CITY OF BROCKTON

MASSACHUSETTS

FINANCE DEPARTMENT

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MAYOR BILL CARPENTER

MEMBERS OF THE CITY COUNCIL

MEMBERS OF THE SCHOOL COMMITTEE

Ladies and Gentlemen:

I HEREBY CERTIFY, IN ACCORDANCE WITH SECTION 5 OF CHAPTER 324 OF THE ACTS OF 1990, THAT IT IS MY PROFESSIONAL OPINION, AFTER AN EVALUATION OF ALL PERTINENT FINANCIAL INFORMATION REASONABLY AVAILABLE, THAT THE FINANCIAL REVENUES OF THE CITY ARE ADEQUATE FOR FY16 TO SUPPORT THE ADOPTION OF THE MAYOR'S PROPOSED BUDGET. THE BUDGET AS SUBMITIED IS BALANCED, WITH A REASONABLE ESTIMATE OF REVENUES TO SUPPORT THE FY16 EXPENDITURES. HOWEVER, IT IS CRITICAL TO NOTE THAT THE LEVELS OF SERVICE WHICH WILL BE PROVIDED BY THIS BUDGET REPRESENT DETERIORATION FROM SERVICES PROVIDED IN THE PAST, ESPECIALLY WITH RESPECT TO THE BROCKTON PUBLIC SCHOOLS. IN THAT DEPARTMENT, A NUMBER OF LAYOFFS OF CERTIFIED STAFF WILL RAISE CLASS SIZES. THE DEEP REDUCTIONS AND EVEN ELIMINATION OF MANY PROGRAMS WHICH OCCURRED LAST YEAR WILL CONTINUE. IN THE BUDGETS OF THE MUNICIPAL DEPARTMENTS, OTHER ORDINARY MAINTENANCE COST REDUCTIONS WILL BE IMPLEMENTED, AND THE REDUCED STAFFING LEVELS WHICH HAVE OCCURRED IN MANY CITY BUDGETS OVER THE PAST FIVE YEARS OR MORE, WILL

CONTINUE. EVEN MORE ALARMING, IT IS MY OPINION THAT EVEN THIS REDUCED LEVEL OF SERVICES CANNOT BE MAINTAINED IN FUTURE YEARS WITH THE PRESENT REVENUE BASE. THE BALANCES IN CITY RESERVES, WHICH WERE FORMERLY HEALTHY BUT WHICH HAVE BEEN USED IN THE RECENT PAST TO AVOID EVEN DEEPER CUTS TO SERVICES, NO LONGER EXIST IN SUFFICIENT AMOUNTS TO PERMIT THE CITY TO AVOID DIFFICULT CHOICES IN FUTURE BUDGETS.

Anyone who has read my letters of commentary on the past several years of budgets and on the public safety union contract settlements of FY 14 should not be surprised at the opinions expressed above. The most recent of those letters, which were filed with the city clerk, were dated: May 28, 2012, June 8, 2013, August 20, 2013, April 22, 2014, May 6, 2014; and June 6, 2014. These are available for the record, and for reference. The circumstances which concerned me before have continued; in fact, in some ways they have worsened. My opinion in this regard is supported by the bond credit rating agency Standard & Poor (S & P). In late FY2014, the agency examined the city's fiscal position and issued a formal report, in which S & P changed the city's fiscal outlook from "stable" to "negative" and warned of potential future credit rating downgrades, unless corrective steps are taken. The major concerns in the S&P report focus on a structural imbalance between revenues and expenses in the city's operating budgets, which have persisted for several years, caused mainly by permanent cuts in the amount of unrestricted State aid. This simply means that recurring revenues consistently have been less than recurring expenses. This city has a basic, continuing imbalance between ongoing expenses and ongoing revenues worth about four percent of the budget. The revenue increases and expenditure reductions necessary to correct this problem must be taken at some point, and they will be painful.

