Worcester
Municipal
Research
Bureau

AN INDEPENDENT VOICE FOR RESPONSIBLE GOVERNMENT

BUDGET BUSTERS CREATE DEFICIT IN FY00

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EXECUTIVE SUMMARY

- During the last five years, increases in municipal spending in Worcester have been well-above the rate of inflation. [1]

- Worcester's spending on non-school services has increased by $29 million, or more than 27% between FY94-FY98.

- The Research Bureau has identified a number of "budget busters" that will create a deficit of more than $4 million in FY00. These include municipal employee salaries, debt service, health insurance, Police and Fire Department obligations such as Injured-on-Duty compensation and the Quinn Bill, Early Intervention Plan for disabled employees, and mandated payments to the Worcester Public Schools (WPS).

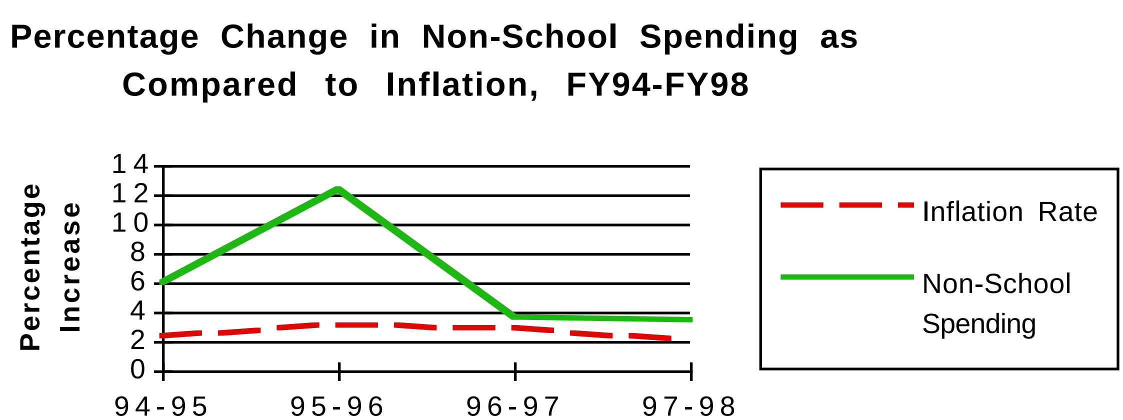
In light of the City's serious financial difficulties, the Research Bureau recommends that the City Manager and the City Council take steps to bring the budget under control, and ensure that annual expenditures be kept at or below the rate of inflation.

INTRODUCTION

Between FY94-FY98, as indicated in Table A, increases in municipal spending in Worcester have been well-above the rate of inflation. Worcester's non-school spending has increased by almost $29 million, or more than 27% between FY94-FY98. (See Appendices A and B for details of municipal expenditures.)

Table A

Years	**94-95**	**95-96**	**96-97**	**97-98**
Inflation Rate	2.39	2.96	2.82	1.91
Non-School Spending	5.92	12.39	3.52	3.38



Sources: City Auditor's Year-End Financial Reports, FY94-FY98.
Consumer Price Index, Boston Metro Statistical Area,1994-1998, Bureau of Labor Statistics.
Note: Increase in FY96 is result in part of record snowfall that year. The inflation rate for 1998 is calculated using the midyear figure.
Prepared by: The Worcester Municipal Research Bureau

[1] This report will not address school spending which constitutes about 53% of the total FY99 General Fund budget of $333.3 million. The Massachusetts Education Reform Act of 1993 requires the schools to spend an amount determined by the formula established in the law. Neither the City Manager nor the City Council has the power to reduce spending below the mandated amount.

This trend is expected to continue in the current fiscal year, FY99, as well, when spending will increase by almost 8%, partly because of the Fire Department arbitration settlement. (Even without that settlement, spending in FY99 would have increased by more than 5%.) Such municipalities as Baltimore, Indianapolis, Milwaukee and San Diego, according to their mayors, have been able to reduce taxes and keep their yearly budget increases at or below inflation.

