THE FINAL REPORT OF
MAYOR SUTTER'S TRANSITION TEAM

The State of Fiscal Affairs
in the City of Fall River

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Table of Contents

Listing of Attachments

ATTACHMENT A, "Structure of the FY 2015 Revenues and Uses"

ATTACHMENT A illustrates the FY 2015 budget revenues and uses. In summary, 30% of the General Fund is in the fixed costs of employee benefits and debt service, 45% is in educational services (state-mandated foundation budget), and 25% represents the totality of all other services delivered (with 61% of that amount going to public safety).

ATTACHMENT B, "Fund Balances Report – Trend FY 2012 to FY 2015"

ATTACHMENT B shows each of the one-time revenues used as deficit financing to balance the budgets over the last four years. The total of $14,456,332 is detailed, including free cash, the Stabilization Fund, CDA grant funding for debt service, building sales, overlay surplus, and a variety of smaller available funds.

ATTACHMENT C, "FY 2015 Budget Changes and Uses of One-time Fund"

ATTACHMENT C documents the appropriations and transfers after the beginning of FY 2015, highlighting the dates and amounts of specific transactions from such one-time funds as Free Cash, Stabilization Fund, and EMS Retained Earnings.

ATTACHMENT D, "Enterprise Funds: Reserves and Retained Earnings Analysis – Trend FY 2010 to FY 2015"

ATTACHMENT D presents the detailed enterprise fund analysis of the retained earnings used since FY 2012. It also provides our level of a reserve requirement for each and the imputed reserve deficit. Additionally, it shows the extent to which the Sanitation Fund lacks self-sufficiency, requiring $17 million from the General Fund over the past four years to finance its budget.

ATTACHMENT E, "Authorized Position Summary"

ATTACHMENT E summarizes the city's (non-school) authorized positions, in full-time equivalents (FTEs), over the past four years, and includes all positions, regardless of funding. The summary is by department and division (for General and Enterprise Fund positions) and by department and grant for grant-funded positions. It shows that, over the period, enterprise fund slots have declined by 11 FTEs, the General Fund positions have increased by 76 (of which 47.5 FTEs is in public safety), and grant positions have declined by 52 (in large part, due to SAFER grant termination).

ATTACHMENT F, "Overlay Report – FY 1999 to FY 2015"

ATTACHMENT F presents the overlay by year, as well as the detail of our calculation of the underestimated overlay (based on the actual for FY 2007 to FY 2012), the last years for which all abatements/exemptions have been processed, except for personal property uncollectible bills. It shows a potential overlay deficit for FY 2014, as well as a $375,870.51 to $403,755 underestimate for the FY 2015 overlay.

ATTACHMENT G, "Overlay Reserves for Comparable Cities"

ATTACHMENT G compares and outlines the overlay reserves for comparable cities in our peer-group, as well as a state-wide average.

ATTACHMENT H, "Report on Uncollected Personal Property FY 1999 to FY 2014 and Impact on Overlay"

ATTACHMENT H provides detail, by fiscal year issued, on the number of bills unpaid, the aggregate amount, the percentage assumed uncollectible, the current overlay reserve, the amount of personal property that should be offset against that reserve, and the projected impact on the overlay surplus. It projects a potential overlay deficit for FYs 2002, 2003, 2007, 2008, 2010, and 2014. When both surpluses and potential deficits are accounted for, the potential overlay deficit aggregated from FY 1999 to FY 2008 is projected at $20,952.25.

ATTACHMENT I, "Property Tax Report – Trend FY 2009 to FY 2015"

ATTACHMENT I documents the changes in property valuation, taxes, and Proposition 2 ½ levy capacity (including changes in annual new growth). It shows that assessed valuation between FY 2010 and FY 2015 declined by $927,967,371, or 15.2%, while the taxes levied increased by 24.9% or $17,230,943. The average single family tax bill increased, over the period, by $566 ($2,705 in FY 2015), an increase of 26.5%, while assessed single family home value declined by 12.6%, or $29,767, to an FY 2015 level of $206,812.

ATTACHMENT J, "Overtime Control Report – Trend FY 2013 to FY 2015, Mid-Year"

ATTACHMENT J verifies actual department overtime, on a pro-rata, first 6-months basis, for FY 2013, 2014, and FY 2015. It confirms that significant unfunded overtime has continued in EMS, Sanitation, Police, Fire, Inspectional Services, and Schools. In this comparison of first half fiscal year data for 2013, 2014, and 2015, FY 2015 is an aberration from the past.

ATTACHMENT K, "FY 2015 Fire Overtime, by Category, by Pay Period"

ATTACHMENT K compares and outlines the Fall River Fire Department's overtime by category and by pay period. It shows that the initial $210,000 annual overtime appropriation was overspent by September 5; by the time the City Council voted a $250,000 supplemental transfer on November 18, that amount had already been spent. Internal departmental reallocation brought the overtime account to a total of $486,629, which likewise was exceeded by December 12, 2014 – less than half way through the fiscal year. As of the February 20, 2015 pay period, Fire's overtime was $579,025.42, or $92,395.83 over budget allocation. In addition, the department has spent down $72,645.45 of its $242,500 grant allocation.

ATTACHMENT L, "Fire Department Overtime Comparison, FY 2003 – FY 2015"

ATTACHMENT L provides an historical context against to compare and contrast the FY 2015 overtime expenses. Since FY 2003, annual actual Fire overtime has never exceeded $495,615. In FY 2010, after the lay-off of 45 firefighters, and at a staffing level of 153 (rather than 175 today), the actual overtime was only $431,003 – $600,000 less than the FY 2015 experience (including use of grant funds.)

ATTACHMENT M, "FY 2015 Police Select Salary Line-Items"

ATTACHMENT M analyzes detailed Police Department information for FY 2015, by pay period, of select salary items, including overtime by category of use.

ATTACHMENT N, "Snow Removal Account Trend – FY 2010 to FY 2015"

ATTACHMENT N provides a detailed analysis of snow removal budgets and actual expenditures/deficits from FY 2010 to FY 2015. The 5-year average snow removal cost has been $1.8 million, although the city continues to budget slightly more than $500,000. The resulting $1,044,884.95 is rolled over to the next fiscal year and reduces the funds available to other departments by that amount.

ATTACHMENT O, "Universe of Delinquent Real Estate Taxes"

ATTACHMENT O lists all real estate tax titles – delinquent real property taxpayer – who owe more than $10,000 or who owe taxes on more than one parcel. Please note that the listing provides the owner at the time the original lien was filed for failure to pay taxes due, and does not include subsequent owners nor the current owner of the property, who may have contributed to the unpaid taxes due. It provides a listing of 193 taxpayers, owing more than $6.7 million on some 298 parcels. (Another 126 persons are not listed, as they owe less than $10,000 each; in the aggregate they have not paid $0.77 million on 215 parcels.)

ATTACHMENT P, "Financial Comparative Report"

ATTACHMENT P is public information derived from the Massachusetts Department of Revenue website. It provides general demographic data, FY 2014 assessed valuation (tax levy and rates) by class, outstanding receivables, FY 2013 general fund spending by function, and other financial indicators, comparing Fall River to the comparable cities of Lawrence, Lynn, Brockton, New Bedford, and Lowell, as well as the near-comparables of Framingham, Somerville, Quincy, Newton, and Cambridge.

ATTACHMENT Q, "Financial Flexibility Report – FY 2015"

ATTACHMENT Q compares and contrasts Fall River to comparable cities, near comparable cities and others in the Commonwealth. It is also derived from the Department of Revenue website and provides a tool to create a report on the resiliency of select cities to fiscal forces. Among the salient points is that Fall River has the smallest budget, possesses the least excess levy capacity, has the least free cash, Stabilization, and other available resources available, maintains the second lowest bond rating, and has the highest long-term debt outstanding as a percentage of equalized valuation.

ATTACHMENT R, "Changes in Outstanding Tax Balances, FY 2011 to FY 2015"

ATTACHMENT R provides the details of outstanding unpaid personal and real property bills, as well as water and sewer liens, by tax year. The balances are analyzed on a fiscal year end basis for FY 2011 to FY 2014, with outstanding balances at of February 28, 2015.

ATTACHMENT S, "Trends in Actual Net School Spending, FY 1993 to FY 2015"

ATTACHMENT S shows the changes in state and city contribution to education. Since FY 1993, Fall River has provided minimum net school spending in all but three fiscal years (FY 2009, FY 2010, and FY 2014). In the four fiscal years before the 2009 recession, Fall River exceeded minimum net school spending levels by 4.6% to 9.1% ($4.5 million to $9.6 million). The city's contribution from its own tax levy, over the past 8 fiscal years, has been between 16.1% and 19.1% of the actual net school spending amount, with Chapter 70 state aid the largest component of meeting the requirement.

