



Portsmouth Budget Challenges
2008 – 2009 and 2009 – 2010
Prepared by the PCC

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Overview:

The Portsmouth Council will face two immediate budget challenges resulting from declines in state revenue; one beginning in January, 2009 which will involve fiscal year 2008 – 2009 and a second in fiscal year 2009 – 2010, beginning in April of 2009. The Council faces a period of revenue shortfalls that result from state budget deficits of at least \$357 million in fiscal year 2008 – 2009 and \$450 million in fiscal year 2009 – 2010. These revenue declines are a consequence of the state's recession resulting in the present 9.2% unemployment rate, which is expected to increase as the national recession proceeds. The state crisis is driven by a recession expected to extend into next fiscal year, and likely an additional year to the 2011 – 2012 fiscal year. If the state government elects to significantly increase broad based taxes, declines in state revenue are likely to accelerate with funding for the cities and towns further reduced.

The Governor, on January 7, 2009 proposed to the Assembly a supplemental budget, which contained in part, elimination of all general revenue sharing. In Portsmouth's case, that constitutes a \$555,000 in lost revenue, if the proposal is adopted by the Assembly. The Town estimated and budgeted for state revenues from general revenue sharing of \$505,140, so this is the amount that the current year town budget must be reduced. With that reduction, the budget increase will be 2.13%, year over year.

The Council's budget options have been seriously reduced by depletions of the town's Fund Balance in recent years and the underfunding of future retirement obligations. It is our recommendation that the Council preserve the \$1.9 million in the Fund Balance to meet potential near term revenue shortfalls or further unanticipated state revenue difficulties. Disruption in other town revenues, in addition to property tax collections, is likely to cause intermittent cash flow difficulties.

In addition to the town's revenue problems, the current town budget is already unstable as the annual growth of salaries and benefits in the Police and Fire Departments significantly exceeds the maximum allowable growth given the state tax cap law. This is the principal expenditure problem. Please see appendix Figure 1, Selected Trends in Personnel Costs.

The Council has a range of choices from inaction to a decisive reduction of expenses to match expected revenue. The budget should have been restructured during the last two years, but the past Council continued the pace of budget increases of recent years and exacerbated the problem. The State's economy and many of our personal budgets are in duress and the PCC believes Portsmouth taxpayers would best be served with permanent solutions rather than workarounds that deal only with the immediate cost of state revenue reductions. We do not believe that new fees and taxes are the answer to our current fiscal situation.

There are two general approaches that can be employed in reducing expenditures: temporary and structural (permanent). Structural reductions will result in permanent cost savings in subsequent years and temporary reductions, usually in discretionary funding, will have to be repeatedly initiated in follow-on years.

Budgetary Policy

We believe that the Council should adopt a policy of managing to budget objectives in all fiscal years. Specifically, that requires expenditure targets and supporting revenue estimates, included in four year budget plan. We believe that it should be the principal budgetary policy of

the Council to ensure the stability of town operations. Budget instability is almost always caused by revenue shortfalls, which lead to substantial tax increases, personnel reductions or both.

Part of ensuring budget stability is to avoid emergent funding obligations that shock the budget. These usually occur in two areas: physical plant deterioration and sudden replacement requirements that result (primarily in school buildings) and the failure to properly fund long term obligations, such as retirement accounts.

In Portsmouth's case the Fund Balance has been depleted through use of the Fund for inappropriate purposes and the failure to replace withdrawn funds. In the case of retirement obligations, commonly neglected by governments at all levels, Portsmouth has fallen behind to the tune of \$13 million. Both of these situations have significantly reduced financial flexibility for the Town going into our current fiscal difficulties. This did not have to be the case.

Long Term Obligations

Fund Balance - Designate \$150,000 to \$200,000 from the School Department Budget and \$100,000 per year from the municipal budget for deposit into the Fund Balance to return the fund to the level required by prudent budgetary policy and the Portsmouth Fund Balance Ordinance. In addition, all unanticipated revenue received by the town should be deposited in the Fund Balance. A separate Reserve Fund Account, containing what is currently identified as the Town's Fund Balance assets, should be established to support prudent accounting and investment practices. Fund Balance investment returns should remain in the Fund.

Unfunded Retirement Obligations – The municipal side of the Town Budget has approximately \$13 million of unfunded health benefit obligations, as outlined in the Angell Pension Group report presented to the Council in January. The Council must, despite imminent current state revenue reductions, properly fund this account. This obligation must be addressed and cannot be allowed to continue to grow. Proper funding of this obligation will require an increase of \$1,052,469 beginning in the next fiscal year, as recommended by the Angell Group and the Finance Director. The Council should also establish an investment account for funds that are surplus to annual needs so that returns support future payments. The current pay as you go approach does not allow offsetting cost with investment income.

