

How is our local government funded?

Let's break this down into three levels: 1) where money comes from, 2) where money is "held" to be spent, and 3) where this money goes.

Where Money Comes From

Northampton has a few main sources of revenue: property taxes, local receipts, state funds, and fees collected for services.

Property Taxes

Under state law (Proposition 2 ½), the city can collect at most 2.5 percent of the prior year's property taxes, plus new growth, unless there is a voter-approved override or debt exclusion. Over the last decade, inflation has ranged from approximately 2 to 6 percent, with particularly high rates of inflation post-pandemic. This means that **property taxes alone cannot keep up with inflation.**

Local Receipts

Luckily, Northampton derives more of its revenue from local receipts, such as meal and hotel taxes, cannabis fees, and permit fees, than most other municipalities, particularly in the Valley. These local receipts are a steady source of recurring revenue that are not subject to the same limits as property taxes.

State Funds

The city receives a steady stream of funds ("the cherry sheet") from the state government. This is determined by state legislation that does not materially fluctuate year to year.

Fees for Services

The city collects fees for some services, such as water, stormwater, sewer, and solid waste services. These services are "self-funded" by the fees paid to use those services, as we will see below.

Where This Money Is “Held”

All of these “receipts” are routed into a few different funds. In particular, property taxes, local receipts, and state funds are used for the *operating budget*. The fees for services are held in the *enterprise fund*. There is also something called the *reserve fund*; we’ll get to how this is funded in a minute.

Where This Money Goes

The operating budget is the primary source of funds for *city services*. This includes things like education, public works, public safety, and health and human services.

Like all municipalities, Northampton underestimates receipts and overestimates expenses as part of the budgeting process. This creates an operating surplus at the end of every fiscal year. One-time or unanticipated receipts, such as federal grants or insurance settlements, are added to this surplus. This total amount is certified by the state and becomes known as *free cash*,¹ which is routed back to the reserve fund.

Legally, free cash can be spent for any purpose. The current administration’s official policy is to use free cash as the primary funding source for capital expenditures. (Capital expenditures are also funded by some additional sources, which we won’t get into here.) A small part of this (1/12th) is reserved for city services in the fiscal stability.

Finally, the enterprise fund is routed to the appropriate services.

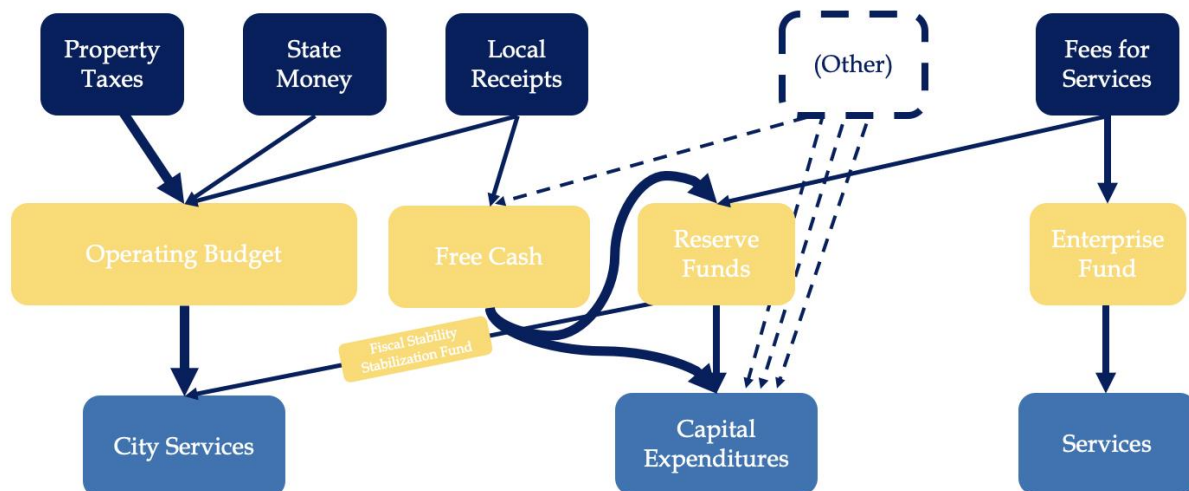
¹ State guidance advises municipalities to generate free cash of at least 5% of the overall budget per year. Northampton’s free cash has been well in excess of 5% in the last 3 years, although much of that excess was due to federal grant money.

The Big Picture

Putting this all together, we see that most money flows through the city as shown below. (Of course, this is high level document so we've left out a lot of details!)

While the flow of money for self-funded services is straightforward, the routing of funds for city services and capital expenditures is more complex.