ATTACHMENT T, "Trends in Actual Budget Expenditures, FY 2011 – FY 2015"

ATTACHMENT T provides the detail of how each department and division budget had changed over the past five years. Our analysis of the trends in actual expenditures from FY 2011 to FY 2015, shows that from FY 2012 to FY 2015, funds for the Fall River Public Schools (which does not include indirect employee benefits costs) has increased from $83.2 to $98.3 million, an 18.1% increase in four years. For all other non-school expenditures, our analysis shows in increase of 12.6% (from $133.7 to $150.2 million).

ATTACHMENT U, "Revenue Summary, FY 2011 to FY 2015"

ATTACHMENT U, "Revenue Summary, FY 2011 to FY 2015" provides the current structure of receipts by department and tax, comparing FY 2015 Year-to-Date (February 29, 2015) to actual full fiscal year revenues for FY 2011, FY 2012, FY 2013, and FY 2014.

ATTACHMENT V, "Underperforming Revenue Sources"

ATTACHMENT V, "Underperforming Revenue Sources" indicates those areas of revenue concern for FY 2015, in which actuals have lagged projections (on a pro-rated year-to date basis).

ATTACHMENT W, "Governor's FY 2016 Cherry Sheet Proposal"

ATTACHMENT W, "FY 2016 Cherry Sheet" presents the detail of the Governor's Budget Proposal (House 1), as it related to state aid receipts and assessments/charge. It shows that the Governor is proposing $135 million for state aid to Fall River ($4.3 million more than FY 2015), but after adjusting for $3.9 million more in state charges and assessments, the estimated net income increase from FY 2015 to FY 2016 is $343,666.

ATTACHMENT X, "Outstanding Recommendations, DoR Financial Management Review (March 2009)

ATTACHMENT X details the six DoR recommendations that remain open after six years, as well as the Financial Team responses. It provides the 3 open recommendations for the Treasurer, the 1 for the Collector, the 1 for the Auditor, and 1 for the Assessor.

ATTACHMENT Y, "Authorized Position Control Report, Trend FY 2012 to FY 2015"

ATTACHMENT Y provides the trend detail (which is summarizes in ATTACHMENT E) of positions by department and by grant, from FY 2012 to FY 2015. For the larger departments, for example, Fire and Police, the authorized positions are further specified by rank or type of personnel; for grant-funded personnel, the grants are specified.

Part I – Executive Summary

A. Introduction

The Transition Team believes that you, as our Mayor, are taking office at a critical juncture for the future of our city's long-term wellbeing. The City of Fall River is currently in a state of fiscal instability. Putting the City on sound financial footing cannot be done without significant policy changes and a new approach to the budgeting of the City's funds. The kinds of changes that must be made in Fall River will take time, and they will require a substantial effort across the board – both inside and outside City government. However, a great number of the problems facing Fall River can be corrected by strong leadership and meaningful coalition-building going forward. The Mayor, above all, needs to be frank with the citizens of Fall River at this time:

- clearly articulate that Fall River has been living beyond its fiscal means,
- indicate the magnitude of its financial challenges,
- prepare the citizens of Fall River and both past and present employees of the City government for the shared sacrifices that gradually will be required to return the City's finances to a healthy state, and
- plot a decisive course and vision for a positive, sustainable, responsible, and balanced future.

Living beyond our means, years of spending more money than the City brings in, has resulted in an unstable situation in which our essential reserve funds are almost completely depleted. This came about because budgets were passed in which expenses exceeded the City's recurring revenues (including property taxes, state aid, auto excise taxes, charges for permits and licenses, and interest/penalties on taxes). When this took place, city management chose to pay its bills using unreliable one-time revenues, which consist of money from the following sources:

- Stabilization Fund
    - The City's overall reserve account, which carries over from year to year

- Building Sales Fund
  - From the recent sale of school and municipal buildings.
- Overlay Surpluses
  - Funds that remain in a reserve account after uncollectable taxes, tax exemptions (for veterans, seniors, etc.), and tax abatements have been accounted for.
- Free Cash
  - Unrestricted funds that remain in reserve from the operations of the previous fiscal year.

These one-time resources should only be used as an extraordinary, temporary measure while a viable long-term plan is implemented. This year alone, $4.3 million of one-time money was used to close a structural deficit in the FY 2015 budget. This is not sustainable. The City's independent, external auditors – the firm of Clifton Larsen Allen, who recently spoke before the City Council – have noted that our net financial position has deteriorated, and continuing down the same path will put the City at a serious fiscal risk similar to that confronted by Springfield and Chelsea in the past.

Mayor Sutter, you need to engage in meaningful, honest communication with the City Council, School Committee, City employees, and the public to bring about the kinds of changes our City needs. For example, when re-evaluating the Sanitation Fund with the goal of making it self-sufficient, you must solicit input from the Council and citizens in order to build essential support from the community before going forward with any new or updated system. In your campaign and in your inaugural address, you spoke of starting a new era of cooperation with the City Council and School Committee, and the Transition Team agrees that creating such a partnership – coupled with an openness with the public regarding the City's finances, beginning with the publication of this document – will be essential to the City.

B. Overview

In the current budget, for Fiscal Year 2015, the City's expenses total $276.4 million. However, the City only raised $272.1 million in recurring revenues for FY 2015. This imbalance created a $4.3 million deficit that had to be filled with one-time money. One-time money is meant to be used for only two purposes: covering one-time expenses (such as disaster responses and land purchases) and building up a city's reserves so that it can have a comfortable rainy-day, emergency account. Because one-time resources have been used consistently to fund the operating budget, our reserves have dwindled every year. Ideally, a fiscally sound city the size of Fall River should have enough reserves to cover two months' worth of expenses – or one month at the very least. For Fall River, that would mean having roughly $24 to $48 million set aside. We currently have less than $500,000 in reserves, which is only 1% to 2% of that. To stress the seriousness of this condition, the Transition Team invites comparisons between Fall River and other similarly situated Massachusetts cities:

City	Operating Budget	Available Resources
Lowell	$364.1 million	$25,455,413
New Bedford	$320.7 million	$25,080,570
Lynn	$307.3 million	$14,170,553
Lawrence	$288.8 million	$10,978,965
Taunton	$205.0 million	$14,555,286
Fall River	**$276.4 million (as of 7/1/14)**	**$ 499,598 (as of 2/20/15)**

Every mayor, regardless of the city he or she represents, is forced to make difficult decisions when budgeting city funds for the new fiscal year. Properly balancing a budget – either by reducing current expenses, increasing current revenues, or both – requires a mayor to make hard choices that will inevitably leave certain constituencies dissatisfied. Your Administration will be tasked with negotiating nine new collective bargaining agreements, which have the potential to be politically contentious. When making these difficult decisions, it is critical that you are regularly consulting with the Financial Team and department heads and making sure that your decisions are influenced solely by what is best for the City – not what is politically expedient. Seek input from the individuals who have the most hands-on knowledge of the City's finances and operations, and make sure that the long-term implications of the collective bargaining agreements and concessions are carefully considered. You will need to take into consideration that staffing throughout City government is currently at an unsustainable level. This pattern of staffing our City government beyond what our city can afford has caused reserves to dry up. It falls on you and your Administration to fundamentally restructure and, ultimately, create an affordable staffing level so that our City has a government it can realistically pay for going forward.