For example, in each of fiscal years FY2015 and FY2016 the city had more than $13 million in certified Free Cash available as a financial resource. With more prudent fiscal budgeting, this sum mainly would have been directed individually or in combination to these three uses: paying for capital needs, building up reserves, or paying down at an accelerated rate the city's long term liabilities. Instead, in both years the city appropriated the funds to pay for the current year expenses. What revenue increases or service reductions will the city's elected leaders and voters tolerate to avoid this poor choice in the future? In these years, significant appropriations were needed, but not made, for capital projects, many of which have now been deferred for many years. Nor was any appropriation made to reduce the funding term of the pension or "other than pension" liabilities. The S&P report mentions as troublesome, the large value relative to revenues of the long term pension and other benefits liabilities, when combined with long term debt obligations, as a percent of both the city's operating budget revenues, and fund balances. At June 30, 2014, for the last independent audit, the city's long term direct debt was about $230 million. At January 1, 2014, its actuarial pension liability was $529.5 million, with its actuarial assets at $363 million, leaving its unfunded liability at $173.8 million, with a funding ratio of 67.2 %. The city's funding schedule would fully fund this liability in 2033. On June 30, 2014, the city's actuarial liability for its Other Than Pension Employee Benefits (OPEB) was about $417 million. The city has not adopted a funding schedule. According to national guidelines from the General Accounting Standards Board (GASB), the liability should be fully funded by 2040. There are no offsetting assets. At this point, as the city has not adopted a funding schedule, it will be difficult to meet this date. The recent health insurance plan benefit reductions negotiated by the city did reduce this liability from almost $694 million in 2010, to the most recent estimate, as valued at 6/30/14. The combined value of these long term liabilities is worth about one fifth of the city's assessed property values. As new state aid programs are unlikely to help with this problem, it will be the property tax which must pay the bill.

In prior years, I have discussed in depth the city's budget trends and its relative tax burden. I don't believe that the city's homeowners pay property taxes which are too high. Compared to other communities, the city's residential property taxes are relatively low. As a percentage of household median income, the city's residential property tax bill closely tracks the state median burden. In the rest of this letter, I want to focus on three matters: in the General Fund, the driving forces behind financing the trends in the FY16 budget; the consequences in the school budget of the city's education financing strategy; and finally, the persistent delusion that there are sources of funding on the city's balance sheets adequate to pay for more city services without tax increases, if only I would endorse their use for that purpose.

Starting with the first point, the pressure points on the budget, it is helpful to look at changes in basic budget categories over time. The FY16 General Fund budget, when compared to the FY13 budget, presented several funding problems. The first of these is a continuing political pressure to refrain from appropriating the property tax increase allowed under Proposition 2 ½. This caused the constricting of revenues available. In FY 2015, nearly $2.5 million of allowable levy increase was not appropriated. In FY16, that amount is more than $3.0 million.

The second problem is similar, a decrease in reserve funds available to pay the budget needs in the General Fund in FY16 compared to FY13. The available funds from reserves declined over those three years from $19.1 million to $14.4 million, a decrease of $4.7 million. In other words, because of this factor alone, the FY16 budget compared to FY13, started off in a "revenue hole" of nearly $5 million. This was composed of lower Free Cash reserves, in the amount of $1 million, and the fact that $3.1 million from the stabilization fund and other reserves were not available in FY16, to the same extent that they were used in FY13. I have discussed for years diminishing capacity of the city's reserves to pay for its operating budgets, because they have been drawn down without replenishment.

Another budget problem over the FY13 to FY16 period involves spending which is needed by the city but is absent from the budget because of revenue constraints. This spending, as previously mentioned, involves the urgent need to spend in order to upgrade and replace capital assets, to replenish reserves, and to reduce long term liabilities.

The final factor involves financing the spending increases, which did occur. The major pressure points here, exacerbated by the city's revenue decisions, are to pay for collective bargaining increases for the city's union employees and to finance the city's public education obligation. By the beginning of FY13, the city's unions had already experienced two years of zero increases in FY11 and FY12, and the FY13 budget continued that trend. This was unsustainable, and during the FY14 period, retroactive contract settlements were agreed to. This had the effect of burdening the FY13 to FY16 period with six years of settlement costs.