Options for Fiscal Year 2008 – 2009

The State Assembly is expected to reduce state distributions to cities and towns to help correct the current year revenue shortfall, presently estimated to be \$357 million. This amount is approximately ten percent of the total state budget. Half of the state government revenue is received from the Federal Government and this is not expected to decline, and may actually increase. The most politically acceptable method of reducing state aid is to reduce revenue equally to all cities and towns.

Reductions to cities and towns will likely be approved in February of 2009 and will take effect seven months into the fiscal year. These reductions will be imposed at a time when more than half of the expected revenues have been committed and will affect the second half of the budget year, only. As no reliable estimate exists at this time for the size of the reductions in state revenue, an estimate, produced by the town's two financial directors, is provided in the attached spreadsheet as Appendix Figure 2. The Governor's proposal of January 7, 2009 would eliminate all current year State Aid to Cities and Towns.

School Budget Options – The Governor's proposal: a reduction for Portsmouth of approximately \$914,000, offset by permission to defer payments into the State Teachers Pension Fund of \$734,000 in the current fiscal year, which results in a net \$180,000 decrease, or .33%. In addition, the Governor proposed a law setting health care co-pays of 25% for all districts. It is likely that the deferral of the \$734,000 will have to be paid either next year or within the next two years to preserve stability of the Fund. We will recommend to the School Committee that it forego at least half of the proposed deferral, should it be adopted by the Assembly, in order to preserve the stability of next year's budget.

1. The School Committee may request the Council make up some or all state aid reductions, but this should be resisted. The estimated net School Department reduction is likely to be in the range of \$200,000 to \$300,000. Any additional revenues that can be provided to the School Department by the Council would come from the Fund Balance; which must be avoided. Please see appendix, Figure 2
2. Should the School Committee choose to reduce personnel costs, reductions must be confined to non-teaching staff positions and/or their benefits. Reductions in certified teaching staff are presently prohibited by state law, without notice in March of the previous calendar year. No March 2008 lay off notices have been retained by the School Committee and School Department staff reductions are outside the Council's authority.

Options for the Municipal Budget – It appears that an immediate budget reduction for the town departments of 2.6% must be implemented. Town department managers should be directed to present to the Council their recommended reductions. The likely range of required reductions is \$505,000 to \$600,000. The Governor's proposal includes a reduction in State Aid to Cities and Towns (Portsmouth) of \$555,000. The Council budgeted \$505,140 and this amount will have to be removed from the budget. That constitutes a budget **increase**, year over year, of \$394,629 or 2.13%. Please see appendix, Figure 3.

The following steps are suggested options to overcome the revenue loss in the current budget:

1. Avoid any new personnel hires.
2. Reduce Overtime for Town Employees. Overtime should be approved on an emergency basis by the Council President.

3. Suspend pay increases associated with promotions. Should employment contracts or state law require increased pay for promotions, suspend those promotions.
4. Eliminate one-time expenditures in the current budget.
5. Stop remaining Capital Purchases.
6. Furlough Staff. This option is temporary and will not reduce future expenditures, unless repeated in future fiscal years.
7. Do Not Fill Vacant Staff Positions. Vacant positions should not be filled in the current fiscal year. A long term reduction of staff through retirement and resignations should be implemented.
8. Avoid Tax Increases. The Council lacks authority to raise taxes at mid year. Additionally, we believe that charging fees for existing services is an indirect tax imposed on a citizenry whom have already paid for the service.
9. Avoid Debt Obligations. All new bonds and warrants should be avoided until the state revenue picture stabilizes. In addition, we recommend suspension of expenditure of the remainder of the School Technology Warrant in the current year. We recommend that the Maintenance Warrant be continued.
10. Suspend further Open Space and Recreation Bond Expenditures. While funds for open space acquisitions and recreation projects come primarily from the 2007 Open Space and Recreation Bond, expenditures should be suspended until the future economic and budgetary circumstances are more clearly understood.
11. Freeze further reductions in the Fund Balance. Future budgetary conditions are uncertain and this fund is the source of our emergency revenue.

Options for Fiscal Year 2009 – 2010

A number of the suggested reductions in Fiscal Year 2008 – 2009 may result in changes in structural costs. If implemented, these reductions will be transferable to the subsequent fiscal year. The tendency, however, in municipal budgeting is to make temporary reductions. If that approach is employed commensurate reductions will have to be repeated in the 2009 – 2010 budget.