The longer the City goes without changing its approach to budgeting, the harder it is going to be to return Fall River to a state of stability. But before looking ahead to FY 2016 and beyond, it is important to analyze our current budget closely:

Projected Expenses at Start of FY 2015:

- Water, Sewer, Sanitation, and
  Emergency Medical Services Enterprise Funds....…….. **$ 33.7 million**
  - This does not include $2.1 million in pension costs, $1.5 million in employee benefits, and $3.3 million in administrative overhead included below in the General Fund

- General Fund Budget………………………………..….. **$224.8 million**
  - Education ($100.7 million)
  - Fixed costs of debt service ($10.1 million)
    - Payment of interest and principal on bonds
  - Employee benefits/insurance ($58.7 million)
  - All other services, including:
    - Police ($20.1 million)
    - Fire ($14.7 million)
    - Community Maintenance ($8.1 million)
    - All other departments/expenses ($12.4 million)

- County and State assessments and charges, regional
  transportation, and charter school tuition assessments… **$ 13.5 million**

- Money reserved for veterans/senior tax exemptions,
  tax evaluation abatements, and uncollectable bills……..**$ 1.0 million**

- Snow removal deficit……………………………..........**$ 1.9 million**

- Sanitation Fund subsidy…………………………….……..**$ 1.5 million**

Total: **$276.4 million**

Projected Revenues at Start of FY 2015:

- State aid…………………………………………….......... **$130.8 million**
- Taxes………………………………………………….. **$ 86.4 million**
  - Real estate ($81.0 million)
  - Personal property ($5.4 million)
- Excise taxes..……………………………….………….. **$ 7.2 million**
  - Includes Auto, Boat, and Meal & Room taxes
- Local receipts………………………………………...**$ 8.3 million**
  - Includes penalties/interest on taxes, fees, licenses & permits, fines, Medicaid reimbursements, and miscellaneous revenues
- Revenue from enterprise funds………………………… **$ 39.0 million**
- Other available funds……………………….....……..**$ 0.4 million**
  - Includes Community Development grant and library receipts

Total: **$272.1 million**

One-time Revenues Built into FY 2015 Budget: ***Total:*** **$ 4.3 million**

Of the $4,278,436 of one-time funds used to close the FY 2015 deficit, $3,203,500 million came out of the City's stabilization fund; $600,000 came from the sale of municipal buildings; $109,943 came from overlay surplus reserve; and $364,993 was free cash. To get a sense of how substantial that is within the budget, consider that the non-school spending, discretionary part of the budget has only $44.4 million in salaries. This is the portion of the budget that is available after satisfying state mandated minimum levels of net school spending (under Chapter 70) and considering fixed costs of debt service, employee benefits, and other insurance. See below:

Total Non-School Salaries

- **Police** (43% of salaries) — $19.1 million for 261 positions
- **Fire** (32% of salaries) — $14.1 million for 180 positions
- **City Hall** (14% of total City salaries) — $ 6.4 million for 114 positions
- **Community Maintenance** (11% of salaries) — $ 4.8 million for 104 positions

Total: $44.4 million

The $4.3 million deficit is problematic enough on its own, but that number actually grew as the year went on. Due to unforeseen expenses and departments exceeding their budgeted overtime levels, $5.4 million worth of one-time funds have already been allocated this fiscal year (as of 2/1/15). Some department heads have not been held accountable for their spending in recent years, and after the Transition Team completed its review of every department, we concluded that it is imperative that you hold department heads much more accountable to prevent over-spending. For example, in FY 2015, the Fire Department spent their entire overtime budget by September 5th – less than a quarter of the way through the fiscal year. But unfunded overtime was by no means unique to the Fire

Department; far exceeding overtime budgets in the first half of this fiscal year became the standard for a number of departments.

By looking at the spending of one-time funds in the last four budgets, it is clear that the current practice of permitting unsustainable excesses is nothing new:

Budgeted One-Time Expenditures, FY 2012-FY 2015

- FY 2012 - $ 928,000
- FY 2013 - $4,427,284
- FY 2014 - $3,740,004
- FY 2015 - $5,441,044 (as of 2/1/15)

FY12-15 total - $14,536,332

The credit rating agency Moody's Investor Services released a report last month titled: "New Issue: Moody's revises Fall River, MA's outlook to negative." Last year, Moody's downgraded the City's bond rating from an A1 rating to an A2. This year, Moody's repeated the A2 rating but assigned us a negative outlook, highlighting Fall River's need to:

- address balanced operations, without use of one-time injections of free cash, stabilization funds, and other available reserves;
- create multiple years of budget surpluses and direct them to increasing reserves;
- monitor and ensure that FY 2015 does not end with an operating deficit; and
- grow the tax base valuation.

In its section, entitled "Financial Operations and Position," Moody's documents the fundamental structural imbalance in the FY 2013, FY 2014, and FY 2015 budgets. They acknowledge that, although there have been marginal improvements made in the last year (reduction in the Sanitation Fund subsidy due to the "Pay-As-You-Throw" system), the City still urgently needs to balance its revenues and expenses. The section concludes:

> *"While the current fiscal year budgeted operations are more structurally balanced, the city will continue to be challenged through*

> *fiscal 2016… The city's ability to fully implement balanced operations without the use of free cash and produce an annual operating surplus will be key rating factors in future reviews.*"

Action must be taken soon to improve in the areas identified by Moody's, or else the City runs the risk of seeing its bond rating downgraded further. Another downgrade would mean that the City could jeopardize its ability to use the state's bond rating when going to the bond market, which means it will cost the City more money to make crucial capital improvements. Also, if Fall River's rating is downgraded again, it could affect the attractiveness of the City to potential new businesses. The negative outlook we were assigned this year by Moody's indicates that they see Fall River heading down an unsafe path, and it will be your responsibility as Mayor to change the course.

This will by no means be a simple task, especially with the constraints limiting revenue increases. Since Proposition 2 ½ was passed by referendum in 1980 and signed into law in 1982, the state has mandated that municipalities cannot raise taxes by more than 2.5% in a year, plus new growth. Considering that the State sets net school spending requirements higher every year, almost all newly generated tax revenue ends up funding additional education costs. Costs in our pension system for all retired City employees also increase by $1.6 million per year, and health insurance costs for current employees and retirees are projected to increase $2 million to $3 million in FY 2016. Consequently, taxing alone will not solve our fiscal problems.

The inability to raise new revenues is only made worse by the City's difficulty in collecting monies rightfully owed to the City. In the Transition Team's research, we identified $7.6 million in uncollected real estate tax bills and $0.9 million in uncollected personal property taxes. Although some of these bills will be difficult to collect, with some of them dating back as far as the 1990's, your Administration should develop a plan to systematically bring in as much of that money as possible. The top 100 real estate delinquents owe a total of $4.97 million between them, and that is a substantial amount of money in our current financial condition. Adding this money to the City's reserves would be an important first step towards building up a secure rainy-day fund (i.e. through the stabilization account).

With respect to fines, permits, and licenses, revenue has not kept pace with expenses for the City of Fall River. With only minor raises in some fees over the last six years, this revenue has not kept up with inflation over the years and does not cover the costs of administration. By raising late tax payment penalties and fair user charges for services just 15%, our analysis suggests that the City would see a $1.2 million increase in revenue in the first year. This may sound like a nickel-and-dime approach that does not address the large-scale budget issues, but attention to small details like these will contribute to cost-saving and revenue-generating actions that will add up quickly.

The City has also lagged behind in preparing for adjustments to inflation and other growing costs. For example, the City under-budgets for its snow removal operation every year by only providing $526,243 for it in the General Fund. In our study, the Transition Team found that the City spent $1.8 million on average for snow removal per year over the last five years. This year's operation is already over 400% of what was budgeted, over $2.5 million (as of 3/10/15). Further, we understand that due to fluctuation in utility rates, the City will owe roughly $400,000 to $500,000 more for electricity costs than was budgeted at the start of the fiscal year. Because the possibility of a spike in utility rates was not adequately taken into consideration, not enough money was allotted for electricity costs and will now have to be taken from other areas in the budget or drawn out of our limited reserves to cover it.

Similarly, departments drastically overspend their overtime allotments and then, for some reason, receive the same initial allotment the next year. One of two things must take place in situations like these:

- More realistic assessments of the costs of operations must be made, and the next year's budget should reflect those reassessments; or
- Department heads must be held much more accountable and required to stay within their budgets. Overspending in these accounts creates far too much instability in the budget.

Another factor limiting economic recovery outside of the General Fund is that the City's enterprise funds (Water, Sewer, Sanitation, and Emergency Medical Services) have not been adequately self-sustaining. These departments are called "enterprises" because they are supposed to be run as similarly to private-sector business enterprises as possible. The enterprise funds should be generating enough revenue to cover all of their own costs of operations while leaving two months' worth of retained earnings. Retained earnings – which are unused funds left over from the previous years' operations – are meant to be set aside in a reserve account to serve as a rainy-day fund for the enterprises. Instead, the Water, Sewer, and EMS funds have been relying on the retained earnings of past years just to break even, meaning their reserves are dwindling just like the City's overall reserves are.

The use of one-time monies (retained earnings and stabilization fund) within the enterprise funds has also been a recurring problem. For FY 2015 alone, the four enterprises are using $1,372,083 from retained earnings. Over the last four years, the total use of one-time money was $7,961,901 within enterprises, broken down as follows:

- Sewer – $3,981,733
- Water – $1,172,385
- EMS – $1,172,385
- Sanitation – $ 866,447

What is even more concerning is that the Sanitation enterprise fund cannot sustain itself even while dipping into its retained earnings, requiring an additional subsidy from the General Fund to make ends meet. This year, taxes paid by Fall River citizens subsidized the Sanitation enterprise account for $1.5 million; in the last three years, taxpayers have contributed as much as $5.5 million annually, and from FY 2012 to FY 2015 have provided $17,532,679 as a General Fund subsidy. Over the four year period, the enterprise funds' revenues were $25,494,580 less than they needed to be to make the enterprises self-sustaining because rates have not kept up with expenses. Taking steps to correct this situation so that rates keep pace with expenses is necessary.