The Research Bureau has identified nine "budget busters " which will create a deficit in FY00.

I. BUDGET BUSTERS

A. Health Insurance

The total health insurance budget for municipal employees, school personnel, and retirees for FY99 is about $26.9 million. Blue Cross, one of the City's two carriers, insures almost 70% of all City employees. The FY99 enrollment and cost for each plan in Worcester are summarized in the table below. This table indicates that the City currently pays $10,945 per year for Blue Cross Master Medical family membership, $5,500 for Blue Cross/Blue Choice, and $4,781 for Fallon Community Health Plan.

Table B

FY99 HEALTH INSURANCE COSTS

	BC/MASTER MEDICAL			BC/BLUE CHOICE			FCHP		
	Ind.	Family	Medex	Ind.	Family	Care 65	Ind.	Family	Senior
Enrollment	46	10	2,404	1,615	2,094	325	834	1,246	753
City's Yearly Cost(per employee)	$4,946	10,945	1,638	2,037	5,500	595	1,851	4,781	731

The current contract with Blue Cross and FCHP expires June 30, 1999. Therefore, the Executive Office of Human Resources prepared a Request for Responses for new bids on the City's health insurance. The request required that potential insurers have experience providing insurance to municipalities in Massachusetts and that they replicate or enhance provisions currently in force under the City's existing indemnity plan, point of service plan (POS), and HMO. As a result of these requirements and new regulations, increases in the rates proposed range from 4.8% to 25.1% for the POS plan, 8.9% to 26.2% for the HMO, and 3.7% to 89.1% for the indemnity plan. (The 3.7% indemnity increase reflects a plan which did not meet the minimum qualifications. The 89.1% increase relates to the family plan for existing Master Medical coverage which reflects the premium needs based on actual experience.)

Based on FY99 estimates, for every one percent of premium increase, the City's budget would increase by approximately $250,000. In other words, a 10% increase in health insurance, a likely possibility on the basis of current bids, means an additional expenditure of $2.5 million to cover all City employees. For municipal employees and retirees, the increase would be about half that figure, or **$1.25 million.**

B. Municipal Employee Salaries

Based on contract negotiations, salaries will increase by 4%. In addition, there is an automatic step increase for all employees until they reach the maximum step. The step increases add about .5% to the total payroll. Based on a payroll of $75 million (not including the WPS) in FY00, municipal salaries will increase by **$4.2 million.** This increase is far above the rate of inflation, which is currently under 2% in the Boston metropolitan statistical area (which includes Worcester). The departments with the most significant increases will be police and fire.

C. Fire Department

As a result of the “HazMat” (hazardous materials) arbitration award between the City and Firefighters' Local 1009, the City owed $4.9 million - $3.4 million for one-time retroactive pay in FY95 - FY98, and $1.5 million for FY99. This brings the Fire Department budget for FY99 to $28 million. Prior to the arbitration award, the Fire Department budget was $23.7 million in FY99. The Department's budget for FY00 drops to an estimated $26.7 million because there are no longer any one-time retroactive payments to be made. (About $1.5 million that was used for part of the one-time retroactive salaries in FY99 can be allocated elsewhere in FY00.)

D. Police Department

Projections for the Police Department for FY00 must factor in the phase-out of the federal community policing funds from both the COPS Universal and the COPS Renewal programs. These grants total $565,000 which must be replaced by tax levy funds. Thus the Police Department budget in FY00 will increase an estimated $1.4 million or 5.4% from $25.6 million to $27 million.