The following steps are suggested options to overcome the expected revenue loss and budgetary problems in the 2009 - 2010 budget:

1. Cancel any Remaining Non Bond Capital Purchases in the Budget.
2. Reduce the Rate of Increase in Salary Costs. Renegotiate the Police and Fire salary costs in order to reduce the rate of annual increase. Please see appendix Figure 1. A one year suspension of increases is recommended. At the minimum, annual salary costs should be reduced to meet the 2008 - 2009 year budget increase, which is approximately 2.6%.
3. Reduce the Cost of Health Benefits. This is the second area of rapid cost growth, in the area of 11% per year, and cannot be sustained. The Governor has proposed an increase of all health care co-pays to 25%. This is unlikely to pass the Assembly, but should be re-negotiated with the town's unions. The Finance Director should be instructed to present to the Council a cost comparison study of the current costs of the health package used by the town versus that used by the state. The town can join the state health care system at any time.
4. Implement Full Funding of Retirement Health Care Obligations. The Council should increase funding for the Annual Required Contribution by an additional \$1,052,469.
5. Reduce Staff. Reductions should be realized in this fiscal year. Retirements and resignations should meet the required numbers. If not, re-negotiation of the current contract specifications of minimum manning levels should begin.
6. Consolidate Operations. This area contains a number of cost savings that have been implemented in other Rhode Island communities
 - a. Combine the Town and School Department Finance Offices. The maintenance of separate capabilities is not necessary and unification can save personnel costs as well as the costs of any support services provided by contractors.
 - b. Combine the
 - c. Town and School Department Web site functions. In most cases the two organizations are maintaining separate servers and services. The server can host both web sites and with a team of no more
7. Avoid Debt Obligations. All new bonds and warrants should be avoided until the state revenue picture stabilizes.
8. Sell Surplus Vehicles.
9. Repeal/Suspend State Mandates. Coordinate with the Town's Assembly representation a bill suspending of mandates impacting current operations.

- a. In particular the Fire Code Upgrade requirements in Elmhurst and other town buildings should be eliminated or suspended until the state's revenue stabilizes.

Appendix Figure 1

Selected Trends in Personnel Costs				
Municipal Budget				
Fiscal Year 2008 - 2009				
Department	2007-2008	2008-2009	Increase	% Increase
Administration				
Salaries	\$160,742	\$167,064	\$6,322	3.93%
Benefits	\$63,373	\$70,555	\$7,182	11.33%
Police				
Salaries	\$2,163,423	\$2,287,484	\$124,061	5.73%
Benefits	\$1,219,891	\$1,356,971	\$137,080	11.24%
Fire				
Salaries	\$2,152,618	\$2,273,489	\$120,871	5.62%
Benefits	\$1,165,080	\$1,301,626	\$136,546	11.72%
Public Works				
Salaries	\$956,852	\$988,359	\$31,507	3.29%
Benefits	\$474,516	\$504,109	\$29,593	6.24%
Tax Assessor				
Salaries	\$253,420	\$261,909	\$8,489	3.24%
Benefits	\$143,163	\$155,486	\$12,323	7.93%
Totals	\$8,753,078	\$9,367,052	\$613,974	7.01%

Estimated Budget Increases (year over year)

	2007-2008	2008-2009	2008-2009 Adjusted	Increase	% Increase
Total Town Budget	\$52,014,553	\$54,073,447	\$53,568,307	\$1,553,754	2.87%
School Budget	\$33,451,958	\$34,611,083	\$34,388,843	\$936,885	2.71%
Municipal Budget	\$18,562,595	\$19,462,364	\$18,957,224	\$394,629	2.13%

Prepared by PCC

Appendix Figure 2

Estimated Fiscal Year 2008 - 2009 State Revenue Reductions

	Total	Reduction Rate:	Reduction	
State Aid to Education (statewide)	\$690,000,000	8.70%	\$60,000,000.00	Reported in the Jan 9 ProJo
Aid to Cities & Towns	\$233,000,000	100.00%	\$233,000,000.00	

Governor Proposed State Revenue Reductions (Portsmouth)

School Department					
	Budgeted	Reduction %	Reduction	Credit	
Portsmouth State Aid to Education (Est.)	\$5,366,738	17.03%	\$846,000		
Teachers' Retirement Fund Deferral ¹				\$734,000	
After Hours Gambling Revenue (state)	\$68,000	100.00%	\$68,000		
Subtotal of State Reductions/Deferrals			\$914,000	\$734,000	\$180,000
Wind Turbine Delay (income loss)	\$128,000	33.00%	\$42,240		\$42,240
Est. Total Current Year Reductions					\$222,240

Notes: 1 - The Teachers Retirement Fund Contribution is deferred to future fiscal years, but still must be made.

Municipal Departments			
State Aid to Cities & Towns (Portsmouth)	\$555,000	100.00%	\$555,000
Budgeted Revenue	\$505,140	100.00%	\$505,140

Appendix Figure 3

Effect of Proposed State Revenue Reductions
Portsmouth Municipal Budget
2008 - 2009 Fiscal Year (year over year)

	2007-2008	2008-2009	Proposed Reductions	Amended 2008-2009	Amended Increase	% Increase
Municipal Operational Budget	\$18,562,595	\$19,462,364	\$505,140	\$18,957,224	\$394,629	2.13%