



# **THE FY04 BUDGET: DID WORCESTER MAKE THE TOUGH CHOICES?**

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## Executive Summary

Shaping a budget in difficult economic times requires tough choices, since the City must choose among competing priorities and acknowledge the opportunities lost when using tomorrow's tax revenues today. Based on an analysis of the FY04 budget and a comparison with the suggestions proposed in the Research Bureau's report, "Tough Choices for Tough Times: Worcester's FY04 Budget" (#03-02), we found the following:

- The City's strategies to close the FY04 budget shortfall included a number of one-time actions using one-time revenues that will make it more difficult to close budget shortfalls in the coming years. Rather than restructuring municipal operations to save money, the City chose to cut services, use free cash (the amount a community has accumulated when revenue projections exceed budget estimates that were used when setting the tax rate, and/or when actual expenditures or encumbrances are less than appropriations)<sup>1</sup> and one-time grants, defer capital improvement payments, and use other strategies that cannot be repeated to cover budget obligations in FY05 and beyond.
- The City used aggressive revenue projections for local taxes, fines, and fee receipts that may not materialize. This means there may not be any free cash at the end of FY04 to be used in FY05. It could also damage the City's bond rating and thus increase the cost of future borrowing.
- The City acquired a Federal grant of \$3.75 million dollars to hire additional police officers that requires a City contribution of \$400,000 in FY04, \$1.6 million in FY05, over \$2 million in FY06, and over \$3 million thereafter as the grant expires and the City's obligations remain. Hiring these officers will be complex and costly due to the state requirement that the City give first preference to officers who have been laid off by other communities.

### I. Introduction:

This year's municipal budget was developed under tight financial constraints, as local aid from the state decreased, while costs escalated for health insurance, pension payments, utilities, workers' compensation, recycling, and other areas. The result was a \$22 million budget shortfall. In June 2003, the City Council approved a balanced budget based on the City Manager's proposed budget. On November 18<sup>th</sup>, the City Council approved changes to that budget in order to certify tax rates for the year. Below is a summary of how the City balanced the budget in FY04 and the implications for the FY05 budget. We then compare the Research Bureau's recommendations with the City's actions in FY04. The City closed the budget gap by employing five strategies:<sup>2</sup>

- 1) Using maximum allowable property tax increases
- 2) Increasing revenue projections from current funding sources
- 3) Employing free cash, one-time deferrals, and other one-time actions
- 4) Making service cuts
- 5) Initiating layoffs

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<sup>1</sup> Since free cash is not a reliable revenue source, it is prudent for municipalities to use it for one-time expenditures or to build reserves.

<sup>2</sup> Data source: City of Worcester. Annual Budget Message and City Manager/Budget Office Communications to City Council.

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### 1. Maximum Allowable Property Tax Increases

**\$4.0 Million: Property Tax Increase**—Under proposition 2 1/2, the property tax levy can be increased by up to 2.5% of the prior year’s allowable levy plus the revenue generated by new construction not previously on the City’s tax rolls. The City increased real estate taxes by 2.5%, or \$4 million in FY04, the maximum allowable increase.

**\$3.3 Million: Increase in “New Growth”**—The City will tax all residential and commercial “new growth” to the limit allowed under proposition 2 1/2, which will generate \$3.3 million in tax revenue. In FY00 and FY01, the City Manager avoided raising taxes on the basis of new construction in order to reduce the tax burden, thereby producing \$11 million in unused—but accessible—tax levy capacity. The City taxed new construction in the succeeding years, FY02, FY03, and FY04, but it has preserved the \$11 million in unused tax levy capacity, which will remain untaxed in FY04. (The new growth was originally projected to be \$3.0 million. The unanticipated \$300,000 was used to reinstate a tax abatement for elderly citizens, as described on page 4.)

### 2. Increase Revenue Projections

**\$1.7 Million: Excise Tax, Hotel/Motel Tax, Fines, Permits and other Revenue Categories**—The City has increased its estimated revenues from motor vehicle excise taxes, hotel occupancy taxes, fines and forfeits, permits and licenses, and other categories by \$1.7 million in FY04. In the annual budget message, the City Manager said he was “cautiously optimistic” that these revenue increases would materialize, but he also indicated that this projection represents a change in the City’s budgeting practices. In past years, revenue estimates were conservative and occasionally yielded year-end surpluses. Without these reserves, Worcester’s bond rating may suffer, increasing the cost of future borrowing.

