



The Portsmouth FY 2011 – 2012 Budget

May 15, 2011

Prepared by the Portsmouth Concerned Citizens

CONTENTS

Executive Summary Page 3

Revenue Page 4

Unfunded Retirement Obligations Page 4

Use of Warrants and Debt Management Page 6

School Department Budget Page 7

Restructuring Page 8

Fund Balance Page 8

Summary Page 8

Enclosures

Enclosure 1 – Trends in Municipal Personnel Costs Page 10

Enclosure 2 – Requirements for Public Approval of Debt Page 11

Enclosure 3 – Portsmouth School Budget – Personnel Cost Management Page 12

Enclosure 4 – Town of Portsmouth – Municipal Employees Page 13

Executive Summary

The 2011 – 2012 fiscal year will continue to be a challenge for Portsmouth government as the depth of the unfunded retirement obligations becomes better defined and the State enters the third year of the most severe recession in memory.

Portsmouth, as many other municipalities in Rhode Island, faces substantial funding shortfalls in its pension and post employment benefit obligations. For Portsmouth, this problem may be moving from a serious fiscal issue to one that is in crises. Immediate action must be taken to reduce the annual growth of the future obligation shortfalls, or an **intractable problem may quickly become unsolvable. The PCC considers the Town at considerable risk in this area.**

Although there have been recent improvements in salary and benefit costs for Town employees, expenditures still increase faster than inflation. The strong tendency of the Council and School Committee to hire new employees must be resisted as long as the State government remains in an unstable financial condition.

Although rising moderately, revenue to the State continues to be severely depressed. The loss of Federal stimulus funding - which was partially integrated into the State budget and as a consequence the Portsmouth School Department budget - will cause significant declines in next year's State revenue to the Town. Federal funding constitutes more than half of the State budget. In addition, a number of the State's cities, including Pawtucket, Providence, Woonsocket and North Providence are nearing bankruptcy. Central Falls is already bankrupt. A financial failure in Providence city government will likely have a significant impact upon State revenue to the cities and towns. Two bond-rating agencies have recently lowered the city's bond rating to two levels above junk bond status, with a negative outlook.

The implications for the Portsmouth budget of the State's crises in its retirement funds are not yet clear, but it is likely to affect local revenues and expenses. The \$6.8 Billion shortfall in state pension plans announced May 11 is probably beyond the State government's ability to resolve without substantial restructuring of the plans. It is nearly twice the annual tax revenues collected by Rhode Island. The \$2.5 Billion State managed municipal pension plans are outside the Town's direct interest as municipal pensions are locally funded. The exception is the Teacher's pension plan, which is managed by the State and will require an additional \$135.3 million in funding for the coming year. In the past, shortfalls have resulted in State directed increases in funding by the municipalities.

The Council should expect the FY 2011 – 2012 State budget to contain either further reductions in State revenue to Portsmouth or an increase in local taxation authority in return for reductions in State funding. We believe State mandated increases in local deposits into the Teachers retirement fund are likely.

Revenue

State Funding to Portsmouth - State revenues derived from direct taxation and fees remain at substantially reduced levels. Although there have been recent increases in anticipated state collections (\$115 million), that trend is unlikely to be sustainable. We do not anticipate that the Rhode Island economy will outpace the national recovery. In the coming fiscal year, most of the Federal Stimulus (ARRA) funding will disappear. That reduction, and other difficulties, have created a \$295 million projected deficit (more recent estimates have been as high as \$331 million) in the State 2011 – 2012 budget.¹ Projected Chafee administration increases in sales taxes are intended to reduce that deficit by approximately \$100 million, although the House Majority Leader has indicated the Governor’s proposal lacks support in the House.

On the municipal side, approximately \$500,000 (2.58% of the municipal budget) in State revenue is expected to remain in the budget and any State reduction cannot exceed that amount. The School Department will enter the first year with reductions in revenue associated with the new student funding formula and receives State funding of approximately \$5 million. In severe State revenue crises, much of that State funding is at risk.

Our Town’s citizens remain under considerable financial pressure. Current unemployment in Portsmouth is approximately 10%. Thirty-two houses were foreclosed upon in calendar year 2010, and a number of other families are assumed to have been forced out of their homes short of foreclosure. The Portsmouth Tax Collector expects to sell ten houses for non-payment of taxes in June. **It is our very strong view that additional taxation will add to the financial stress of our citizens.**

While recent budgets have not risen significantly, State funding losses are being replaced in our municipal budget by increases in property taxes. Property taxes have increased at the maximum under the tax cap for the last few years. Our government, in effect, expects its citizens to replace losses in revenue from the State, but it is doubtful that those taxes will be returned should State revenues recover.