The Transition Team has identified the enterprise funds' inability to sustain themselves as a key problem to address moving forward. Water, Sewer, and EMS are already operating with as nearly a low level of expenses as possible, but the budgets of each department should be looked at for any opportunities to increase efficiency, and there are surely cost saving measures available within Sanitation. Just as fees for licenses and permits need revising to make them catch up with expenses, the rate structures of all four enterprise funds should be revised upward to ensure that recurring revenues cover expenses.

C. Conclusion

The structural changes that need to be made will require a shared sacrifice from the community. These changes cannot be made overnight – they should be implemented deliberately and collaboratively, with consideration given at all times to the seriousness of our current situation and the consequences of each decision. For example, you will need to consider:

- revising staffing to affordable, realistic levels;
- controlling overtime costs by mandating adherence to established budget levels;
- reviewing salary and non-salary costs within City government;
- creating greater efficiencies within City government.

Mayor Sutter, the Transition Team believes it is imperative that your Administration approach the FY 2016 budget by solely focusing on the real problems that our City faces, not the political obstacles that will be presenting themselves in the coming months. Your Administration will have to make decisions that are not politically popular and will require a shared sacrifice within our community and government. The City needs a professional restart to get its fiscal house in order and make competency, collaboration, and trust the hallmarks of your Administration. If City Hall does not control its spending, shake its dependence on one-time money, and put sustainable policies in place, the negative consequences will be felt in Fall River for many years to come.

Although the financial challenges our City faces are daunting, we believe that the resiliency of Fall River's citizens – which has been demonstrated time and again over our City's history – will enable Fall River to overcome our current challenges. It is encouraging to remember that just five years ago, our neighboring city of Providence was in a situation very similar to ours, but on a larger scale. Nevertheless, they have made great progress towards sustainability through a combination of strong leadership, consensus-building, and decisive action, and we are in a position to do the same. The resources Fall River possesses can make our city among the best places to live and do business in the entire Commonwealth, and we believe that Fall River can realize that potential with strong, competent leadership and an efficient, productive City government. Despite our justifiable concerns about the City's current finances, we on the Transition Team identify ample opportunities for you and your Administration to make significant changes and put the City on the right track.

Part II – The State of Fiscal Affairs in the City of Fall River.

<u>The City's Fiscal Position</u>.

The City's unstable fiscal status is highlighted in the independent audits for FY 2013 and FY 2014:

> *The statement of net position presents information on all of the City's non-fiduciary assets and liabilities, with the difference between the two reported as net position. Over time, increases or decreases in net position may serve as a useful indicator of whether the financial position of the City is improving or deteriorating.*

The audits continue to cite the City's Net Position:

- for governmental activities:
  - in FY 2012, decreased by $4,008,354
  - in FY 2013, decreased by $10,028,385
  - in FY 2014, decreased by $28,939,321;

- for business-type (enterprise) activities:
  - in FY 2012, increased by $1,957,042
  - in FY 2013, decreased by $704,546
  - in FY 2014, decreased by $2,396,721.

Worse yet, the General Fund Unassigned Fund Balance declined from:

- FY 2011, $6,831,372 (2.8%) of General Fund Expenditures/Transfers, to
- FY 2012, $7,284,268 (2.7%), to
- FY 2013, $5,121,753 (2.0%), to
- FY 2014, $4,033,913 (1.5%) of General Fund Expenditures/Transfers.

Recently, Moody's Investors Services issued a report, entitled "New Issue: Moody's revises Fall River, MA's outlook to negative." It reiterated Fall River's A2 rating (which had been a higher A1 in early 2014), but noted a major change in its "negative" outlook. Moody's compares cities based on risk factors and in the real world of finance current income equals or is greater than current expenditures and accumulating reserves is a positive factor. Moody's compared this standard to Fall River, its budget imbalances, and drawing down of reserves to precipitous levels.

The negative outlook is, at the same time, a warning, a challenge, and an opportunity for the future to correct structural imbalances. It highlights the needs:

- to address balanced operations, without use of one-time injections of Free Cash, Stabilization, and other available reserves;
- to create multiple years of budget surpluses and direct them to increasing reserves;

- to monitor and ensure that FY 2015 does not end with an operating deficit; and
- to grow the tax base valuation.

Some $5.4 million in one-time revenues (including Free Cash, Stabilization, CDA funds, and Overlay Surplus Reserve – much of which is non-recurring) was required for deficit funding. Moody's research report maintains that the limited reserves narrow our financial flexibility, identifies our elevated reliance on state aid as a serious risk factor, comments on the regional economy with high poverty and unemployment, and challenges the City to deal with a sizeable liability for other post-employment benefits.

In its section, entitled "Financial Operations and Position," Moody's documents the fundamental structural imbalance in the FY 2013, FY 2014 and FY 2015 budgets. The section concludes:

> *While the current fiscal year budgeted operations are more structurally balanced, the city will continue to be challenged through fiscal 2016…. **The city's ability to fully implement balanced operations without the use of free cash and produce an annual operating surplus will be key rating factors in future reviews**.*"
> [Emphasis added.]

<u>Factors Contributing to the Budget Crisis</u>.

Fiscal Imbalance. The fact is that recurring revenues *must* equal recurring expenses in order to have fiscal balance and stable service levels, going forward. Additionally, provision must be made for reserves and rainy-day funds. In recent years, Fall River has not embraced this reality, using short-term fixes to balance the budget; it has depleted reserves and has not established rainy-day funds, which are needs for emergencies and unforeseen contingencies. Fall River is living beyond its means, and as Mayor you will need to rein in expenses to make ends meet.

Structural Deficit. It is inappropriate to balance the budget with one-time funds. Each year, there was a gap analysis based on how much it would cost to maintain current service levels and then to match that against any revenue – not only recurring revenue. There was no distinction made between one-time monies as a recurring need and one-time money as allowable bridge financing linking to actual recurring funds the next fiscal year. To compensate for a recurring revenue shortfall, year after year, it became standard practice to take savings and/or one-time revenues, which are non-recurring in nature, to close the budget deficit.

Revenue Constraints.

- Like every Gateway City, Fall River's budget is comprised mostly of state aid, especially for education. For FY 2015, Fall River's budget was projected based on:
  - $130.8 million from the state, of which $106.6 million is education-related (in Cherry Sheet receipts),
  - $86.4 million from property taxes,
  - $7.2 million from excise taxes,
  - $8.3 million from recurring penalties, licenses, permits, fees, and other miscellaneous receipts,

    - $39.0 million from enterprise fund rates/receipts.

  It also used $4.7 million in one-time revenues (including Free Cash, Stabilization, CDA funds, Library Offset Receipts, and Overlay Surplus Reserve – $4.3 million of which is non-recurring) as deficit funding. As the fiscal year went on, the use of one-time resources climbed to $5.4 million by February 1, 2015.
- Property Taxes can increase 2.5% per year plus new growth (approximately 1.5%); effectively, if Fall River increases taxes each year to the maximum allowable by law, this means $3.4 million additional per year. Two years ago, the tax levy was reduced by excluding any personal property account valued at less than $10,000, wiping out 1,200 accounts. There are only two ways to increase this revenue stream: over the long-term, high levels of economic growth (without counterbalancing tax exemptions/abatements) or, over the short-term, a Prop 2 ½ override.
- Fall River does not increase rates, fees, penalties, etc. every year to adjust for inflation. It waits 5 to 10 years, rather than evaluating increases annually for inflation and cost-of-living factors. For FY 2016, non-enterprise fees and penalties should be reviewed to cover the costs of administration and could be increased by 15% (up to $1.2 million); thereafter, to adjust for inflation annually would only yield approximately $100,000. While not a significant amount, every little bit helps.
- The enterprise funds have relied on retained earnings to balance their budgets in lieu of fully-funded rates; for FY 2015, the level of retained earnings used is $1.4 million; moreover, the Sanitation Fund has never been balanced and, for FY 2015, relies on a $1.5 million subsidy from the General Fund.

Expenditures Increase At a Rate Greater Than Revenues.