### 3. One-Time Budget Actions and Deferrals

**\$2.6 Million: Additional Grant Funds and Free Cash**—The City used \$600,000 in state and Federal grants from the Massachusetts Executive Office of Public Safety (MEOPS) to maintain 12 police officer positions. The City also used an unexpectedly early Medicaid reimbursement and other free cash (totaling \$2 million) to rehire 40 public safety officers (20 police and 20 fire) who had been laid off. These funds will have to be replaced with tax-levy funds in subsequent years.

**\$2.5 Million: One-Year Deferral of Worcester’s Payment into the Capital Campaign Bond Payment Account**—Since FY99 Worcester has been putting aside \$2.5 million each year into a capital campaign account to be used for payments for debt service on five major city projects: Worcester Vocational High School, Forest Grove Middle School, the Worcester Public Library, the Worcester Senior Center, and North High School. In FY04, the City opted to forego payment into the capital campaign account, and instead used the funds to preserve 60 staff positions. The City Manager acknowledged in the annual budget message that “This is a one-time budget fix that will require funding to be replaced in future years.”

**\$500,000: Transfer of Tax Levy-Funded Positions to Other Sources**—A number of City positions are now paid with State and Federal grants rather than with tax-levy dollars. These transfers took place in a number of departments, particularly in the Library and the Water/Sewer department. In general, they involved moving grant funds for non-salary purposes (or from salary reserve accounts) to pay for positions that were removed from tax-levy support. These are funds that cannot be continuously used to pay for staff. The City will have to replace these funds or reorganize departments to pay for these positions.

**\$1.6 Million Refinancing Debt**—The City’s improved bond rating, along with falling interest rates, created a favorable environment for debt refinancing. The refinanced debt saved the City \$1.6 million (\$300,000 more than originally expected). As the national economy improves, it can be expected that future debt will require borrowing at higher interest rates, even assuming that the City’s bond rating remains the same.

**\$650,000 Federal Universal Hiring Grant (requires \$400,000 City contribution in FY04)**—The City received a Federal Universal Hiring Grant of \$3.75 million over three years which will be used to hire police officers. \$650,000 of this grant will be used along with \$400,000 from the City to fund the 50 police officer positions.<sup>3</sup> Under this grant, Federal funds decline and City obligations increase each year. In FY05, the City will be responsible for \$1.4 million, over \$2 million in FY06, and more than \$3 million in FY07 and beyond, increasing the burden on the City. In addition to the large salary obligations, hiring officers at this time is problematic regardless of the funding source: State civil service law (MGL 31 sec. 40) requires the City to give priority to officers who have been laid off by other communities. According to the Police Department’s report to the City Council regarding hiring under these circumstances, “it is not irrational to assume that several of these 95 officers [on the statewide list of laid-off officers] were problematic employees for their department, and the veil of fiscal constraints offered their original employer a convenient manner to dispose of them.” This possibility requires that the WPD perform extensive and costly background investigations across the state in order to select the best candidates. Further, these candidates may be recalled to their original communities (at their previous salaries) for up to ten years, which may result in a greater rate of attrition for officers hired through this process.

Chart 1.1

One-Time Budget Actions Used to Balance the FY04 Budget

One-Time Funding Source	Amount Used in FY04	Obligation in FY05	Reason for Obligation in FY05
State administered MEOPS Grant:	\$600,000	\$600,000	One-year State grant used for police salaries that need another funding source in FY05.
Medicaid Reimbursement:	\$1,000,000	\$1,000,000	FY03 Free Cash from Medicaid reimbursements used to pay salaries. Salaries need funding in FY04.
Deferred Capital Campaign payment:	\$2,500,000	\$3,500,000	Capital campaign funds were used for salaries that need funding in FY05. The City is committed to rebuilding the capital account with 1.0 million in FY05.*
Federal Universal Hiring Grant:	\$650,000	\$1,400,000	The grant requires City contribution of \$1.4 million in FY05. In FY06, The City obligation will be over \$2.0 million, and \$3 million in FY07.
Other Free Cash from FY03:	\$1,000,000	\$1,000,000	Free cash was used for operating expenses including salaries that require funding in FY05 and thereafter.
Transfer of grant funds to salaries:	\$500,000	\$500,000	Salaries funded by these grants will need to be funded in FY05 and thereafter.
Debt Refinancing	\$1,600,000	\$0	
<b>Totals</b>	<b>\$7,850,000</b>	<b>\$8,000,000</b>	

\* Rather than attempt to make up the FY04 contribution in FY05, the City Manager has recommended that the City begin contributing to the capital campaign again in the amount of \$1 million in FY05. The \$2.5 Million used to pay salaries in FY04 will require an additional funding source in FY05, bringing the total obligation in FY05 to \$3.5 million.

