



CITY OF WORCESTER, MASSACHUSETTS

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City Manager

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Attachment for Item #

8.34 A

February 3, 2009

TO THE WORCESTER CITY COUNCIL

COUNCILORS:

As you know, on January 28, 2009, Governor Deval Patrick released formal notice of the Commonwealth's "9-C" reductions to Local Aid for the current fiscal year (FY2009), as well as his proposed FY2010 budget that included further reductions to Local Aid. My previous memorandum detailed that the State's FY2009 9C Local Aid reduction would be \$5 million, or roughly 9.75%, per the Governor's presentation at the MMA last Friday. This has now been confirmed through correspondence from the State Administration. It must be noted, however, that we await details as to the State's reductions to FY2009 earmarks and grant programs. These provide targeted funding for public safety, public health and economic development. This information is critical to a true and accurate assessment of the FY09 impacts from these mid-year State cuts.

Our preliminary analysis of the proposed FY2010 State Budget reveals a net reduction of the State's Local Aid and other revenue support to the City (all non-Worcester Public School) of \$17.4 million. This total is comprised of a Local Aid reduction of \$14.8 million, as well as significant reductions in the State's line-items for Quinn Bill reimbursements, community policing and veteran's and elderly exemption payments that would have obvious detrimental effects on our revenues. We continue this detailed analysis and expect to report in greater detail in the week ahead.

Our Five Year Fiscal Forecasting identified the reality of \$7M budget deficit for FY2010 as we consistently updated over the past two years (FY08-FY09), as adjusted for then economic conditions. This forecast was based on expected growth in City costs for categories such as employee health care, debt service, and the State foundation formula/ City contributions for education. Conversely, these calculations also forecast declining City revenues in a rapidly cooling national economy in categories such as new real estate growth, motor vehicle excise taxes and other fee/ charges. These forecasts included the level funding of State Aid categories, which in itself is a net reduction, for our costs grow between 3-4% annually and State Aid is 25% of our revenue stream (flat line growth of 25% of our revenue stream while the expense-side of the budget grows at 3-4%).



All City revenue and expenditure categories were updated to reflect current conditions to include the expected double digit increases in employee health care costs. Our projected City-side revenue/ expenditure deficit for FY2010 remained at \$7 million, exclusive of the State's proposed \$17.4 million in Local Aid/ other reimbursement/ revenue/program reductions, City snow deficit carryovers and City retirement system loss recovery. Please note, this updated forecast factors and preserves the City's commitment to continue to meet the City's contribution to the State's foundation formula for education. The State formula as applied, however, does result in a net \$2 million less for the Worcester Public Schools when these proposed dramatic State Local Aid reductions to the City-side are factored and calculated.

It is important to note there is a similar FY2009 City budget effect when the State's education formula is recalculated due to the mid-year cuts in Local Aid to the City of \$5 million. The result would be \$500,000 net less for the WPS through June 30, 2009. Much like the Governor's recommendations, it is clear this City Council will want to mitigate any mid-year disruptions to our classrooms and therefore will stand firm in maintaining our "pre 9-C" levels of funding to the WPS through June 30, 2009. I concur, without question, and I will proceed accordingly with all projections and recommended actions to balance the FY2009 Budget.

The following represents our revised fiscal forecast for FY2010. It factors the Governor's proposed reduction of \$17.4 million to the City's Local Aid and other line items and revenues, as well as the projected \$2.5 million snow removal deficit carryover.

FY 2010 Updated Projections

- Governor's Proposed 2010 Local Aid Reductions & Other Cuts (\$17,400,000)
 - Lottery and Additional Assistance Cut \$14,800,000
 - Quinn Bill Reimbursement Cut \$ 1,100,000
 - Community Policing Cut \$ 800,000
 - Veteran's Exemption Reduction \$ 400,000
 - Elderly Exemption Reduction \$ 300,000
- City's FY 2010 Adjusted Exp. / Revenue Projection (Non-State Aid) (\$ 7,000,000)
- FY2009 Snow and Ice Removal Carry-Over to FY2010* (\$ 2,500,000)

*This snow and ice projected deficit is inclusive of 75% FEMA and 25% MEMA reimbursements for the City expenses associated with the December 2009 Ice Storm.