- The expenditures side of the ledger is personnel driven:
    - Salaries constitute 75-80% of the discretionary budget; every 1% increase in salaries equates to $1.1 million (in non-school salaries, this amounts to about $400,000); every year, without a pay increase, there are $200,000 in increases in non-school salaries just due to step increases, longevity, and education incentive increments. On the School Department side, the salaries account will grow 2.5% for the next 2 fiscal years, due to current labor relations contracts and "pattern bargaining." On the City side, all collective bargaining agreements will have expired by the end of FY 2015.
    - Due to its 60% unfunded retirement liability, the City's retirement contribution is $21.6 million and is slated to go up $1.6 million in FY 2016 ($1.3 million net of grant reimbursements), $1.4 million in FY 2017, $1.5 million in FY 2018, with additional marginal increases of the prior year's increase plus $100,000. The City's contribution to pensions, as a percentage of base payroll, is 35% – and increasing annually.
    - The employee group insurance costs (health, dental, and life insurance for employees and retirees) is $33.9 million; if the insurance costs increase by the average health costs annually, the FY 2016 increase would be $2.0 million, plus an estimated $800,000 deferral of City's CanaRx drug liability from FY 2015. The City's contribution to employee insurance benefits is estimated at about 26% of base payroll.

- The City's unfunded liability for post-employment benefits is 100%, at $600 million – and the City has made no provision for it, nor does it have a plan to address it.
- Debt service costs have been reduced over the past few years by rescheduling and reissuance at lower interest costs. In FY 2012, three refundings saved the City $4 million over the life of the bonds; in FY 2013, the City retired some North End School debt, saving $1.4 million; and in FY 2014, the City refunded the balance of the North End School debt for a further savings of $0.3 million. Debt Service requirements, currently, stand at about $10.4 million. Further decreases are unrealistic; in FY 2016, a further $200,000 will be needed and it is expected that debt service will be increasing in the out-years as debt burden is enhanced.

- The major items in expenses include electricity, heating, and fuel which are highly dependent on market factors. For example, in the FY 2015, the spike in electricity rates and an uncertain offset of solar energy credits is resulting in a projected shortfall of some $500,000. The energy line-items are projected to increase by $300,000 for FY 2016.

- The School spending is effectively set by the state with its foundation budget and requirements to satisfy minimum net school spending; in FY 2014, the City did not meet net school spending by $3.4 million, and preliminary School Department projections for FY 2015 show us being short by $1.5, due to health insurance actual costs coming in less than projected. The savings in the health insurance account results in a deficit in net school spending, requiring reallocation of these savings to other eligible education expenses, to comply with state law.

Non-Discretionary Expenses (Fixed Costs) Constitute 87.5% of Tax Levy.

For FY 2015, the City was able to levy $86.4 million in real and personal property taxes, as follows:

<u>Real Property</u>	<u>$81.0 million</u>
consisting of:	
- Residential Property -	*$51.8 million*
- Commercial Property -	*$20.1 million*
- Industrial Property -	*$ 9.1 million*
<u>Personal Property</u>	<u>$ 5.4 million</u>

Before we pay the salary of one police officer, one firefighter, one office worker in City Hall, or one laborer repairing streets, there are certain fixed, non-discretionary costs that must be taken care of first with all taxes raised. These include such items as pension/retirement costs, interest and principal on City and School bonds, the prior year's snow removal deficit, the overlay (reserve offset required for uncollectible taxes – e.g., over-assessment abatements and senior/veteran exemptions), state-mandated minimum net school spending, and employee benefits. In sum, these costs amount to $75.6 million, or 87.5% of the property taxes we pay.

The following listing details our fixed costs:

Overlay	$ 1.0 million (1.2% of taxes)
FY 2014 Snow & Ice Deficit	$ 1.9 million (2.2%)
Debt Service	$10.4 million (12.1%)
consisting of: *- School Debt - $6.0 million* *- City Debt - $4.4 million*	
Retirement Contributions	$22.0 million (25.4%)
consisting of: *- School Pension (non-teacher) -$ 5.3 million* *- City Pension - $16.7 million*	
State-Mandated Minimum Net School Spending	$27.4 million (31.7%)
consisting of: *- Fall River Public Schools (incl. ($21.1 million in Employee Benefits) - $23.9 million* *- Diman Vocational High School - $ 3.4 million* *- Bristol Agricultural High School - $ 0.1 million*	
Employee Benefits (Non-School)	$12.9 million (14.9%)

Uses of FY 2015 Revenues.

<u>Uses</u>	**<u>$276.4</u>**	**<u>million</u>**
Snow Removal Deficit	$1.9	*0.69%*
State/County Assessments	$13.5	*4.88%*
Reserve for Abatements	$1.0	*0.36%*
General Fund Budget (*Details below*)	$224.8	*81.32%*
Enterprise Fund Budgets (*Details below*)	$33.7	*12.27%*
Sanitation Fund Subsidy	$1.5	*0.54%*

<u>General Fund</u>	***<u>$224.8</u>***	***<u>million</u>***			
Fall River Public Schools	$97.2	*43.24%*	Education	$100.7	*44.80%*
Regional Vocation Assessments	$3.5	*1.56%*			
Employee Group and Other Insurance	$37.1	*16.50%*	Employee Benefits	$58.7	*26.11%*
Pension	$21.6	*9.61%*			
Fire	$14.7	*6.54%*	Public Safety	$34.8	*15.48%*
Police	$20.1	*8.94%*			
Administrative Services	$2.5	*1.11%*	Other Departments	$20.5	*9.12%*
Financial Services	$2.3	*1.02%*			
Community Maintenance	$8.1	*3.60%*			
Community Services	$2.9	*1.29%*			
Veterans Services	$3.1	*1.38%*			
Miscellaneous Departments/Other	$1.6	*0.71%*			
Debt Service	$10.1	*4.49%*	Debt Service	$10.1	*4.49%*

Enterprise Funds	***$33.7***	***million***
($6.9 mil. Indirect costs included in GF: $2.1 mil. in Pensions, $1.5 mil. in Employee Insurance, & $3.3 mil. in Admin. Overhead)		
Sewer	$18.0	*53.47%*
Water	$8.1	*24.01%*
Sanitation	$4.5	*13.34%*
EMS	$3.1	*9.1%*
Total GF & EF Budgets	***$258.5***	***million***

The table above is a snapshot, as of the date of budget approval, and not subsequent appropriations made during the fiscal year. It shows that the bulk of the uses of the FY 2015 resource flows were in the General Fund ($224.8 million, or 81.3% of total revenues), the Enterprise Funds ($33.7 million, or 12.3%), and State/County Assessments ($13.5 million, or 4.9%).

Nearly half of the General Fund, $100.7 million or 44.80%, represents the cost of education, both to the School Department and to regional vocational schools. The second largest component is Employee Benefits/Other Insurance, $58.7 million, or 26.11%. Debt Service amounts to some $10.1 million or 4.49%. This effectively means that Public Safety and All Other Departments share the remainder of the General Fund, with Fire and Police combining for 15.48%, at $34.8 million. All Other Departments represent only $20.5 million or 9.12%.

In summary:

- 30% of the General Fund is in the fixed costs of employee benefits and debt service,
- 45% is in educational services, and
- 25% represents the totality of all other services delivered
    - 61% of that amount going to public safety

Fixed costs are expected to increase higher than the rate of inflation on an on-going basis, and education costs are actually a function of state-mandated foundation budget and minimum net school spending, which have historically increased higher than the rate of inflation. For these reasons, non-school departments are left to divide a comparatively small and slowly growing amount of funding left after our obligations have been met. See ATTACHMENT A, “Structure of the FY 2015 Revenues and Uses.”

ATTACHMENT T, “Trends in Actual Budget Expenditures, FY 2011 – FY 2015” provides the detail of how each department and division budget had changed over the past five years.