<sup>3</sup> Since these officers will not be hired until March, the City will be paying for those salaries for the latter part of FY04 only. The City portion of the funds for FY04 (\$400,000) will come from a community policing grant currently reserved for overtime in the Police Department.

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### 4. Program and Service Cuts

**\$400,000: Elderly Tax Abatement Reduction (restored)**—The City has matched the state’s \$500 per-person property tax abatement program for senior citizens who meet certain income eligibility requirements.<sup>4</sup> The City initially planned to cut its matching funds to \$250, but reinstated the double abatement with funds from the higher-than-expected “new growth” property tax revenues (see page 2).

**\$200,000: Limit Cost Of Living Adjustments to Inflation Increase (restored):** In the FY04 proposed budget, the City initially limited pension Cost of Living Adjustments (COLA) for municipal employees (not including teachers) to the rate of inflation. However, savings generated from debt refinancing (see page 3) were used to restore the full COLA for FY04. While the Romney administration is discussing pension reforms to control the impact of pension increases on municipalities, Worcester has opted to increase its own obligation by restoring the full COLA.

**\$2.0 Million: Program and Service Reductions**—There have been substantial cuts in a number of programs, cuts that will not be restored without renewed funding or structural reorganization to cut costs. These cuts include the following:

Summer 2003 Pools Program	\$377,000
(The summer pools program was restored by private donations from the business community through Park Spirit’s fundraising efforts.)	
Worcester’s Centrum Centre Tax Levy Support	\$210,000
(The Centrum now operates without tax dollars from the City; ordinary revenues are up over the last year.)	
Worcester Marketing Funds	\$165,000
Worcester Convention and Visitors Bureau	\$150,000
(Both of these budget items were eliminated, hampering efforts to market Worcester through advertisements and media coverage.)	
Public Works—Bulk Waste Pickups	\$150,000
Public Works—Sunday Waste Collections	\$110,000
(The elimination of these free programs increases the probability of dumping, since residents of Worcester will have to request service and pay for it.)	
Library Sunday Summer Hours and Reference Materials	\$140,000
(Total library reductions in this budget \$450,000. See library section below.)	
Technical Support Services & GIS program	\$169,000
(The City’s Technical Services department eliminated the Geographic Information System programmer and the City will not be able to undertake any new projects or mapping services, a key component of the GIS program.)	
Elder Services Program Funding Operations	\$98,000
(Elimination of Financial Services, Home Care, Legal Advocacy, Senior Companion programs. 33% reduction in the outreach programs at Friendly House, Multi-cultural Services, and St. Paul’s Outreach.)	
Other Departmental Accounts	\$494,000

**\$400,000: Self-Funding Health Insurance**—The City is now self-insured, which means that it has stopped paying premiums to Blue Cross<sup>5</sup> and pays employees’ medical bills directly to the health care providers. By assuming the risk normally borne by the insurance company, the City hopes to benefit from

<sup>4</sup> The program is established under Massachusetts General Laws Chapter 59 sec.5, and includes an option for localities to match this abatement.

<sup>5</sup> The City continues to pay premiums for Fallon Community Health Care programs.

the savings generated when employees do not require the full amount of their premium for medical coverage. If an individual's medical costs exceed the premium, the City is liable for the additional costs. In order to protect itself against large claims, the City has acquired stop-loss insurance for cases in excess of \$90,000. The City projects that the program should save roughly \$400,000 in FY04 based on an analysis by Group Benefit Strategies, a consultant hired by the City. First-quarter numbers show that this projection is still valid.

### **5. Layoffs and Hiring Freeze**

**\$1.4 million: Hiring Freeze**—Forty (40) tax levy-funded positions are being left vacant in a number of departments (and have been vacant since November 2001).

**\$4.0 million: Employee Layoffs**—Seventy-one (71) non-public safety, 20 firefighter, and 20 police officer positions were eliminated in the proposed FY04 budget. Unanticipated free cash from a Medicaid re-imbursment that had been designated for Worcester Public Schools debt re-payments was used to re-hire the police and fire personnel. The City had previously intended these funds to be allocated to the City's capital campaign to pay future debts. Debt service and interest will still have to be paid, but the City will have fewer resources with which to meet those obligations.

## **II. Alternative Solutions to the City's Financial Problems**

In our March 2003 report, *Tough Choices for Tough Times: Worcester's FY04 Budget*, the Research Bureau examined the looming budget crisis and advanced a number of suggestions to address the City's fiscal problems, which we believe cannot be solved over the long term with one-time budget measures and stop-gap solutions. Below is a review of the Research Bureau's recommendations and updates on City action in those areas.