Subtotal City-Side Projected FY2010 Deficit (\$26,900,000)

- City Auditor's Rec. FY2010 City-Side Pension Deposit** (\$ 4,500,000)

**City Auditor's estimates the need of an additional FY2010 City-side deposit of \$4.5 million into the City's Pension System. His request is based on our responsibility to begin to address the dramatic stock market losses within the retirement system portfolio over the past year.

City Side Projected FY2010 Deficit (w/ City Auditor's Recommendation) (\$31,400,000)

This City-Side FY2010 deficit of \$26.9 million is a forecast and is inclusive of all proposed State reductions and other known factors (as of this writing). I have also indentified the City Auditor's recommendation (as to the City's Pension System challenges) in order to provide City Council with a full panorama of the potential liabilities we will be faced with in our FY2010 Budget deliberations. I await the projections from the Worcester Public Schools for FY2010. The Governor's FY2010 Budget Recommendation holds the State's Chapter 70 Local Aid for Education "harmless", in essence level funding WPS at the State's FY2009 funding levels. I believe it was universally received as a generous proposal to level fund the State's Chapter 70 Education Aid in these trying fiscal times. However, it is safe to say that State's level funding of almost 75% of the WPS annual budget (Chapter 70 Local Aid for Education) in the face of increasing fixed costs for salaries and employee health care, as well as required additional pension deposits, adjustments due to City-side State Aid cuts (its effects on City contributions to WPS due to the State's formula), etc. will likely have a negative impact on WPS's FY2010 outlook. However, it is also important to note that President Barack Obama, Capitol Hill leadership and the Governor have referenced additional operating funding for public education as part of the Federal Stimulus Legislation. The Federal Stimulus Legislation appears, as of this writing, to have limited options for operational funding for the City-side, with the exception of a note for "public safety/ police/ fire" on one line item. I will forward additional information on the Federal Stimulus Legislation and its potentials as it becomes available and I will also seek to secure more detailed information for the City Council regarding WPS's FY2010 projections in the week ahead.

The Patrick-Murray Administration has also proposed an Emergency Recovery Bill which includes proposals for revenue enhancements for the City including hotel/ meals taxes (Statewide), hotel/ meals taxes (local option), and closing the so-called telecommunications loophole.

Emergency Recovery Bill – Estimated Net New City-Side Revenues

• Statewide Hotel/ Meals Tax	\$5,876,707
• Local Option Hotel/ Meals Tax	\$3,000,000
• Telecom Loophole	<u>\$2,400,000</u>
Subtotal City-Side - Estimated Net New Revenues	\$11,276,707
• Pension System Reforms and Options	\$4,000,000
Emergency Recovery Bill – Estimated Net New Revenues	\$15,276,707

These net new revenues and expenditure reductions, as presented, could assist the City's FY2010 Budget and could provide financial relief as we look to address the losses in the Pension System. Please note these estimates are as prepared and presented by the State Administration. These are subject to change (positive/ negative) based on a variety of factors to include their passage by the State Legislature, the language of the legislation (as adopted), the continued economic downturn, DOR assessments, City Council adoption and other variables. If adopted, there would be a companion benefit to the WPS of approximately \$2 million dollars in revenues, not exhibited on the schedule above, as a result of the calculations of the State's Foundation Formula for

Education. There would also be financial relief from the pension system reforms and options for the WPS.

The Governor's budget recommendations are now before the State Legislature and are obviously subject to change as the House and Senate develops their document and respective line items and then debates and deliberates upon this, factoring the up to date State revenue receipts/trends through the late winter/ early spring. It is crucial that the Legislature weigh the Governor's proposals and then act as expeditiously as possible. It is their work, hopefully complete in the weeks ahead, that will provide the direction we need on final local aid amounts (Joint Resolution on Local Aid), on new revenues (from the Emergency Recovery Bill) and on other tools they will develop to assist us through these difficult times.

Per my previous memorandum, the goal is to present an 18 month FY2009/ FY2010 Budget Recommendation (January 1, 2009 through to June 30, 2010), by no later than Mid-March, to adapt to this dramatic reduction in State Aid and other factors - all in one comprehensive action. This Budget Recommendation would address the Governor's FY 2009 "9C" Mid-Year Cuts of \$5 million and again, hopefully, the actual FY2010 deficit due to State cuts (upon the Legislature actions on the Joint Resolution and the Emergency Recovery Bill) and all other factors. Preliminary discussions with our Statehouse Delegation as to the Legislature's timeline on these measures found that, though it is their desire to act expeditiously, they may not meet our deadline for specifics due to the reality of the continued decline of the State's FY2009 revenues and other issues. They stated that the continued rapid decline of State revenues may have their current estimates as "optimistic at best" and that additional time is required to re-analyze these trends prior to the Legislature's actions on FY2010 matters.