Our analysis of the trends in actual expenditures from FY 2011 to FY 2015, shows that from FY 2012 to FY 2015, funds for the Fall River Public Schools (which does not include indirect employee benefits costs) has increased from $83.2 to $98.3 million, an 18.1% increase in four years. For all other non-school expenditures, our analysis shows an increase of 12.6% (from $133.7 to $150.2 million), as follows:

Expenditure Trends: FY 2012 to FY 2015

Category/Department	FY 2012 Actuals	FY 2015 Revised Budget	Difference	%
School Department	**$83,236,701.60**	**$98,301,000.00**	**$15,064,298.40**	**18.1%**
Salaries	$63,628,417.28	$72,241,068.00	$8,612,650.72	13.5%
Expenses	$19,608,284.32	$26,059,932.00	$6,451,647.68	32.9%
Non-School, General Fund	**$133,667,084.17**	**$150,179,605.17**	**$16,512,521.00**	**12.4%**
By Expenditure Category:				
Salaries	$34,854,283.24	$44,521,462.00	$9,667,178.76	27.7%
Expenses	$9,389,746.39	$10,647,257.44	$1,257,511.05	13.4%
Pensions	$18,070,647.77	$21,605,576.00	$3,534,928.23	19.6%
Assessments	$12,882,942.48	$16,977,065.00	$4,094,122.52	31.8%
Other	$6,383,430.52	$8,833,446.49	$2,450,015.97	38.4%
Debt	$12,439,508.30	$10,439,379.24	**($2,000,129.06)**	**-16.1%**
Insurance	$39,646,525.47	$37,055,419.00	**($2,591,106.47)**	**-6.5%**
By Department:				
Financial Services	$1,600,166.78	$2,317,518.00	$717,351.22	44.8%
Fire & Emergency Mgmt.	$11,464,330.36	$15,001,667.40	$3,537,337.04	30.9%
Community Maintenance	$6,230,216.30	$8,066,174.00	$1,835,957.70	29.5%
City Clerk	$284,778.14	$366,149.00	$81,370.86	28.6%
Administrative Services	$2,023,956.31	$2,521,735.00	$497,778.69	24.6%
Police	$16,258,233.72	$20,087,375.44	$3,829,141.72	23.6%
Elections	$251,405.14	$298,902.00	$47,496.86	18.9%
Community Services	$2,594,415.27	$2,906,305.60	$311,890.33	12.0%
City Council	$193,968.30	$213,624.00	$19,655.70	10.1%
Veterans Benefits	$2,953,789.81	$3,099,342.00	$145,552.19	4.9%
Mayor	$351,445.71	$271,648.00	**($79,797.71)**	**-22.7%**
Harbormaster	$33,579.76	$18,279.00	**($15,300.76)**	**-45.6%**
By Centrally-Funded Account:				
State/County Assessments	$9,883,546.48	$13,477,433.00	$3,593,886.52	36.4%
Pension Contribution	$18,070,647.77	$21,605,576.00	$3,534,928.23	19.6%
Education (Regional)	$2,999,396.00	$3,499,632.00	$500,236.00	16.7%
Insurance	$39,646,525.47	$37,055,419.00	**($2,591,106.47)**	**-6.5%**
Claims & Damages	$391,690.52	$350,000.00	**($41,690.52)**	**-10.6%**

Debt Service	$12,439,508.30	$10,439,379.24	**($2,000,129.06)**	**-16.1%**
By Other Account:				
Cherry Sheet Offsets	$0.00	$316,621.00	$316,621.00	N/A
Other Financial Uses	$0.00	$2,890,653.49	$2,890,653.49	N/A
Retirement Board Salaries	$3,744.03	$0.00	**($3,744.03)**	**-100.0%**
General Unclass. Expenses	$5,841,740.00	$5,276,172.00	**($565,568.00)**	**-9.7%**

Note that the amounts for debt and insurance have decreased due to re-funding the debt (at lower rates) and employee health insurance redesign; both of these are one-time savings which will not be replicated.

Use of One-time Funds. In FY 2015, some $5.44 million was used in one-time moneys for deficit financing:

- $4.28 million in non-recurring funds (i.e., Free Cash, Stabilization Fund, Overlay Reserve, and Building Sales) was used in the initial balance,
- an additional $0.65 million was of these non-recurring funds were appropriated during FY 2015 for budget expansion/revision (including $175,000 to purchase park land); and
- finally, $0.51 million (in CDA grant funds, Library, Waterway Improvement, and Conservation Funds) were used for initial balance, but these funds are of a continuing, quasi-recurring nature.

Nearly all reserves were spent to support a budget that did not contain enough recurring revenues to cover its expenses. This compounds our problems for FY 2016, as the base is already $4.3 million too high and there will be additional requirements for pension, employee insurance costs, net school spending, debt service, snow removal deficits/carry-forward, increased utility and step increases amounting to at least another $11.9 million.

Use of Grants to Supplant, Rather than Supplement. To make matters worse, Fall River used grants to build the base up further. Simply put, there is a proper way and an improper way for a city to utilize a grant. Proper usage is to dedicate the funds to pilot projects, allow seed money for efficiency upgrades, and help with technology upgrades; they should provide one-time money for one-time activities. Improperly utilized grants supplant general funds; they fund recurring costs, they fund staff that otherwise the city could not afford; they create expectations, higher service levels, and over-reliance on continuing funding that may not materialize. Sometimes, grants can provide bridge financing, but you need to know what you are bridging to, the funding sources on the other side, any termination costs that are involved, an exit strategy, and the risks associated with maintenance of effort.

Unfortunately, Fall River is still heavily dependent on grants to provide services that supplant general funds, rather than supplement them. When grant funds dry up, the consequences are very problematic. The reduction of 79 SAFER Fire positions resulted in severe departmental dislocations, cuts in service levels, reduction in force of 26 positions, along with an increase of 34 positions in the General Fund, resulting in a budget increase of $3.3 million. Over four years, there was no bridging to a sustainable revenue source. Also concerning is that the Police

Department find themselves in a similar situation, in which they are dependent on grants for current personnel. One factor that makes their situation less worrisome is that the grants and sources are sufficiently diversified to reduce (but not eliminate) risk. Of the authorized staff level of 281 (excluding environmental police and animal control), 36 (13%) are grant-funded positions:

- 5 patrolmen under the DoJ COPS program,
- 7 dispatchers (paid by a 9-1-1 grant),
- 5 patrolmen funded by a Mass Staffing grant,
- 7 walking beat patrolmen paid by CDA,
- 4 School-(and Diman-)funded Resource Officers,
- 6 patrolmen under Housing Authority funding, and finally
- 2 patrolmen funded by the Disability Commission.

Additionally, the Fire Department received $485,000 and the Police Department $464,000 in public safety grants to underwrite FY 2015 overtime. (The Police Department Mass Staffing grant was originally to fund 5 officers, but was re-purposed to overtime instead.) This effectively relieved any pressure to control overtime and restructure staffing and workloads; it exacerbates the overtime problem for FY 2016.

The City cannot look upon all grants as “free money.” We must understanding that some grants require maintenance of effort, while others create a level of expectations of unsustainable service levels.

Enterprise Fund Imbalances. The Transition Team has identified the enterprise problem as being two-fold: (a) dependable, recurring revenues do not equal or exceed expenses, and (b) adequate reserves do not exist for emergencies, contingencies, or cash flow. Rates for Water and Sewer have been kept artificially low by use of retained earnings to balance the enterprise fund budgets. Each enterprise fund does not have a Stabilization Fund, or any appreciable reserve position – which is absolutely essential for contingencies, one-time needs, and unforeseen and/or unforeseeable eventualities. The enterprise funds are not truly self-sufficient, do not include the full costs of pensions and employee benefits/insurance, and do not operate as a business-type, not-for-profit public utility. Indeed, the Sanitation Fund does not even include vehicle insurance or capital outlay. It makes heroic assumptions on overly optimistic “pay-as-you-throw” (PAYT) receipts and does not cover the costs of operations, requiring a $1.5 million General Fund subsidy, in FY 2015 (and potentially $4 million in FY 2016). Without doubt, the Sanitation enterprise needs to be addressed in the immediate future.

Collective Bargaining Agreements. It appeared that the City has negotiated collective bargaining agreements without a detailed analysis of the explicit and implicit costs; additionally, the City did not consider the long-term sustainability implications of the labor relations contracts. Going forward, the City needs to be better prepared to deal with these costs and sustainability issues. In this regard, the City’s contribution to the Employees’ Group Insurance Program amounts to 75% of the self-insured claims, 75% of life and dental insurance premiums, and 100% of the costs of administration. Both active employees and retirees (and surviving spouses) enjoy the same 75/25% employer/employee split, which creates and deepens a post-employment benefits unfunded liability of $600 million. Collective bargaining – or the Public Employees Committee – needs to address this long-term liability and fashion creative, shared solutions.

The General Fund Is Structurally Imbalanced, Requiring the Use of One-Time Funds/Fixes.

According to the external audits, the General Fund positions have deteriorated in FY 2013 and 2014. For FY 2013, the General Fund analysis showed a deficit of budgeted revenues vs. expenditures of $3,568,573; by FY-end, the actuals still showed a $2,780,471 deficit. For FY 2014, the budget was in deficit by $5,581,274, which equated to an actual deficit at the end of the fiscal year of $3,603,740. These structural deficits were superficially fixed by the use of one-time funds. Clearly, current expenditures exceed current revenues leading to a persistent structural fiscal imbalance.