Unfunded Retirement Obligations

General - Past Councils have not dealt effectively with retirement obligations. **The problem has grown to the point where we believe it risks the financial stability of Town government.** The total unfunded Liabilities in both pension and retiree health care programs is now estimated at \$45 million, which is 82% of the current year’s operational budget. It is generally accepted that when the unfunded liabilities reach 100% the problem is unsolvable without radical budget and employee changes. It is now clear that these programs must be run with current actuarial studies to help accurately define the Town’s exposure. The OPEB (Other Post Employment

¹November Revenue and Case Load Estimating Conference quoted in RI Revenue Department presentation of December 17, 2010

The Portsmouth FY 2011 – 2012 Budget

Benefit) plans have recently completed those studies – including actuarial studies for the first time. The May decisions by both elected bodies to commission an actuarial study of the Town pension program is an important decision and finally reverses what has been a policy of benign neglect.

UNFUNDED PORTSMOUTH RETIREMENT OBLIGATIONS FY 2010 - 2011 Audit				
Town Retirement Plan – Actuarial Study Incomplete				
Departments	Actuarial Accrued Liability (AAL)	Funded AAL	Unfunded AAL	% Unfunded
Municipal and School	\$54,054,944	\$32,779,646	\$21,275,298	39.36%
Other Post-Employment Benefits (OPEB) - Health Care				
Departments	Actuarial Accrued Liability (AAL)	Funded AAL	Unfunded AAL	% Unfunded
Municipal	\$13,248,340	\$153,249	\$13,095,091	98.84%
School	\$11,000,000	\$0	\$11,000,000	100.00%
Total	\$24,248,340	\$153,249	\$24,095,091	99.37%
TOTALS			\$45,370,389	

Pensions – The Town operates a combined pension program, which includes all School Department non-certified staff (about 80 individuals) as well as all employees in the municipal departments. As of June 30, 2009, Portsmouth had a total unfunded retirement obligation of \$19,639,078. By June 30 of 2010, the unfunded retirement obligation increased to \$21,275,298. This estimate is unreliable until the actuarial study is completed. It is widely believed by professionals in the accounting and bond fields that large unfunded obligations in these areas are a mark of a poorly managed municipal budget. State Revenue Director Ms. Rosemary Gallogly was recently quoted:

Gallogly said the state looks at all the issues as a whole, but a healthy reserve account and fully funding a community’s pension obligations are good financial practices. – Providence Journal February 23, 2011

The growth in the shortfall occurred despite a moderate increase the investment markets of approximately 4% during the audited period, suggesting that the annual rate of increase in the shortfall is significant. The pension shortfall increased \$1,636,220 in the last audited year. This problem remains a critical threat to budget stability, even in the short term. This Council has begun a study of the pension system, in concert with the School Committee and this is a

The Portsmouth FY 2011 – 2012 Budget

significant development. The Council, however, must implement measures to deal with this growing deficit in this fiscal year to avoid massive tax increases to fund shortfalls.

Health Care - Portsmouth has adopted procedures that are common in Rhode Island municipalities. This does not mean that they are wise. The retiree health care (OPEB - other post-employment benefit) programs for the municipal departments and for the school department are pay as you go programs and until recently lacked investment trusts to reduce costs and level upward spikes in benefit expenditure requirements. Cost estimates for these health care programs have been recently updated, revealing that estimated costs were far too low in the School Department program. The estimated unfunded obligations in that program increased from \$4.5 million to a stunning \$11 million. The municipal OPEB actuarial study produced results verifying previous estimates of Actuarial Accrued Liabilities (AAL). The current unfunded liabilities (shortfall) are \$13,248,340.

FY 10 - 11 Municipal Retiree Health Plan Costs vs. Expenditures

Department	Annual Costs	Covered Costs	Annual Shortfall
Town - Health	\$1,349,118	\$645,276	(\$703,842)

Recommendation: The recently initiated cost studies for pension and OPEB programs must be presented to each of the elected bodies for a major review of the retiree health care programs. We believe that at present, insufficient data and analysis exist to evaluate this financial problem. We also believe that this issue is a major budget decision, yet action during the budget process for FY 11 – 12 has been limited. The Town Council and School Committee must complete their review of the retirement program before budgets are finalized and act.