A balanced budget requires we acknowledge all known revenues and expenditures. That said, and for example, it would require that we present a FY2010 Budget Recommendation with a net reduction of \$26.9 million dollars, as of this writing, exclusive of the City Auditor's recommendation for the Pension System and prior to actions on other City-side recommendations for cost savings detailed later in this memorandum. A \$26.9 million reduction represents a cut of over 20% of our net operating budget once all fixed costs are factored. Timely action (prior to our FY2010 Budget Recommendation) on the Legislature's Emergency Relief Bill and their Joint Resolution on Local Aid would result in a **\$15.6 million reduction, or a 12% cut**, to the net operating budget. This is, of course, if all Local Aid and other reductions/ revenue estimates were to hold true to the Governor's recommendations/ projections. This would again be exclusive of the City Auditor's recommendation for the Pension System and be prior to other City-side recommendations for cost saving detailed later in this memorandum. The clear preference is to develop a FY2010 Budget with these Legislative actions complete and resultant State aid/ revenues known - for all the obvious reasons.

Last week, I detailed that this is an evolving process due to a host of variables and that timely Legislative action would be required to meet the goals of an 18-month budget. The candid assessment by our Statehouse Delegation may very well prevent our ability address these multi-FY budget reductions once due to the fact that we may not have the required Legislative direction (within our timelines). As such, we will likely have to undertake a two-phase action plan to adapt to these State aid reductions. Therefore, I am preparing our Administration's recommendations for a phase one, City-side, FY2009

reduction in staff (layoffs), programs and initiatives to accomplish this. Our anticipation of these mid-year State cuts places us in an improved overall position for there are over 50 open positions due to a “case by case” hiring freeze, etc.. Please note that these 50 unfilled positions also compromise our ability to undertake the core municipal services outlined in our FY2009 Budget, as approved. I expect to brief all and to present this phase one reduction to City Council formally for the City Council Meeting of February 10, 2009.

It has been reinforced that all must “be on the table” as we seek to assess, adapt and address these necessary FY2010 reductions (phase two) and I assure this City Council and this community that we are analyzing each and every facet of our operation, top to bottom and all options that may be available. We must work from reality and propose new, sound financial and operational reductions, reforms, reorganizations and revenues. The following are scopes under final evaluation: layoffs, elimination of divisions and services in their entirety (reduction to below core mission), further Departmental/ Divisional reorganization, negotiated furloughs, negotiated wage concessions, negotiated employee health care cost changes, an early retirement initiative, the transfer of the airport, public-private partnerships to assist City services, fees, and much more. There are also additional elements of the Patrick-Murray Emergency Recovery Bill that may assist us in these various categories, if adopted. We expect to present these recommended scopes with specifics in briefings to all and in a formal presentation to the City Council for the Meeting of February 10, 2009. As stated in my previous memorandum, this will require immediate and short-term actions and cooperation on multiple fronts: City Council Requests, Administration Recommendations, City/ WPS Collective Bargaining, City Council Actions, State Legislative Actions, School Committee Actions, etc.. We must stay on track with real solutions, within the context of our Five Point Financial Plan, and stay away from any sizable influx of one-time cash and “sleepers” such as wage freezes where the wage liability exists to be paid in some future year. These unfortunately ignore the long-term negative consequences of living well outside our means.

Please know that even in these difficult times, the development of the City’s budget will continue the tradition of an inclusive process as we focus on our collective priorities and we address these budget challenges together. What you can expect throughout this, without question from my Administration and me, is thorough planning, fiscal prudence, candor, transparency, communication, creativity and partnership – all to stabilize our community through this difficult period. Please know I also understand and respect that our ability to adapt and to address our current challenges will require an enhanced level of partnership and good faith with our collective bargaining units and I will proceed, as always, in this spirit - for we are indeed all in this together.

Respectfully submitted,



Michael V. O'Brien
City Manager