The prospects in FY 2015 are even less favorable and the FY 2016 figures are concerning. For FY 2015, overtime is exceeding projections and, without remedial action, will exceed its aggregate budgeted amount by $850,000. This figure includes EMS, Sanitation, Fire, Police, Community Maintenance, the School Department, and Inspection Services. The Snow/Ice Budget was purposefully underestimated from prior year actuals and is already another serious challenge based on actual expenditures through mid-February 2015. The bulk of the $3.96 million in Free Cash/Stabilization Fund was provided to the School Department, as the City failed to provide minimum levels of net school spending in FY 2014. The City no longer has sufficient one-time funds and short-term fixes to balance an inherently imbalanced budget. Our reduced cash flow (and diminishing reserves to support cash flow) has resulted in our Retirement Contributions being delayed past October 1 each year, which is not in line with the Public Employee Retirement Administration Commission (PERAC) funding schedule provided in 2013.

Before we consider FY 2016, we need to clearly understand the size and nature of the structure deficit of the FY 2015 budget. A budget is balanced if recurring revenues equals or are greater than recurring expenses. The general approach to achieve balance is to either enhance revenues or to reduce expenses. If expenses are greater, you have a deficit. Deficits are not financed through one-time moneys, as one-time funds should only balance one-time expenses, not recurring expenses. Non-recurring revenues may be used for deficit financing only under exceptional circumstances and then only as a bridging mechanism to definite recurring revenues in the following fiscal year. Otherwise, over time, continuing use of one-time monies becomes a self-fulfilling prophecy requiring further use each succeeding year. It creates a structural deficit; short-term reliance on non-recurring resources becomes a long-term need. In Fall River, this prolonged fiscal imbalanced required continual use of Free Cash, Stabilization Fund, Building Sales Fund, and Overlay Reserve Surplus to finance the General Fund deficit – and retained earnings to finance the operating deficit in the enterprise funds.

The dimensions of the use of one-time funds – $14,456,332 – are substantial, both in terms of duration and in terms of increasing dependency, over the past four years. According to the Tax Recap sheets and audited statements, the following one-time moneys – Free Cash, Stabilization

Fund, CDA moneys for debt service, Building Sales, Overlay Surplus, and other available funds (mostly non-recurring in nature) were employed to finance the deficit:

- FY 2012 - $928,000
- FY 2013 - $4,427,284
- FY 2014 - $3,740,004
- FY 2015 - $5,441,044 (as of 2/1/15).

For FY 2015, as of February 1, the $5,441,044 budget operating deficit was balanced by the following one-time resources:

- $379,874 - Community Development Debt Service Grant (continuing, quasi-recurring in nature);
- $100,000 – Offset Library Receipts (continuing, quasi-recurring);
- $7,579 – Waterways Improvement and Boat Excise Fund (continuing, quasi-recurring),
- 25,000 – Conservation Commission (continuing, quasi-recurring),
- $670,148 – Free Cash (non-recurring), of which $305,155 was appropriated after July 1, 2014;
- $3,373,500 – Stabilization Fund (non-recurring), of which $170,000 was appropriated after July 1);
- $109,943 – Overlay Surplus Reserve (non-recurring), and
- $775,000 – Building Sales Fund (non-recurring), of which $175,000 was transferred for Maplewood Park land purchase outside the General Fund (one of the few examples of the appropriate use of these one-time funds).

See ATTACHMENT B, “Fund Balances Report – Trend FY 2012 to FY 2015.”

ATTACHMENT C, “FY 2015 Budget Changes and Uses of One-time Fund” documents the appropriations/transfers after the beginning of FY 2015.

<u>The Consequences of the Structural Deficit for FY 2015 and Additional Expenses Foreseen for FY 2016 Will Compound the Deficit Problem.</u>

In summation, some $4.3 million in non-recurring funds were included in the budget as deficit financing on June 26, 2014.

Effectively, this meant that:

- the staffing base was kept artificially high;
- the budget base going forward into FY 2016 was $4.3 million too high; and
- positions were maintained in FY 2015 that should not otherwise have been there; in essence, these positions were living on unsustainable money.

To compound the problem, we can foresee $14.4 million in certain expense increases for FY 2016 such as:

- Snow Removal (covering the FY 2015 Deficit) + $3.0 million (so far)
- Adequately Funding Snow Removal in 2016 + $0.5 million

• Pension Contributions	+ $1.6 million
• Employees' Group Insurance	+ $2.0 million
• CanaRx (Canada Drug Program) FY 2015 Deferral/ Borrowing from Employees' Health Trust Fund	+ $0.8 million
• Fall River Public Schools Minimum Net School Spending	+ $2.2 million
• Regional Schools Minimum Net School Spending	+ $0.2 million
• School Transportation	+ $0.6 million
• Utilities (electric, gas) and Fuel	+ $0.3 million
• Debt Service (Interest and Principal on Bonds)	+ $0.2 million
• Salary (steps, longevity, stipends, etc.)	+ $0.2 million
• Increase in Overlay for Abatements During Revaluation	+ $0.3 million
• Increase in the Sanitation Fund Subsidy, due to loss of all BFI Payments and Realistic PAYT Receipts	+ $2.5 million

With the level-funding base for FY 2016 already too high by $4.3 million deficit in FY 2015, we now have a *compound deficit* of $18.7 million going into FY 2016.

However, we can only hold down FY 2016 costs, if the following assumptions are correct:

- The $1.5 million net school deficit for FY 2015 health insurance actual claims is resolved in FY 2015, by transferring funds from Employee Group Insurance to Schools.
- Controlling Fire and Police overtime increases and not replacing expiring Police Grants with General Fund resources, netting $1 million in expense avoidance.

Otherwise, the $18.7 million becomes a very problematic $21.2 million.

<u>Revenues are Not Keeping Pace with Expenses, with Much of the Revenue Flows Are Beyond Fall River's Control.</u>

Now, let's look at the revenue side of the equation.

1. Tax Increase - $3.4 million. The increase in the tax levy is constrained by the 2.5% limitation of Prop 2 ½, which would yield some $2.1 million; in addition, we can increase the levy by new growth, estimated at about 1.5%, or $1.3 million. This means that a maximum tax increase will result in $3.4 million in additional revenue.

2. Auto Excise and Licenses, Permits, Fees, and Fines/Penalties Increase - $1.1 million. Except for building permits, few licenses, permits, or fines have been raised in the past 6 years. They have not kept pace with inflation and do not cover the costs of administration. A 2.5% increase in auto excise estimates and a 15% adjustment in non-enterprise fees/penalties would increase revenue by $1.1 million.

3. Eliminating the Sanitation Fund Subsidy - $4.0 million. Even with Pay-As-You-Throw, the Sanitation Fund requires a subsidy from the General Fund, as it does not operate as it should, in a self-sufficient fashion. The $1.5 million subsidy in FY 2015 will grow to about $4.0 million in

FY 2016, as residual BFI revenue has ceased in the first quarter of FY 2015. By establishing a household unit user fee and/or revising the PAYT bag charges in such a way that the revenues collected equal the costs of operation plus marginal reserves, we can end the $1.5–4.0 million General Fund Subsidy, freeing up those funds for maintaining service levels elsewhere.

4. Revenue Decreases: Investment Income, Medicaid Reimbursement, and Medicare Part D Payment – $1.1 million decline. As a consequence of employee health insurance plan re-design, the Medicare Part D payment will cease in FY 2016; lower revenue levels are projected for Medicaid Reimbursements and interest on investments.

5. Fully-Financing Pension, Insurance, and Indirect Costs in the Enterprise Funds - $1.0 million. The current rates for the four enterprise funds do not cover the entire actuarial costs of pensions, the actual cost for employee group insurance, and the indirect costs of administrative and financial overhead. A reasonable increase in rates would end the General Fund subsidy of these centrally-budgeted costs.

Thus, the maximum amount of revenue enhancements in the General Fund that is within the City's control is $8.4 million.

Other sources of revenue are harder to predict with certainty. In these areas, we can only assume certain revenue levels – which may or may not come to pass in June, when the State budget is approved. At this time, according to the Governor's Budget Submission, we may realize:

- + $3.8 million in Chapter 70 (educational assistance) and perhaps
- + $0.5 million in General Government Receipts.