**Health Insurance:** *Increase Employee contribution rates to bring Worcester into the mainstream of other municipal and state employees. Increase employee contribution to health insurance to 20% as now required of most state employees.*<sup>6</sup> This change could have saved the City \$4.2 million in FY04 alone. This proposal was rejected by the municipal employee unions, but it can be considered again this year as the City is currently negotiating health insurance with municipal employee unions.<sup>7</sup>

**Reorganize the Police and Fire Departments:** *The City should restructure the Police and Fire Departments.* The Research Bureau recommended changes in the organization of the Police Department to reduce the number of supervisory personnel, as has been done in both Boston and New York. These changes could save over \$2 million in supervisory salary costs. The recent appointment of a new police chief and the addition of 50 new police officers this spring as the result of a Federal grant present an opportunity for reorganizing the Police Department. In a recent interview, Chief Vizzo expressed interest in examining various divisions of the WPD for restructuring possibilities.<sup>8</sup>

The Fire Department should also be reorganized so that there are more firefighters per supervisor. In addition, two engine companies should be eliminated and the 22 firefighters assigned to other companies, saving the City approximately \$1 million and increasing the readiness of the remaining engine companies. (Currently, if an engine company is short-staffed, it is shut down and the remaining firefighters are redeployed. With additional firefighters in each company, this would happen less often). The Fire Department is the City's official first responder for medical emergencies; as a result, the vast majority of Fire Department responses are to emergencies that do not involve fires. The number of fires in Worcester decreased from 2,400 to 1,600 between 1998 and 2002, while first-responder calls increased from 19,700

<sup>6</sup> New state employees pay 25%, and employees earning under \$35,000 pay 15%.

<sup>7</sup> The teachers' contract expires on December 31, 2003; the other contracts expired on June 30, 2003.

<sup>8</sup> Chris Echegaray, "Vizzo will look at Structure," *Worcester Telegram & Gazette*, November 19, 2003.

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to 24,700 from FY98 to FY02.<sup>9</sup> There has been no corresponding restructuring of the Department to make its operations more compatible with its changed responsibilities.

According to the Fire Chief, while structure fires are down and emergency calls are up, eliminating two engine companies might increase response times and “risk to the community as a whole.” On the other hand, the Chief favors eliminating two engine companies and replacing them with ambulances: “I would instead propose that we replace two of our Engine companies with light rescue units (ambulances) that can respond to assist UMass EMS with transportation issues when necessary and free up the use of Engine companies when possible.” These comments suggest that the Fire Department’s non-fire emergency-response duties may, in fact, tie-up important fire-fighting resources. Since the City currently benefits from free Emergency Medical Services provided by UMass EMS, and their response time is better than the national average, it is not clear why the Fire Department needs ambulances at considerable cost in terms of equipment and training for firefighters. These competing claims for Fire Department equipment and manpower point to the need to review the entire organization and staffing as the Research Bureau suggested.

**Pension Reform:** *The City should work with other communities and the Massachusetts Municipal Association (MMA) to advocate pension reform in the Commonwealth.* The State should change its pension plan for new employees from a defined-benefit plan to a defined-contribution plan, as has been done in other states. The state should also modify the “presumption” provision so as to disallow disability pensions for non-work-related illness. Governor Romney has acknowledged a need for the state to restructure pensions for public employees, and Worcester’s City officials and legislative delegation should be advocates for reform at the state level.

**Public Libraries:** *The City should close branch libraries, and direct both resources and library users toward the newly renovated Main library downtown.* As a result of budget cuts, the main branch of the Worcester Public Library is now closed on Thursdays and Sundays, and hours have been reduced on other days. This state-of-the-art facility should be open as much as possible and during the hours most beneficial to the public. Closing branch libraries—even the popular Francis Perkins Branch—should be considered in order to maximize the return on the investment in the downtown library. In order to receive state funding, the library must be open 63 unique hours each week. The City has elected to get 12 of those hours from the Francis Perkins branch library which requires only 6 employees to operate (compared to the Main library’s 40). Preliminary data suggest that reduced hours are hurting circulation and library use at the Main library as well as the Francis Perkins branch. With a 23% reduction in hours of operation, the Main library has seen a 14% reduction in number of visitors and a 7% drop in circulation compared to the same time span in 2002.<sup>10</sup>

**Senior Center:** *The Senior Center should be closed and the space leased or the building sold.* Operating the senior center costs roughly \$300,000 in operating expenses and \$350,000 in debt service for the construction of the Center. The Center expects to earn \$20,000-\$30,000 in income from Center space that has been rented. The Center shows few signs of becoming self-sustaining in the next 5-10 years, and its services are typically available at other agencies. Examples of these duplicated services include, exercise programs offered through the YMCA, crisis intervention from Elder Services of Worcester; elder rehabilitation from Vision Community Services, recreation through Friendly House or the Jewish

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<sup>9</sup> Data Source: Massachusetts Fire Marshall, Worcester Fire Department, from CCPM Report *Benchmarking Public Safety in Worcester: 2003*. The Worcester Fire Department is the City’s official “First Responder” for medical emergencies.

