building upon the work already done by the Capital and Utility Committees. We propose a minimum percentage for the CIF because there has been a historical practice of reducing or even eliminating this important line item from the budget. Our upper end percentage is consistent with the Capital Committee's estimates for the 2015-19 period, but does take into consideration issues still being worked on by the Utility Committee.*

*While capital SPENDING can swing from "large and lumpy" in a given year to "reasonably small" in other years, it is prudent to smooth the BUDGETING for such spending over time even if this means appropriating the money before it is needed. Because Madison is an old town, it is reasonable to provide for regular and consistent appropriations to maintain and update the Borough's aging infrastructure.*

*It is equally reasonable to develop a multi-year revenue plan for the CIF appropriations. The CIF historically has been funded almost exclusively by transfers from the electric utility and non-recurring revenue sources (e.g., property sale). But the amounts from these sources have varied considerably year over year, both in annual amounts and in mix. Much more reliable and predictable funding is needed.*

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<sup>2</sup>This guideline does not apply to the CIF at the two utilities. The guideline range does not reflect capital spending embedded in operating appropriations.

## Property Taxes

**GUIDELINE 6A:** Property taxes in the municipal budget should be maintained at prudent levels after considering (a) inflation, (b) increases in municipal appropriations and (c) the availability of utility transfers and other municipal revenue.

*Since 2010, total appropriations have grown at a compound annual rate of 4.5% while property taxes rose only 1.7%. More significantly, total appropriations increased substantially in 2014 compared to 2013 while property taxes remained flat (and the budgeted municipal tax rate went down). Given the Borough's needs, particularly with respect to capital expenditures, a "no increase" approach to property taxes is unsustainable. It seems more reasonable to increase property taxes modestly every year, as allowed by statutory caps.*

**GUIDELINE 6B:** Maintain the reserve for uncollected taxes at its current 2.63% of the total tax levy (about \$60 million). Increasing the magnitude of the reserve can be considered when there is a significant decrease in actual collection rates or settlements of valuation appeals materially lowering the amount of taxable property.

*As the collection agent for the Madison School District and Morris County, the borough bears the sole risk of any uncollected taxes and establishes an annual reserve for this risk. While actual collections have been significantly better than the reserve would imply<sup>3</sup>, the Borough's historically conservative approach allows the "excess reserve" to be an embedded form of surplus generation in the annual budget.*

## Guideline Reports

**GUIDELINE 7:** As part of each budget cycle, the Chief Financial Officer should prepare and present to the Council the following three reports;

- A. A 5-year history of how budgets have performed relative to the guidelines, highlighting any adverse trends.

*As an example, no municipal funds, other than one-time property sales and general capital fund transfers, were allocated to the CIF for the 2008-12 period. As a consequence, significant portions of the Borough's infrastructure fell into disrepair, which was most apparent in the condition of its roads. Such a trend should have been uncovered and probably rectified earlier. A publicly available trend analysis would have underscored this situation.*

- B. A comparison of the proposed current year's budget against the guidelines and their 5-year trends, highlighting and explaining any material variances from the guidelines.

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<sup>3</sup> The reserve included in the 2014 budget implies an expected collection rate of 97.3% compared to an average actual collection rate of 99% over the 2008-13 period.

*A current year report is intended to (i) bring the Council's and public's attention to budgeted items that differ from targets endorsed by the Council, (ii) explain the administration's reasoning behind any guideline variances and (iii) prompt early and fact-based discussion of important budget issues.*

- C. At least a "budget in brief" document for each of the next 3 years (i.e., 2016-18 for 2015).

*A multi-year approach to budgeting will serve as an early warning of any looming financial issues, both positive and negative, that may require advanced planning to address and could have implications for the current year's budget.*

**RESOLUTION OF THE BOROUGH OF MADISON ADOPTING BUDGET GUIDELINES FOR 2016**

**WHEREAS**, the Madison governing body previously authorized a comprehensive Strategic Plan process for the Borough of Madison concentrated on the areas of the municipal budget, capital budget, operations/communications and utilities; and

**WHEREAS**, the Municipal Budget Strategic Plan Committee was appointed consisting of dedicated resident volunteers with staff support from Borough Administration; and

**WHEREAS**, the Committee was charged with reviewing the current budget process and preparing a report for the current and future Borough Councils that would include observations and recommendations in the form of general guidelines and "Best Practices"; and

**WHEREAS**, the Committee initiated, completed and initially presented their report to the Council in 2014; and

**WHEREAS**, the Committee has prepared the attached Budget Guidelines to provide on-going guidance to the Borough Council and administration as they annually prepare the municipal budget; and

**WHEREAS**, the guidelines should not be considered as hard and fast rules that cannot tolerate exceptions, but rather be seen as a firm, but flexible rubric that needs to be complied with over the long term or revised accordingly, with any consistent material deviations publicly disclosed by the CFO and explained as part of the annual budget process; and

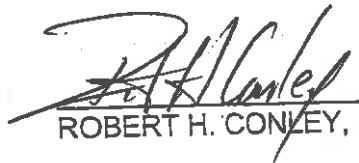
**WHEREAS**, the annual municipal budget shall be established to provide and support the services desired by the residents. The principles employed in its formulation shall include financial prudence, consistency, stability and predictability subject to the realities of inflation, emergencies and New Jersey legal requirements.

**NOW, THEREFORE, BE IT RESOLVED**, by the Council of the Borough of Madison, in the County of Morris and State of New Jersey as follows:

- (1). The attached budget guidelines are approved for the preparation of the 2016 municipal budget and will be reviewed and readopted or revised at the 2017 reorganization meeting on January 1<sup>st</sup> and future reorganization meetings thereafter.
- (2). The Chief Financial Officer (CFO) shall prepare a five (5) year history of how budgets have performed relative to the guidelines, highlighting any adverse trends, a comparison of the proposed annual budget against the guidelines and their five (5) year trends, highlighting and explaining any material variances from the guidelines and a three (3) year budget projection when the annual budget is initially presented to the governing body each year.
- (3). If the proposed budget is not in compliance with the guidelines, the CFO shall

indicate the actions required to bring the budget into compliance.

ADOPTED AND APPROVED  
July 13, 2015

  
ROBERT H. CONLEY, Mayor

Attest:

  
ELIZABETH OSBORNE, Borough Clerk