E. Police and Fire IOD (Injured-on-Duty Compensation)

Employees of the Police and Fire Departments injured in the line of duty may be placed on the IOD list at full compensation, which is tax-exempt, even if they are only partially disabled. Since public safety employees can earn more on IOD status than otherwise, there is no incentive to be removed from that status. During FY98, IOD compensation cost the City $1.6 million - $847,064 for police and $761,236 for fire. In June, 1998, there were 15 police and 18 firefighters on IOD. Since FY94, police IOD spending has decreased by about 22% while fire IOD has increased by almost 78%. It
should be noted that structure fires declined by 34% between FY92-FY97.

F. Quinn Bill

The Quinn Bill provides increases in salary based on additional college-level education. Allocating funds for the Quinn Bill is a local option that was adopted by the City in 1987. The cost of the Quinn Bill is estimated at $2.1 million in FY99. The cost of this local option has more than doubled since FY94 when it was $1 million. (Over the past five years, the state has reimbursed the City somewhere between 33%-45% of the cost each year.)

G. Debt Service

Debt/Interest payments are expected to increase by almost $3 million over last year from $22.9 million to $25.9 million. This estimate is based on the assumption that all projects authorized by the City Council will be financed by bonds in FY00. In addition, there will be temporary borrowing costs of $1.5 million in FY00 for short term debt costs. In total, debt service will cost **$4.5 million** more than last year. The major projects responsible for the increase in debt service include the convention center, new school buildings (Quinsigamond, Norrback, Roosevelt, A.L.L schools), rehabilitation of city buildings, and capital equipment purchases..

H. Pensions

The state recently approved an Early Intervention Plan that could cost the City up to **$1.5 million** in start-up costs. The goal of the plan is to limit the liability which retirement systems face for disability benefits by ensuring the continued employment of disabled employees through medical and vocational rehabilitation.

To accomplish this goal, the City must develop, implement and fund an early intervention plan to provide a coordinated employee assistance program for injured employees, and provide educational programs designed to encourage workplace safety. All costs associated with an early intervention team, including medical or vocational rehabilitation and the compensation of early intervention team members, must be borne by the City of Worcester.

I. Worcester Public Schools

According to the Education Reform Act formula, the City will have to increase its contribution to public education by about **$2 million** in FY00 in order to meet the required level of school spending.

In sum, additional municipal expenditures required in FY00 in the absence of renegotiating various commitments amount to an estimated **$13.45 million.**

Table C

NEW EXPENDITURES

Pensions	$1,500,000
Health Insurance	$1,250,000
Employee Salaries	$4,200,000
Debt Service	$4,500,000
WPS	$2,000,000
Total	$13,450,000

III PROJECTED REVENUE

Will the City's revenue offset these anticipated expenditures?

Revenue for municipal expenditures comes from three major sources: property taxes, local aid from the state, and local receipts.

A. Property Taxes

Under Proposition 2 1/2, the property tax levy can be increased by 2.5% of the prior year's maximum allowable levy plus the tax base for new construction. The total allowable levy in FY99 was $132.5 million. The actual levy, however, was $2.8 million less or $129.6 million because in FY97 and FY98, the City Council chose not to tax the maximum allowable amount. If the City Council continues to tax $2.8 million less than the maximum levy, the actual tax levy in FY00 will be $134.6 million including $1.56 million in estimated new growth. Therefore, property taxes will be **$5 million** more than last year.

B. Local Aid

Since the Governor will not submit his budget to the state legislature until January, it is too early to know how much local aid the City will receive. However, the Governor and legislature have publicly stated their intention to fully fund Chapter 70 in the final year of the Education Reform Act of 1993. Based on the foundation aid formula, the City should receive about **$10 million** more than last year in Chapter 70 aid, which must be spent on the City's public schools.[2] FY00 is the last year of the five-year schedule to eliminate the cap on Lottery Aid distributions.[3] So the City should receive about $1.5 million plus any new growth in lottery aid. Based on current estimates, this could be about $1 million. Overall, the City could receive about $2.5 million in additional lottery aid. This **$2.5 million** represents the increase in local aid that can be designated for non-school services.