Use of Warrants and Debt Management

The total Town debt remains manageable at approximately \$25 million. Restructuring of debt obligations by the Finance Director have been effective in limiting the cost of borrowing in a time of low interest rates. Warrants, however, remain a problem from both the cost and legal points of view.

The Town’s reserves also remain severely depleted at a time of need. The deposit of the 2009 – 2010 surplus in the Fund Balance restarts a past procedure, which we consider very positive. While large deposits in the Fund Balance are probably impractical for the next two years, all unrestricted surplus and unexpected funds should continue to be deposited in the Fund Balance upon receipt.

Recommendation: The Council should re-establish the procedure of depositing surpluses and unexpected revenues as a budget policy in a new ordinance.

The Portsmouth FY 2011 – 2012 Budget

Warrants - The Town Administrator has recommended omitting the annual municipal warrants to support technology and maintenance in the School Department in FY 11 – 12. We support the use of the school maintenance funding in the municipal budget, but not the use of warrants to fund the practice. The cost of interest on any future warrants are an unneeded expenditure and the warrants should be included as operational costs in the annual budget.

The PCC also believes that debt obligations in excess of \$50,000, without citizen approval, are a violation of the State constitution (see Enclosure 2). Movement of the school maintenance and technology annual costs into the operational budget would resolve these objections.

The budget does not contain a summary of total town debt and previous year totals so that trends are obvious to the Town's citizens. The Council's decision add that data is appreciated and will aid in understanding of the Town's budget process by our citizens.

School Department Budget

General - State education revenue will continue to decline for Portsmouth in the 2011 – 2012 fiscal year. Those reductions, plus an increase in funding of the Teacher's retirement plan directed by the State Retirement Board to 18% of salary, will cause this to be a difficult year. The department was flat funded last year, an action the PCC supported in the difficult financial circumstances, but is a factor the Council should consider in FY 11 – 12 funding.

The negotiations with the Portsmouth NEA, presently underway, are critical to the department's budget stability. The School Committee simply cannot agree, or be forced to agree, to any agreement more expensive than their last offer to the union.

Once again, the School Committee's budget request is unbalanced as submitted. This is the third consecutive year that this has been done. The budget is \$497,876 in deficit (expenditures exceeding revenue), and the Council cannot legally adopt the budget until revenues and expenditures match.

Revenue - The Loss of Stimulus funding, in the IDEA Federal funding and those State funding areas into which this was inserted in the previous two years, will reduce revenue further. The department expects State and Federal revenue losses this year to be \$827,415.

The Department will shift \$625,130 in Restricted revenue to the Operational budget this year to conform to new State requirements, but this does not involve a loss of revenue.

While a budget increase of \$639,834 is requested, an increase of \$1,198,665 (4.25%) is requested in the local tax levy. The School Department is replacing the shortfall in expected State revenues with Portsmouth property taxes.

The Portsmouth FY 2011 – 2012 Budget

FY 11 – 12 School Committee Budget Request

	FY 10 - 11	FY 11 - 12	Change
School Department Budget	\$35,957,720	\$37,296,252	3.72%
Town Appropriation (Taxes)	\$28,203,873	\$29,402,538	4.25%
Town Appropriation Inc.		\$1,198,665	%

Restructuring of Personnel Costs – In recent years, the department has reduced teaching staff with the decline in student enrollment. This year the process of staff reduction has ended and salary and benefit cost will be a challenge. The cost of personnel remains too high. This year’s labor negotiations with two of the department’s unions must produce further reductions in this area. Otherwise, department budgets will grow faster than anticipated revenue. Salaries in the requested budget grown by 1.12% and benefits grew by 10.52%. While the growth in salaries remains under last year’s inflation rate of 1.5%, benefit costs remain uncontrolled. Overall cost of personnel in the department grew by 3.76% and the percentage of the budget of these costs increased slightly to 78.13%. Our study of these trends is in Enclosure 3.

Restructuring

The State revenue crisis is hiding the fact that we are living beyond our means. Simply put the cost of salaries and benefits remains too high. ***The Council must reverse this trend.*** Cost increases in the FY 11 – 12 at this point are unknown, but current year costs are expected to continue at the present pace. That pace is substantially above inflation, which is running below 1.5%. A table of the historical manning of the municipal department is in Enclosure 4.