In summary, the spending budgets of the general fund increased by 11 percent from FY13 to FY16, from $316.0 million to $349.0 million, a total of $33 million. These are the major categories which increased:

From FY13 to FY16, Millions of $ Increase in:

Direct Appropriations to Schools, Including S.E Regional:	$16.6, or 11.0%
Personal Services, City Side Employees	$9.1, or 20%
Health, Pensions, Debt Service	$2.4, or 3%
State Charges for School Choice & Charter Schools	$1.4, or 35%
Increase in Deficit for Snow Removal	$1.3, or 650%
Everything else in General Fund Budget	$2.2, or 9%
Total	$33.0, or 11%

The percentages above are for the full three year period, not annual averages. In effect, to finance the City's increase of $33.0 million in spending and also to make up for the loss of $4.7 million in reserves available to support the budget, the city's ongoing revenue sources needed to increase by $37.7 million. The city enjoys three basic categories of recurring general fund revenues: state aid, the property tax levy, and other local receipts. The state aid consists of many categories, but they can be summarized as three, aid passed directly to the libraries and schools, such as for school lunch programs, Chapter 70 aid to Education, and all else, mainly unrestricted. Here are the trends for FY13 to FY16 for these revenue categories.

From FY13 to FY16, Millions of Dollars Increase in:

Aid to Libraries/School Lunch	$0, or 0%
Chapter 70	$21.9, or 16%
All Other Cherry Sheet Aid	$2.9, or 16%
Other Local Receipts	$1.8, or 9%
Property Tax Increase ($2.5 Million in FY15 and $3.0 Million in FY16 not levied)	$11.1, or 10%
Sub Total	$37.7, or 13%
Less-Loss in Revenues from Reserves	$(4.7), or (25) %
Revenue Increase for Spending	$33.0, or 11%

The above percentages above are for the full three year period, not annual averages.

The preceding tables are worthy of a few comments. Note that the largest percentage increase in spending was for paying for the deficit in snow removal costs for the past year, and that the next largest percentage increase was to the category for payments deducted by the state from the city's Chapter 70 aid to education in order to pay tuition bills, mainly to charter schools with Brockton students. These dollars never even make their way into the revenue stream for appropriation to Brockton schools. It is worth restating that the large rate of increases to city salaries resulted from the fact that at budget time for FY13, most of the city's union contracts, most particularly for the police and fire unions, had been unsettled since the end of FY10. That meant that when they were financially settled, in FY14, with retroactive provisions for the public safety unions, the full burden of six years of pay raises, including three fully retroactive, were financed in this FY13 to FY16 measurement period. Had the settlements occurred at an earlier, normal pace, the amount of the increase from FY13 to FY16 alone would have appeared more like 6 to 8 percent, for a positive achievement in cost control.

The table also demonstrates that the city has controlled the rate of growth in health, pension, and debt costs. The rate of increase is only 3% over 3 years. This was achieved mainly because of the city's savings in health insurance costs, gained by benefit reductions bargained with the unions. In the category of all other costs, the various costs comprising the remainder of the General Fund budget, have simply kept pace with inflation over the past three years. However, there is a negative aspect to this. That is because this category includes spending on capital needs and replenishing reserves, but almost no cash spending for these purposes occurred. The deferral into the future of these capital costs simply means that the city is imposing an obligation which should be financed today, on future budgets and future tax payers. This is both expensive and unfair. In the General Fund, the city confronts but is ignoring millions of dollars badly needed for capital expenditure, for example: for fire firefighting apparatus, fire station repairs, police cruisers, DPW equipment, and for infrastructure rehabilitation. By failing to replenish reserves, we not only impair the city's fiscal stability in the long term, we also jeopardize our ability to pay for services in the short term. Recall the earlier discussion of the decline of $4.7 million in reserves for budget support from FY13 to FY17. Because the city's reserves were reduced from the levels available for the FY13 budget, financing the FY16 budget was made much more difficult.