The operating budget is comprised of property taxes (~60 percent), local receipts (~16 to 18 percent), and state money (~12 to 15 percent). This gets divided into many buckets.

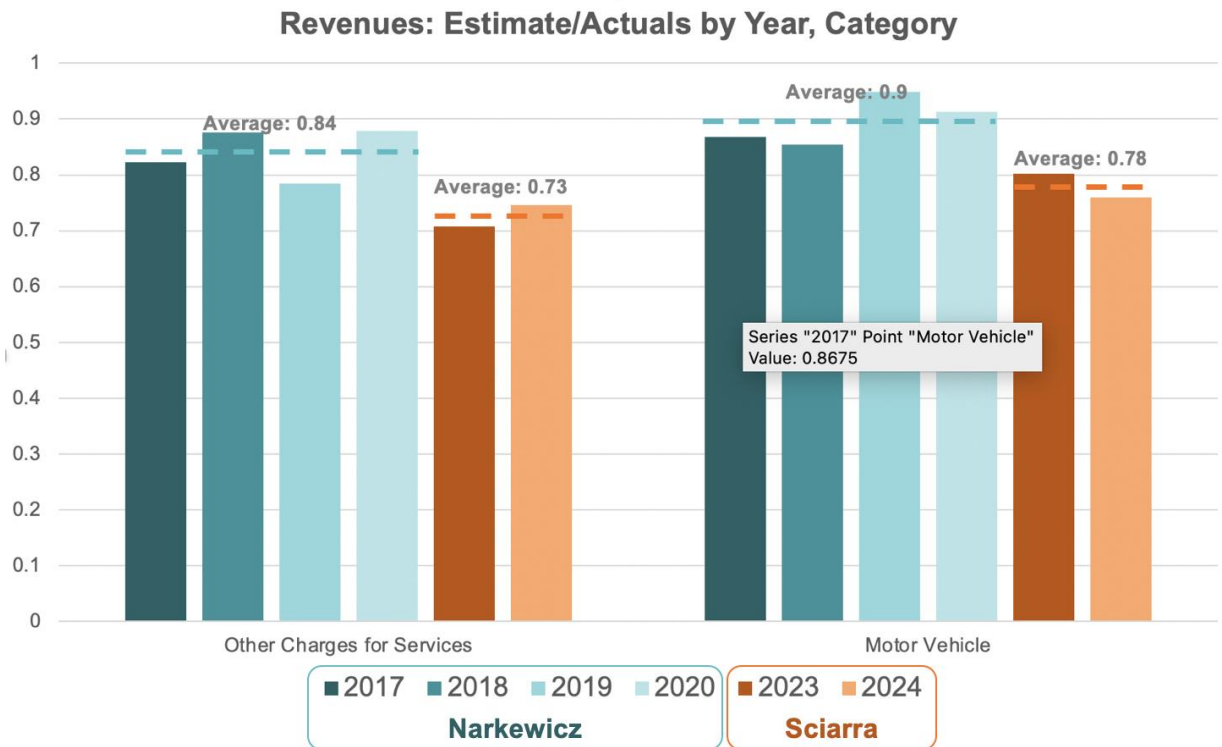


What Can We Do Better?

Better Forecasting

While a certain amount of cushion is appropriate when making budget projections, too much will result in a “cash-rich, service-poor” government. We have seen this happening under the current mayor.

The figure below shows the ratio of *estimated revenues* to *actual revenues* under Mayor Narkewicz (in green) and Mayor Sciarra (in orange). This is shown for the two largest receipt categories, that made up more than half of all receipts in 2023.



A ratio of *less than one* means that the administration *underestimates* revenues, whereas a ratio *greater than one* means that it *overestimates*. We expect this ratio to be less than one; this is prudent!

However, under Mayor Sciarra, this ratio has dropped significantly, resulting in more than \$1.5 million per year being routed to free cash and less money immediately available for city services. Coupled with overestimated expenditures, this results in an operating funding gap of about \$3 million per year.

We advocate for more realistic forecasting. By returning to projections that more closely align with the prior mayor's, our government will make more realistic forecasts while continuing to maintain a reasonable level of caution.

Alternate Capital Funding

We recognize that less free cash means less money headed to reserve funds and capital projects. However, Northampton's excellent bond rating means that we can secure advantageous debt financing (i.e., borrowing at a rate that is less than what we're earning on our investments) for more projects. This would reduce the reliance on free cash and reserve funds. This in turn would permit the city to maintain stable finances even if annual operating surpluses were lower. Northampton's current level of borrowing is significantly below both the city's and the state's recommended levels of debt financing. In other words, there is plenty of room to responsibly borrow more.