Salaries and Benefits – Annual Percentage Increases

	2008 - 2009	2009 - 2010	2010 - 2011
Sal. & Ben. Increases	7.88%	2.41%	2.59%
Inflation	.10%	2.70%	1.50%

Salaries and Benefits as a Percentage of the Municipal Budget

2007 - 2008	2008 - 2009	2009 - 2010	2010 - 2011
58.95%	60.51%	62.70%	63.35%

Any decision to end the hiring freeze is unwarranted in the current fiscal climate. Hiring for new or replacement positions will significantly reduce financial options during the coming fiscal year. Lacking any clear understanding of the course of State government, a conservative approach to the primary cost sector of local government is warranted.

Summary

The Portsmouth FY 2011 – 2012 Budget

We believe that the Council's primary obligation in this recession, and the resulting state revenue crises, is to preserve the financial stability of Town Government, while avoiding the imposition of additional tax burdens on the Town's hard pressed citizens. The prudent management of public funds in times of crisis requires strict adherence to the primary obligation of local government: provide public services at levels the people can afford. In addition, our annual operational budget growth is suppressing funding of retirement and reserve needs that will eventually deliver the town into financial difficulties.

Enclosure 2

Rhode Island State Constitution's Provisions on Debt

Section 16 “Limitation on state spending” of Article IX “Of the Executive Power” prohibits deficit spending at the state level. According to the principle of derivative powers, this prohibition also applies to municipalities who derive their power from state government.

Section 16 “Borrowing power of general assembly” of Article VI “Of the Legislative Power” of the state constitution also prohibits the state from incurring debts greater than fifty thousand dollars “without the express consent of the people.” Here again, it is clear that this restriction applies to local governmental bodies whose powers are derived from those of state government.

Prohibition on Deficit Spending in the Rhode Island Constitution Section 1 of Article VI of the state constitution also provides that “This Constitution shall be the supreme law of the state, and any law inconsistent therewith shall be void. The general assembly shall pass all laws necessary to carry this Constitution into effect.”

ARTICLE VI

OF THE LEGISLATIVE POWER

Section 16. Borrowing power of general assembly. -- The general assembly shall have no powers, without the express consent of the people, to incur state debts to an amount exceeding fifty thousand dollars, except in time of war, or in case of insurrection or invasion; nor shall it in any case, without such consent, pledge the faith of the state for the payment of the obligations of others. This section shall not be construed to refer to any money that may be deposited with the state by the government of the United States.

Portsmouth School Budget Structural Imbalances										
	2001-2002	2002-2003	2003-2004	2004-2005	2005-2006	2006-2007	2007-2008	2008-2009	2009 - 2010	2010 - 2011
Budget Expenditures										
Total School Dept. Operational Budget	\$24,220,828	\$25,068,557	\$26,170,614	\$27,862,580	\$29,939,467	\$32,178,738	\$33,451,958	\$34,743,070	\$35,746,286	\$35,527,720
Annual Rate of Increase		3.50%	4.40%	6.47%	7.45%	7.48%	3.96%	3.86%	2.89%	-0.61%
Maximum Tax Cap		5.50%	5.50%	5.50%	5.50%	5.50%	5.20%	5.00%	4.75%	4.50%
Total Salaries					\$17,367,696	\$18,261,278	\$19,072,617	\$20,103,717	\$20,424,729	\$20,905,837
Increase Over Previous Year						5.15%	4.44%	5.41%	1.60%	2.36%
Total Benefits					\$6,268,512	\$6,921,747	\$6,771,316	\$7,370,453	\$7,395,848	\$8,017,433
Increase Over Previous Year						10.42%	-2.17%	8.85%	0.34%	8.40%
Total Salaries and Benefits					\$23,636,208	\$25,183,025	\$25,843,933	\$27,474,170	\$27,820,577	\$28,923,270
Annual Rate of Increase						6.54%	2.62%	6.31%	1.26%	3.96%
Percentage of Salaries & Benefits					78.95%	78.26%	77.26%	79.08%	77.83%	81.41%
Differential between Revenue and Labor Costs						-0.94%	-1.33%	2.45%	-1.63%	4.56%
Annual Rate of Inflation	1.60%	2.40%	1.40%	3.30%	3.40%	2.50%	4.10%	0.10%	2.70%	1.50%
										Prepared by the PCC

Enclosure 4

Town of Portsmouth - Municipal Employees

Year	Police	Fire	Public Works	Other	Totals
2000	30	30	16	23	99
2001	30	31	16	23	100
2002	30	35	16	22	103
2003	29	34	16	23	102
2004	30	31	15	24	100
2005	30	34	16	24	104
2006	31	35	17	24	107
2007	32	35	18	24	109
2008	31	35	18	24	108
2009	34	36	17	23	110
2010	32	33	16	23	104

Source: Town of Portsmouth