It should be noted, however, that these projections for local aid presuppose the continuation of a strong economy. Given that state tax collections are running nearly 11% ahead of levels at this time last year, however, there is reason to think that these local aid estimates are realistic.

C. Local Receipts

The City's Budget Office is estimating that the City will receive about $28 million in various fees and charges, the same amount as in FY99. Local receipts include motor vehicle excise taxes, licenses, permits and office fees, parking and court fines, etc.

D. Cost Avoidance

The state recently passed legislation allowing the City to issue pension obligation bonds. The money borrowed against the unfunded pension liability will be invested by the Retirement Board and become part of the Retirement Board's investment portfolio. This plan will eliminate the City's unfunded liability. The City's annual obligation will be to pay off debt service on these bonds. In FY00, the City will save $738,000, half of which must be appropriated to a reserve account. The other half, or **$369,000**, could be available to spend on municipal services. In addition, the City will not have to pay in FY00 **$1.5 million** for one-time retroactive salaries for the Fire Department that it paid in FY99.

In sum, the City could receive a total of **$22.1 million** in new revenue. After subtracting $12.8 million in revenues designated for the WPS and Charter schools, ($10 million for Chapter 70 plus $2.8 million for charter school reimbursement), there will be **$9.3 million** in new funds available for municipal services.

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[2] While a substantial portion of this increase (about $8 million based on FY99 pupil spending), according to Massachusetts Department of Education officials, will be earmarked for the 1,040 students in the two charter schools, the state will be reimbursing the Worcester Public Schools for any increase over last year in charter school expenditures. According to the formula, the reimbursement for charter schools, which must be spent in the WPS, will be about **$2.8 million.** Therefore, the net gain to the WPS from local aid in FY00 should be about $4.8 million.

[3] Eliminating the cap gave cities and towns the share of lottery aid they were originally promised by the state legislature.

Table D NEW REVENUE/COST AVOIDANCE

Property Tax	$ 5,000,000
Chapter 70	$10,000,000
Charter School reimbursement	$ 2,800,000
Lottery Aid	$ 2,500,000
Pension Obligation Bond Savings	$ 369,000
Retroactive Salary Savings	$ 1,500,000
Total	$22,169,000
Designated for public schools	-12,800,000
Net for municipal services	$ 9,369,000

Since additional municipal expenditures required in FY00 will be **$13.45 million,** the City will be left with a possible shortfall of about **$4.1 million**.[4] Because more than 40% of the municipal budget is made up of fixed costs such as pensions and debt service, the cuts would have to come from departmental expenditures, primarily salaries. A $4.1 million deficit would translate into a 5.5% reduction in total municipal salaries of about $75 million.

III. CONCLUSIONS

Of the additional expenditures outlined above for FY00, the $2 million for the WPS is required by state statute according to the formula mandated under the Education Reform Act of 1993. The estimated $1.5 million for the Early Intervention Program is also a required expenditure unless the City can get it rescinded by persuading the State Auditor that it is an unfunded mandate. Debt service obligations are subject to decisions regarding borrowing for the proposed projects. Decisions regarding health insurance rest ultimately with the City Manager. The Insurance Advisory Commission is, as the name suggests, advisory. And if there are not sufficient revenues to fund the municipal employee contracts, layoffs will have to be made.

The City's current fiscal policy is cause for serious concern. The City Manager must address this anticipated shortfall and bring the budget under control. The Research Bureau recommends that the City Manager and the City Council take steps to ensure that annual expenditures be kept at or below the rate of inflation. (Regarding specific recommendations for reducing expenditures, see Research Bureau report, **98-2, *FY99 and Beyond: Cities Financial Difficulties Abound.)***

[4] The City's Budget Director recently issued a five-year budget estimate projecting a deficit of $3.2 million in FY00. The discrepancy between the Research Bureau's estimate of the deficit and the Budget Director's is because the City has no plan to fund the Early Intervention program.