However, with the current fiscal difficulties facing the Commonwealth, Cherry Sheet Receipts are likely to be counterbalanced by Cherry Sheet Charges of some $4.0 million more this year. The Governor's Budget would provide Fall River with $343,666 in net revenue over FY 2015. ATTACHMENT W, "FY 2016 Cherry Sheet" presents the detail of the Governor's proposal, summarized below:

POTENTIAL CHERRY SHEET CHANGES,
FY 2015 TO FY 2016 (Governor's Proposal)

Category	FY 2015	FY 2016 Proposal	Difference	%
Total Estimated Receipts	$130,678,458	$135,007,253	$4,328,795	3.3%
All Educational Items	$106,541,692	$110,338,821	$3,797,129	3.6%
All General Government Items	$24,136,766	$24,668,432	$531,666	2.2%
Total Estimates Charges	$13,462,720	$17,447,849	$3,985,129	29.6%
County Assessment	$582,861	$595,753	$12,892	2.2%
State Assessments	$427,820	$428,337	$517	0.1%
Transportation Authorities	$970,927	$995,194	$24,267	2.5%

Annual Charges	$33,568	$66,570	$33,002	98.3%
Tuition Assessments	$11,447,544	$15,361,995	$3,914,451	34.2%
NET INCOME FOR FALL RIVER	**$117,215,738**	**$117,559,404**	**$343,666**	**0.3%**

A further resource is the State partial reimbursement of Homeless Student Transportation costs. Based on the School Department's End-of-Year report, the formula for disbursement, and the State appropriation for the McKinney-Vento homeless expenses, the City will receive a reimbursement of an unknown amount; this has been in the $400,000 to $600,000 range in the past.

Clearly, it would be irresponsible to depend completely on State resources to compensate for the magnitude of the shortfall projected. We have been living beyond our means, running up deficit financing at least since FY 2012, such that we have no further reserves. The Stabilization Fund, drawn down to $499,598, must not be touched. These are the only funds we have for any contingency – our only rainy-day fund.

A turn-around will require fiscal discipline and a fundamental rethinking of the structural imbalance of the City finances, to rely on recurrent revenues equaling current expenditures and avoid the use of one-time revenues to artificially build up the fiscal base for the future.

<u>Enterprise Funds: Lack of Fiscal Rigor and Business-Type Approach</u>.

By definition, enterprise funds are to be operated as public utilities in a business-like, private not-for-profit fashion. Expenses should be thoroughly scrubbed, privatization alternatives and private-sector principles fully explored, and fair user charges in the aggregate should be greater than expenditures (including debt service, capital outlay, and a marginal amount for reserve accumulation). A fully established enterprise fund – as is the case with EMS, Water, and Sewer – should be self-sufficient and have built up a reserve position. The Sanitation Fund was created in 2009:

- first, as a mechanism to ascertain the true costs of operation; and
- second, to experiment with user rates over time (in order to reduce the General Fund subsidy and within the longer-term (say five years) become self-sufficient with reliable revenue sources).

Unfortunately, the Enterprise Funds have not lived up to their full potential and one continues to be a liability on the General Fund. There is a lack of fiscal rigor in estimating their budgets, with the same amounts budgeted for major line-items in FY 2014 and FY 2015, when cost increases indicate otherwise. Based on information received recently, it appears that Sanitation Fund is not self-sustaining, while the EMS enterprise is having difficulties with revenue collection and must use retained earnings for operations. Overall, there is a lack of fiscal discipline in establishing self-supporting, fair user charges, as the enterprises have not evaluated their rates adequately to account for all expenses. For example, in the Sewer budget, in the case of the stormwater subaccount, evidence submitted shows that the amount raised in fees covers only 70% of the actual cost of providing the service; the current $35 per quarter/unit fee does not realistically reflect the underlying costs involved. Across the board, budgets for employee group insurance benefits, pensions, and indirect costs appear to be stopgap figures created to yield a seemingly acceptable rate, rather than based on sound analysis and actuarial-based projections – as any private-sector business would undertake.

Going forward, the enterprise funds should operate more self-supporting manner, like private-sector utilities or firms, with consideration for unfunded liabilities or actuarially-sound payments for pensions, current employee benefits, and longer-term post-employment benefits. They should articulate a clear policy on acceptable levels of reserves (or contingencies for claims, damages, court judgments, infrastructure emergencies, and other unforeseen eventualities).

As regards collections and past due bills, in the case of water and sewer, non-payment of bills results in adding that amount to the tax bill as a lien. Such a process is not possible for EMS billing and is not currently possible for Sanitation. We are uncertain of the magnitude or aging of EMS past due bills, though we are aware that collections have lagged during the first half of this fiscal year. We are concerned that projected pay-as-you-throw revenues will not be realized, resulting in a continuing and expanded General Fund subsidy for Sanitation that the General Fund can ill afford. As currently structured, the Sanitation Fund has little in the way of dedicated and reliable revenue resources, has no way to ensure that rates equal expenditures (including debt), and has no enforcement mechanism (such lien and tax title). Indeed, even if staff enforces Sanitation regulations and issues citations or tickets, the fines paid are not included in enterprise receipts, but are rather entered into the General Fund.

<u>Enterprise Funds Are Also Structurally Imbalanced and Lack Reserves</u>.

All the enterprise funds have demonstrated varying degrees of structural imbalance or deficit funding, as is revealed by the use of retained earnings to finance an operating deficit. Generally, the revenue generated by rates must equal or be greater than the costs of operations, including debt service and the allowance for a reserve position. As a matter of prudent enterprise management, reserves should be maintained in a Stabilization Fund; for contingency and cash flow purposes the reserves should equal one to two months' worth of expenses, or 8.5% to 17% of budgeted expenses. None of the enterprise funds have an appreciable reserve position and, over the past five fiscal years, all have used retained earnings to reduce rates and deficit finance their budgets – with the exception of the Sewer and Sanitation Fund in FY 2010. (Even then, the Sanitation Fund relied on a General Fund subsidy in the millions of dollars to be fully funded.)

As regards the Sewer Fund, we verified that from FY 2010 to FY 2014, $5.2 million was certified in retained earnings, and that 76%, or $4.0 million was used to finance their operating deficit. The Sewer operating deficit ranged from 7.9% in FY 2013 to 4.4% in FY 2015. The Sewer Fund should have a $3.4 million reserve position in FY 2015, but as of February 1, 2015, only has $766,065 in retained earnings. This results in a presumptive reserve deficit of $2.6 million.

For Water, during the same time period, certified retained earnings amounted to $2.3 million, of which 81% (or $1.8 million) was used to superficially balance the budget through deficit funding. This meant that the water rate, over from 2010 to 2015, was kept artificially low by $1.8 million. In one year, 2011, the rate yielded $1.2 million less than it should have. The Water operating deficit ranged from 12.1% in FY 2013 to 0.3% in FY 2015. The Water Fund should have a $1.8 million reserve position in FY 2015, but as of February 1, 2015, only has $216,564 in retained earnings. This results in an estimated reserve deficit of $1.6 million.

For the EMS enterprise, from FY 2010 to FY 2014, $2.1 million was certified in retained earnings, of which 50% (or $1.1 million) was used to bring about operating balance. EMS is also the only enterprise fund to have a Stabilization Fund, but that has been drawn down from $134,610 in 2012 to $16,681 today. The EMS operating deficit has ranged from 0% in 2012, to 12.2% in 2013, to a projected 4% for 2015. To meet a reserve target of 17% of budget, it should maintain $856,201 in reserves, but only has $291,680 in retained earnings and stabilization, yielding a reserve deficit of $547,840.

Finally, the Sanitation Enterprise Fund is, by far, in the most unsustainable financial position, failing to meet the self-sufficiency standards that apply to enterprises. The fund has always relied on the General Fund for a subsidy, while using 82% of the $1.1 million in retained earnings over the past five years. It should have $955,846 in reserves, but instead has only $212,422 in retained earnings, leaving a reserve deficit of $743,424. Its operating deficit has been declining from 80% in FY 2013 to 32% in FY 2015. The following table shows the magnitude of its fiscal difficulties:

Sanitation Enterprise Budget and Operating Deficits

Fiscal Year	Total Budget	Retained Earnings Used	General Fund Subsidy	Actual Operating Deficit	% Operating Deficit
2012	$6,771,623	$0	$5,023,323	$5,023,323	74.2%
2013	$7,204,503	$223,475	$5,529,493	$5,752,968	79.9%
2014	$7,470,578	$375,992	$5,453,222	$5,829,214	78.0%
2015	$5,622,621	$266,980	$1,526,641	$1,793,621	31.9%

Detailed enterprise fund analyses are found in ATTACHMENT D, entitled “Enterprise Funds: Reserves and Retained Earnings Analysis – Trend FY 2010 to FY 2015.”

Declining, Minimal City Reserve Position.

On October 1, 2014, Department of Revenue certified the following balances, as of July 1, 2014:

- General Fund Free Cash $3,961,620