

Special Purpose Stabilization Funds: A Long-Term Planning Tool

The 1945 statute that initially authorized cities and towns to establish a stabilization fund restricted the use of any fund balance to capital expenditures. In 1991, permitted uses were expanded to include any lawful purpose, but funds could still not be reserved for a specific purpose. However, with the adoption of legislative amendments in 2003 to M.G.L. Ch. 40 s.5B municipalities can now create multiple stabilization funds, assign a different purpose to each and take advantage of a new funding option.

As a result, at a time when cities and towns are faulted for operating in perpetual crisis mode, for allowing municipal assets to deteriorate, and for general short-sightedness, a special purpose stabilization fund can be an effective planning tool.

A fund might be established, for instance, to pay solely for the maintenance and repair of municipal buildings. Another might be created to supplement state highway funds, received under Chapter 90, and to cover the cost of an on-going street improvement program. A stabilization fund might be set-up to finance a government-wide vehicle replacement program. For example, if a community anticipated the need to purchase a \$400,000 fire truck in five years, it could reserve \$80,000 a year in a special purpose stabilization fund, and retain interest earned. In the past, municipalities would need state approval of special legislation to set-up such a reserve.

A special purpose stabilization fund:

- Encourages a community to think long-term. Programs to replace vehicles, maintain buildings and improve roads require an evaluation of all assets, formulation of a replacement or repair schedule, and calculation of long-term projected costs;
- Helps a community save money. Rather than pay cash, if the \$400,000 purchase price of fire truck were borrowed over 15 years, interest payments could add around \$150,000 to the total cost, depending on interest rates. Even if this additional cost would have a nominal tax rate impact, it can instead be a savings or expended elsewhere;
- Helps a community manage debt. A plan to accumulate cash over time and pay outright for a moderate-range capital expenditure helps preserve debt capacity for major, high-dollar purchases or projects. An approach that balances debt with pay-as-you-go practices, and protects against unforeseen costs is viewed in a positive light by credit rating agencies.
- Builds resident confidence in government. Special purpose stabilization funds directly address resident concerns and provide assurance that money appropriated for a particular purpose will be used for that purpose and will not be diverted.

Creation of the special purpose stabilization fund, and an appropriation to the fund, requires two-thirds vote of a city council, town meeting or district prudential (or similar) committee. The vote must clearly define the purpose of each fund established. Now, under the new law, creating and appropriating to a general stabilization fund also requires two thirds vote.

There are two options for building balances in a special purpose stabilization fund. One is the traditional appropriation in a budget line-item, or in an article, from within the levy or from other general fund revenues. Balances can also be transferred-in from other existing accounts.

A second, new funding option is referred to as an override, but in fact, has characteristics of both a Proposition 2½ override and exclusion. Like an override, additional tax revenue can be raised year-after-year

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without town-wide or city-wide referendum votes beyond the year of inception. However, like an exclusion under Proposition 2½, the levy limit increase need not be permanent. Solely through the action each year of the selectmen, or city council, it can be continued, lowered or deferred entirely and resumed in a later year. In any event, each year, the amount available increases by 2½ percent.

Option 1

The additional levy capacity that can be appropriated, or raised, by the override increases by 2½ percent each year. After the first year, the selectmen or city council may appropriate less than the originally approved amount. However, the lower amount then becomes the maximum that can be raised in subsequent years, plus 2½ percent annual escalations. A higher amount can only be raised with voter approval of another referendum. A year, or years, can be skipped. The selectmen, or city council, can choose not to appropriate to the stabilization fund through an override in any year. They can then, in later years, resume the override. However, the new allowed amount that can be raised would be the last amount raised plus 2½ percent.

Option 2

For example, town meeting and town voters approve a \$100,000 override for a capital project stabilization fund in FY2008. In FY2009, \$102,500 (1.025 x \$100,000) is available for "appropriation" and that entire amount is "appropriated." For FY2010, \$105,062 (1.025 x \$102,500) is available, but only \$80,000 is "appropriated." The amount available in FY2011 now becomes \$82,000 (1.025 x \$80,000), but the selectmen choose to make no appropriation. The amount available in FY2012 is \$82,000 (1.025 x last appropriation made, i.e., \$80,000).

Ultimately, special purpose stabilization funds are most effective as a revenue source, or savings account, for anticipated expenditures. They work best when used to build moderate balances and to pay mid-level expenditures that the community will eventually have to make, like building maintenance, road repairs and vehicle purchases.

Building stabilization balances through an override unquestionably involves an increase to the tax levy but, as important, special purpose stabilization funds provide a response to resident concerns about the absence of long-term planning in municipal government. If considered thoughtfully and implemented prudently, they offer a vehicle that can help a community think and act in a forward looking manner, and effectively plan for future costs.

For more information, please see the DOR Information Guideline Release ([IGR 04-201](#)) which is accessible from the DLS website. Go to www.mass.gov/dls, click on *Quick Links (more)* and then *Information Guideline Release*.