<sup>10</sup> Source: Worcester Public Libraries. Data is from June to October 2002 and June to October 2003. The Francis Perkins Branch also showed similar declines (22% fewer visitors and 9% less circulation).

Community Center Senior Adult Services, and college courses through Worcester State College (free tuition for seniors).

**Union Station:** *Lease space inside Union Station to businesses and develop parcels in this vicinity.* Union Station now houses a restaurant and is expected to add a jazz/blues club. The much-needed parking garage to serve commuters as well as any commercial enterprises within the facility has still not been built, although the state has cleared the way for the City to acquire the former Parcel Post building behind the Station to begin the garage project. None of the parcels around Union Station has been developed. Such development would produce revenues to offset the Station’s operating deficit. In fact, except for the restaurant and jazz club, there has been no visible progress on this project since the City Council rejected the Worcester Business Development Corporation’s proposed mixed-use development in December 2001.

**Chart 1.2 Summary of Possible Savings**

Below is a summary of the possible savings from the above recommendations. Since changes resulting from Union Station development and pension reform could vary widely, we did not include them in this calculation.

Alternative Solutions and FY04 Savings	
Potential FY04 savings(in millions)	
Health Insurance Reforms	\$4.2
Reorganize Police Dept	\$2.0
Reorganize Fire Dept	\$1.0
Close Branch Libraries	\$0.4
Close Senior Center	\$0.5
Union Station*	?
Pension Reform*	?
<b>Estimated Savings</b>	<b>\$8.1</b>
*Union Station revenue and savings from pension reforms could vary greatly depending on the specifics of each program, but both would improve the City's financial outlook.	

**III. Outlook for the FY05 Budget**

The FY04 budget will generate further fiscal woes in FY05. Chart 1.3 is a projection of revenue and expenditure increases in FY05. The City must fund certain increases: Contribution to the Worcester Public Schools (as required by the Massachusetts Education Reform Act of 1993); health insurance and pension increases; and replacement funding for positions paid with one-time budget actions in FY04. The City must also decide whether to restore funding for services that have been cut this past year, or if the reduced level of services is acceptable. Finally, the City must negotiate new contracts with all municipal employees. A conservative 1% increase in contract salaries will add \$1 million to salaries for FY05 plus \$2 million if the salaries are retroactive (which has been the City’s practice) for a total of approximately \$3 million to cover salaries alone in FY05. Assuming level funding of local aid from the state, which represents over 50% of the City’s revenues, it appears at this early stage in the FY05 budget process that the City will be facing an \$8.3 million budget shortfall.



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Chart 1.4 FY05 Budget Projection

<b>FY05 Revenue Increases (in millions)</b>	
Tax levy	\$6.3
State aid	\$0.0
Free Cash	\$0.0
Local receipts	\$1.1
<b>Total</b>	<b>\$7.4</b>

<b>FY05 Expenditure Increases (in millions)</b>	
<b>Ordinary budget increases for FY05</b>	
School Contribution	\$1.5
Health Insurance	\$3.0
Pensions	\$0.6
Other operating budgets: assuming no increase for this projection.	\$0.0
<b>Sub Total</b>	<b>\$5.1</b>
<b>Salaries funded with one-time budget actions in FY04</b>	
FY04 obligations for FY05 (see chart 1.1 on page 6)	\$5.5
<b>Sub Total</b>	<b>\$10.6</b>
<b>Funding required to restore cut programs and services</b>	
Services cut in FY04	\$2.1
<b>Sub Total</b>	<b>\$12.7</b>
<b>Collective bargaining costs</b>	
City salary obligations if unions get 1% retroactive increases to salary schedules.	\$3.0
<b>Total</b>	<b>\$15.7</b>
This conservative projection suggests that the City will need \$15.7 million in additional revenue in order to cover its obligations for FY05. This figure does not restore all eliminated and vacant positions, but does restore eliminated programs and services.	
<b>FY05 Shortfall</b>	<b>\$8.3</b>

Projection prepared by the Worcester Regional Research Bureau based on FY03 and FY04 Budgets from the Worcester City Budget Office.