



MAYOR GINA-LOUISE SCIARRA

City of Northampton

Office of the Mayor

210 Main Street Room 12

Northampton, MA 01060-3199

(413) 587-1249 Fax: (413) 587-1275

mayor@northamptonma.gov

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FAQ: STABILIZATION FUNDS AND UNDESIGNATED FUND BALANCES

Northampton's operating budget for Fiscal Year 2025 must address the \$4.77 million deficit in the Northampton Public Schools budget. The deficit has grown in recent years because recurring expenses were covered with non-recurring revenues. Federal pandemic relief has been spent. The "school choice" account, which takes in tuition money from out-of-city NPS students, had built up \$4 million in reserves by Fiscal Year 2020 but is now all but depleted.

Solving the problem requires more than a one-year infusion of cash. We need to ensure that recurring expenses are covered by recurring revenues this year and beyond.

Arguments are circulating in local print and social media that the Northampton Public Schools budget deficit can be resolved with money taken from the city's "stabilization funds," and different management of what is known as "undesignated fund balances" (sometimes referred to as "free cash").

To help Northampton residents weigh these suggestions and better understand where their taxpayer dollars go, the following provides background information about the city's stabilization funds and how they are supported by undesignated fund balances.

What are stabilization funds? What stabilization funds does Northampton have?

Stabilization funds help maintain stability when budgets are stressed by unexpected events or accelerating cost increases.

According to the state's [Division of Local Services Financial Management Resource Bureau \[FMRB\]](#), "reserves should be used to fund unanticipated or one-time costs rather than to regularly fund operating expenses unless provisions are made to replenish the reserves."

There are two kinds of stabilization funds: general and special purpose. Northampton has one General Stabilization Fund and eight special purpose stabilization funds.

As described by the FMRB, a general stabilization fund provides “emergency funds for use in a major or significant event, such as natural disaster [or] damage to a capital asset.”

The eight special purpose stabilization funds have relatively narrower purposes:

Fiscal Stability: The Fiscal Stability Stabilization Fund helps cover anticipated—but sometimes faster-rising than expected—cost increases such as employee health benefits. This fund was created as a part of Northampton’s “Fiscal Stability Plan,” initially funded with revenue from the voter-approved 2013 property tax override and renewed by the 2020 override.

Because of the annual 2.5% limit on property tax revenue increases, imposed on Massachusetts cities by Proposition 2 1/2, municipal costs generally rise faster than revenues. The only way to go above the limit is through voter-approved overrides.

Under the Fiscal Stability Plan, when the Fiscal Stability Stabilization Fund declines to a certain level, that’s when we ask voters if they want to renew the Fiscal Stability Plan and replenish the fund with a new override.

Capital: The Capital Stabilization Fund supports capital projects to replace aging infrastructure and equipment so they don’t fall into disrepair because of financial neglect. Due to decades of deferred maintenance and insufficient planning for capital expenses, there are many critical building and infrastructure projects on the fiscal horizon. The five-year capital improvement plan was recently approved by the City Council for an estimated total of \$108.8 million over five years. The plan, which renews every year and all projects get reevaluated, anticipates spending at least \$15.7 million on projects for the Northampton Public Schools. That amount is likely low as major school building projects have been put on hold while NPS goes through their strategic planning process.

Climate: The Climate Change Mitigation Stabilization Fund, established in Fiscal Year 2023, was created to prioritize the community’s carbon-neutrality goals and to plan for costs to implement our climate resilience and regeneration plans. Possible needs include planning, and to be able to move quickly to be able to utilize state and/or federal grants which often require some investment or design work from the municipality. This fund will give us flexibility to be able to take advantage of opportunities and leverage more funds.

Opioid: The Opioid Settlement Stabilization Fund was created in Fiscal Year 2023 to handle money from the National Opioids Settlement and its uses are restricted to prevention, harm reduction, treatment, and recovery services. (Following an expected June vote by the City Council, this stabilization fund will be phased out and replaced with what's known as a special revenue fund.)

Enterprise: Four separate stabilization funds support our four enterprise funds—Water, Sewer, Solid Waste, and Stormwater and Flood Control. They help address critical maintenance needs. These are funded through service fees and the money cannot be repurposed.

How are stabilization funds funded?

The four Enterprise stabilization funds are funded indirectly through the service fees on your utility bill. When revenues are higher or expenditures are lower than expected, the unspent fees become part of “retained earnings” which then get appropriated into the stabilization funds.

The Opioid Stabilization Fund is solely from money from the National Opioids Settlement.

The Climate Change Mitigation Stabilization Fund was initially seeded with \$3 million from the federal American Rescue Plan Act's “loss revenue” program, which compensated municipalities for lost revenue from the pandemic.

The Fiscal Stability Stabilization Fund, as noted above, was created and sustained in part with money from periodic property tax overrides.

The Capital Stabilization Fund is partly funded by the general fund budget. In FY23 and FY24, it was funded with \$450,000 each year.