At this point, I want to examine the city's support of its obligation to fund its schools. You will note that the city's direct appropriations to the schools increased by $16.6 million from FY13 to FY16. However, the city's Chapter 70 aid increased by $21.9 million related to classroom support under the Education Reform Act. Why wasn't all of the $21.9 million increase appropriated to the Brockton Public Schools for Education Reform related costs or to the Southeast Regional Vocational High School? Only $14.7 million of this increase was so appropriated, leaving a difference of $7.2 million. Four factors contribute to this. First of all, a total of $1.4 million was retained by the state to pay an increase for school choice and Chapter School tuitions; that amount was never available to appropriate. Second, in 2015 the state legislature changed the law and allowed Brockton to phase in the counting of the cost of health insurance for retired school teachers toward its Education Reform obligation. This cost is funded in the city's health budget, not in the school appropriation, and it is worth about $6.0 million, with $1.5 million countable in FY16. Third, some other costs allowable in financing Education Reform also appear in the city budgets, not the school budget. These are accounted for on a report called "Schedule 19", as are the retired health insurance costs. These other costs grew by about $1.5 million, FY13 to FY16. This leaves about $2.8 million to account for. This amount actually represents a shortfall in FY16 of the city's minimum obligation for funding from local funds under the Education Reform Act. For FY16, the city's appropriation to the Brockton Schools is less than the requirement by almost $2.8 million. The calculation by the state of a community's obligation to fund its share of the Foundation Budget includes the assumption that the provisions of Prop. 2 ½ will provide a predictable revenue growth in which the school system should share – the annual 2 ½ percent levy increase. The state does not force the community to raise this amount of tax, its formula simply prescribes that if that revenue isn't raised, the consequences won't be imposed on the school budget. But this year, the consequences have been imposed on the school budget.

This spending obligation from the shortfall doesn't go away, it simply will be carried forward to add to the FY17 obligation. The city, with a shortfall of $2.8 million, will suffer no penalty on its anticipated FY17 Chapter 70 aid. That would only occur with a shortfall of 5 percent or more of the Foundation budget spending, which would equate to about $10.5 million, not $2.8 million. However, the shortfall will carry an obligation of the current fiscal year into the future, and it will make it more difficult to finance the FY17 school budget. In addition, incurring a shortfall when the fiscal ability to avoid it exists, because of the unused levy capacity of $3.0 million, under the provisions of Proposition 2 ½, undercuts the city's case in arguing that the city's school system suffers financially because the state is no longer fulfilling its constitutional obligation to fund education as determined by Supreme Judicial Court in the Hancock case, which led to the Education Reform Act of 1993.

I believe this assertion that the state's commitment has waned, can be defended. There are also valid criticisms to the Foundation Budget which was established by the Education Reform Act. For one key example, communities with higher percentages of low income students, especially those who are also bilingual, demonstrate consistently, markedly lower outcomes for their students than those achieved by districts where the students are from more well-to-do families. I believe that this fact, beyond dispute, demonstrates that the extra funding in the Foundation budget for low income students is inadequate to the task. If it were not, the results would be less significantly divergent. This inadequate funding for low income students occurs even while the state provides a minimum aid distribution of Chapter 70 funds, in the amount of $20 per student, to districts which otherwise would not qualify for this assistance by virtue of measures of property values or population average income. This unnecessary distribution appears intended to allow each district to share to some degree in the states largesse. So, there are good reasons for the city to exert political pressure to improve the state's share of funding for districts with poorer populations. There are strong data-based arguments which can be made. However, for the city to fall short of meeting this present fiscal obligation to achieve minimum local revenue funding, when meeting it simply requires an appropriation of available, unlevied property taxes, creates a distraction to the city's valid argument.

I want to close with a discussion of whether in fact funds are available on the city's balance sheets for the general and enterprise funds, to allow for more spending without raising taxes and fees. Those who make these assertions, using the city's audited financial statements as the basis, misinterpret the meaning of what is displayed in the schedules on the audited statements. I will focus on the general fund, but the same issues apply to the enterprise funds.