Also, the General Stabilization Fund, the Fiscal Stability Stabilization Fund, the Capital Stabilization Fund, and the Climate Change Mitigation Stabilization Fund receive money from bank interest and capital gains from investments, and can be negatively impacted by capital losses. And each receives money from undesignated fund balances.

What are “undesignated fund balances” or “free cash?”

Undesignated fund balances, also called “free cash,” are another type of one-time funds generated when the city spends less than anticipated or takes in more revenue than anticipated. Such money can be used for any lawful purpose. Unused balances at the end of a fiscal year carry over to the next.

The state’s [Division of Local Services Financial Management Resource Bureau](#) recommends that cities make cautious revenue and expenditure estimates in order to generate free cash, with a suggested target of recouping 5 to 7 percent of the operating budget.

To budget less cautiously—with overly optimistic revenue and expenditure estimates—risks running out of money in the middle of the fiscal year, which could force abrupt, mid-year staff cuts in schools or other city departments.

Undesignated fund balances are never guaranteed to materialize at the amount estimated in the yearly budget, if at all. In turn, the Bureau does not recommend using inherently uncertain undesignated fund balances to support recurring revenues. “We recommend,” [counsels the Bureau](#), “that as much as practicable, communities limit their use of free cash to funding one-time expenditures (e.g., capital projects, snow and ice deficits, or emergencies), or use it to fund other reserves.”

Northampton follows this guidance, with one-third of undesignated fund balances divided among the General, Fiscal Stability, Capital, and Climate Change Mitigation stabilization funds, one-third invested in immediate capital needs, and one-third kept in the undesignated fund balance account for unanticipated one-time needs and emergencies.

The General Stabilization Fund, Fiscal Stability Stabilization Fund, and the Capital Stabilization Fund each received from undesignated fund balances \$500,000 in Fiscal Year 2022, \$973,123 in Fiscal Year 2023, and \$798,127 in Fiscal Year 2024.

How much free cash does Northampton generate?

Between fiscal years 2018 and 2022, Northampton was generating between \$4,175,642 million to \$7,307,125 each year in undesignated fund balances, ranging between 4.4% and 7.3% of the operating budget—roughly in line with the state’s suggested target of 5% to 7%.

In 2023 and 2024, Northampton generated an unusually large amount of free cash, \$18,758,111 million in 2023 and \$12,986,869 in 2024. This is for two reasons: One, some of our federal pandemic aid (ARPA) went into the undesignated fund balance account, which as explained

above was permitted under ARPA regulations as lost revenue from the pandemic. Two, we used extra cautious budget estimates because of the economic uncertainty caused by the pandemic as local receipts had dropped. To not account for those market conditions could have created a mid-year deficit. When our local economy performed better than expected, we collected more revenue than expected. We have since adjusted most of our revenues back to prepandemic levels. Northampton is not unique in this experience of having generated more undesignated funds than usual. Other communities and the Commonwealth also had higher revenues than expected. This unprecedented situation and the resulting large undesignated fund balances will not happen again, barring another massive event resulting in huge federal interventions. We fully expect to return to normal levels of undesignated fund balance generation starting with the upcoming fiscal year.

How much does Northampton keep in its stabilization funds and undesignated fund balance account?

The General Stabilization Fund currently has \$5,632,028.57, which is 4.8% of the operating budget, slightly below the state's recommended target.

The Fiscal Stability Stabilization Fund has \$2,140,846.

The Capital Stabilization Fund has \$4,815,838.

The Climate Mitigation Stabilization Fund has \$3,862,362.

The Opioid Settlement Stabilization Fund has \$526,440.

The current total Undesignated Fund Balance is \$6,059,228.

\$2,649,884 is Undesignated Funds and \$3,409,344 of that total is the ARPA Loss Revenue balance. These ARPA Loss Revenue funds have been designated for the ARPA-eligible uses of covering the \$500,000 pandemic costs the city was not reimbursed for by FEMA, planned utility infrastructure upgrades and the Northampton High School road safety upgrades.

Can more money from stabilization funds and undesignated fund balances be used to support schools?

Money from the General Stabilization Fund, Fiscal Stability Stabilization Fund, and undesignated fund balances are technically permissible to be used for schools. In fact, last year

\$1.2 million from Fiscal Stability was used to help close what was a \$2.3 million deficit in the Northampton Public Schools Budget.

One-time injections of money from stabilization funds can make sense as a temporary measure when part of a larger multi-year fiscal strategy to end unsustainable budgeting practices, either by identifying additional recurring revenues to cover recurring expenses, by reducing recurring expenses, or by a combination of the two.

However, if unsustainable budgeting practices continue, one-time injections of money come with significant risk..

The school budget has recurring, compounding expenses. When you use a one-time fund for such expenses, then the next year the one-time fund is spent, but the deficit it had temporarily filled is even larger. The Northampton Public Schools is experiencing such a scenario today. What was a \$2.3 million deficit last year is now a \$4.77 million deficit.