The most recent fiscal year for which an audit has been completed is for FY2014, which ended on June 30, 2014. It was performed by the firm Clifton, Larson, Allen. This firm replaced the firm KPMG Peat Marwick. The city prepares its financial statements to comply with pronouncements of the national Government Standards Accounting Board (GASB). These pronouncements oblige the city to prepare accounts both in accordance with principles for the government wide financial statements, grouped as governmental activities and business activities, and also for fund financial statements, grouped as governmental funds, proprietary, and fiduciary funds. The accounting rules for the government wide presentation, which attempts to employ private business-like rules, and those for the fund financial statements are quite different. This is especially true for the treatment of long term liabilities and assets. The different rules create different results in the recognition of revenues and expenses and the values in the various balance sheet classifications. There are footnotes, schedules, and written discussion in the audit to help clarify these differences, but the differences are substantial.

For example, in the government wide statement of "net position", the city's unrestricted net position on the balance sheet total is shown to be a negative $156.7 million (see page 23 of audit). However, the city's governmental funds balance sheet shows a positive "unassigned" balance of about $19.6 million. (see page 25). Both balance sheets report a cash and investment total of $104.2 million. In that case, how do such different results occur? Different accounting rules provide the explanation, and a reconciliation is provided on page 26 of the audit. Essentially, the former presentation looks at longer term obligations of the city and shows that the city is not well positioned to meet it so called "Other Than Pension Benefits" (mainly health insurance for employees when they retire). But that is a long term problem – a real, one, which needs addressing, sooner rather than later, but not immediately. The second presentation takes a more short term view. Most of the assets reported are shorter term in nature; most of the liabilities are also shorter term. The "Unassigned" fund balance of $19.6 million means that there are there are accounting impediments to its appropriation. This "Unassigned balance" figure is often erroneously used and quoted by those who oppose property tax increases, as a source of budget financing, which has not been used and should be.

However, before drawing such an inaccurate conclusion, it is important to note the component pieces of the $19.6 million. It also needs to be recognized that the Massachusetts Department of Revenue maintains oversight of the city's budgeting and appropriating process. That includes how much of the $19.6 million, the DOR would permit the city to appropriate.

The $19.6 million "Unassigned Fund Balance for the General Fund", is composed of:

Stabilization Fund -	$2.4 million
Unreserved Fund Balance	$17.2 million
Total	$19.6 million

The stabilization fund maybe appropriated upon recommendation of the mayor and the approval of two-thirds of the city council for any lawful purpose. However, most councilors, the mayor, and I agree that the balance in that fund is too low at the moment; the city should be adding to it, not reducing it. Therefore, although it could be appropriated, it shouldn't be appropriated.

The unreserved fund balance of $17.2 million is the starting point for the Department of Revenue when it calculates and certifies so called Free Cash. This term is simply a euphemism for what is meant: "balance sheet reserves which exist in cash form and which are free to be specifically appropriated after certification by the Department of Revenue". In March of 2015, the DOR certified Free Cash on the balance sheet as of 6/30/14 in the amount of $13,131,133. This amount in fact ALREADY HAS BEEN FULLY APPROPRIATED in the FY16 budget. It was appropriated to support in part the city's FY16 pension assessments. Having been appropriated once, it cannot be appropriated again.

The remainder of the $17.2 million in unreserved general fund balance, which is $4.2 million after the appropriation of Free Cash, is not available for appropriation. In order to be conservative, in calculating Free Cash, the Department of Revenue deducts for deficits in other funds from the unreserved balance of the General Fund. These deficits can exist in grants funds in which funds have been expended, the grant agency has been billed, but the city is awaiting reimbursement. The DOR also deducts for the value of accounts receivable of the general fund which have not been fully reserved by deferred revenue accruals. This also is a practice of conservatism. Thus, of the $19.6 million which supposedly exists to avoid tax increases:

$13.1 million has been appropriated;

$2.4 million should not be appropriated;

$4.1 million may not be appropriated.

There are many in the city who would like to ignore these three facts. They would like the city's elected officials and me to ignore them, too. However, in the end, political fantasy must yield to fiscal reality. If the city wishes to avoid tax increases, it must cut services. If the city wants to avoid service cuts, provide for its long term fiscal stability, and take proper care of assets of the city, significant new revenues are needed.

Respectfully Submitted,

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