



*City of Springfield*

# *Financial Review*

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*Division of Local Services*

*April 2003*



## ***INTRODUCTION***

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At the request of the Springfield Mayor and City Council and at the direction of the Secretary of Administration and Finance, the Division of Local Services (DLS) has conducted a review of the City of Springfield's financial condition.

The scope of this financial review encompasses the following:

- ◆ Review the financial condition of the City of Springfield as of January 31, 2003;
- ◆ Assess the capacity of the city budget to absorb \$3.4 million in FY03 revenue reductions imposed under MGL Chapter 29, Section 9C in late January 2003;
- ◆ Assess the fiscal capacity of the city to manage projected state aid reductions in FY04 as reflected in House 1 and to operate under similar constraints in future years;
- ◆ Make recommendations to enhance municipal revenues;
- ◆ Make recommendations that foster sound financial management practices and work to create a stable fiscal environment over the long-term.

This report was completed by a DLS team which met, in Boston, with Mayor Michael Albano and members of his staff. During visits to Springfield, more in depth interviews were conducted with the city's finance officers, other city hall staff and members of the City Council. With the Mayor's approval, discussions also took place with the city's audit firm and its financial advisor. Financial records and independent audits were reviewed, historical data were analyzed and various city-generated reports were examined.

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## ***REPORT SUMMARY***

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The initial focus of this analysis centered on the city's response to \$3.4 million in local aid reductions under MGL Chapter 29, Section 9C announced by the Governor in late January, 2003. The Mayor's decision to order staff layoffs totaling 287 positions to offset the FY03 revenue reductions raised questions among city councilors and other observers as to whether or not cuts of this magnitude were justified. However, the scope of the review broadened quickly to include an assessment of the city's ongoing ability to weather future local aid cuts and other extraordinary events.

It is our firm conclusion that the Mayor's actions in response to Section 9C cuts were warranted and that Springfield is poorly positioned to handle additional upcoming local aid reductions. At the same time, we believe that, through a combination of local initiatives and state support, the means exist to address the city's financial issues and to formulate a plan for a more stable future.

The fiscal environment within which Springfield, the Commonwealth's third largest city, operates is characterized and influenced by a range of economic pressures:

Springfield has the state's second lowest equalized property value (EQV) per capita (\$31,119) - well below the state average of \$100,940. The city's 1999 per capita income of \$13,360 is third lowest.

Springfield is the second most heavily dependent municipality on state aid (62 percent of budget in FY03). Consequently, any state aid reductions have significant impact.

Between FY93 and FY03, the city's Chapter 70 education aid increased by \$108 million. At the same time, local revenue required to support education grew by only \$2 million. With huge infusions of aid from FY97 to FY01, the city added 189 teachers and increased the average salary by 22.6 percent.

The city continues to carry \$7.0 million in bonds to pay-off remaining municipal hospital operating deficits and must address an incurred, but not recognized, health insurance deficit totaling \$6.7 million as of June 30, 2002.

Due to the steep decline in property values in the early to mid 1990's, the city's levy limit collided with its levy ceiling over a five year span beginning in FY96. As a result, the city had to forego \$9.1 million in levy growth from the annual 2½ percent increases and new construction allowance otherwise allowed by Proposition 2 ½.

In FY91, the city secured needed revenue through a \$10.8 million general override, the second largest in state history. This gain was all but eliminated by the levy limit collision referenced above.

From FY94 to FY03, the city's tax levy grew by only 28.6 percent. In constant dollars, this translated into no real levy growth over the ten-year period.

Tax collections have declined in recent years. Outstanding receivables, tax title and foreclosure accounts are 50 percent higher in FY02 than in FY98.

The city has no reserves and has seen its fund balance decline by \$15.4 million between FY98 and FY02. While the city's budget has been balanced on a budgetary basis, on a cash basis, the city has spent an average of \$3.86 million more, per year, than it has taken in over this period. Similarly, the city's free cash position has plummeted steadily from negative \$6.9 million on 7/1/98 to negative \$57.5 million on 7/1/02.

At Baa3 (Moody's), the city's bond rating is the lowest investment grade rating.

To overcome insufficient cash flow and avoid going to bond markets, the city has requested and received emergency local aid advances from DOR totaling \$96 million between FY98 and FY03.

In this context and looking forward, the city faces a shortfall that may be as large as \$13 million entering the FY04 budget process. (See Appendix A). Annualized savings from the FY03 staff layoffs, together with levy limit increases and a reduction in the city's local effort to education will not be sufficient to offset projected cost increases and revenue reductions in FY04. The combination of House 1 revenue cuts, local fixed cost increases and the gap created by the prior year's use of one-time revenues, are projected to create a budget deficit as high as \$13 million. This deficit may vary depending on the outcome of the state budget. Nonetheless, after the city funds required fixed costs such as net school spending, debt service, pension, health insurance and unemployment, cuts to eliminate any shortfall must come from a remaining budget of only about \$80 million.

Addressing a budget shortfall approaching \$13 million can only be accomplished through a combination of additional budget cuts, access to new local revenue sources, improvement in city tax collections, and enhanced state oversight and assistance. However, the solutions will not come in the short term. Only from a concerted, coordinated effort by the city administration, city council and state government can a long-term plan to right the city's course be devised and effectively implemented.

Recommendations - Rather than require that the city raise the accumulated health insurance trust fund deficit of \$6.7 million in FY04, we recommend that the state draft and support special legislation to amortize this deficit over five years. To help finance this amortization, the legislation would allow the city, on a phased-in basis, to access the Proposition 2½ levy growth from new construction that it was unable to take from FY96 through FY2000. The state will also review ways to effect a more manageable balance between school and municipal spending. It is conceivable that the city meets the qualifications under existing legislation to access a small percentage of net school spending for school construction or debt service costs. Finally, the

Division of Local Services will review a proposal from the city to ease certain regulatory restrictions on the bulk sale of receivables.

We further recommend that to ensure these actions return Springfield to a sound financial position, the special legislation also include provisions to establish a state finance advisory board. The purpose of an advisory board is not to determine or dictate city policy, but to make sure that expenditures are aligned with revenues and that city finances are returned to a healthy state. Toward this end, the advisory board is a means to ensure that city budgets are built using conservative assumptions on revenues and expenditures, that reasonable reserves are maintained and that necessary fixed costs and capital needs are funded. There is ample precedent for this type of state involvement in recent years. The three most recently concluded advisory boards (Brockton, Lawrence and Lowell) were all successful in achieving fiscal stability in situations that were similar to Springfield's.

Conclusion - We have concluded that the Mayor's response to order staff layoffs in response to \$3.4 million in 9C revenue reductions was justified. We have also concluded that the city is ill-prepared to manage or absorb future state aid cuts without identifying new revenue sources on its own initiative and with state support. The city has no meaningful cash reserves and, as a matter of policy, the municipal government spends all that it raises and spending often outpaces revenue collections. Over time, these factors have caused a downward spiral in fund balance which stands as an important measure of financial strength.

The recommendations presented in this report offer a course of action that addresses the city's fiscal circumstances. Among other things, they point to opportunities to generate new revenue, reduce deficits and improve fund balance. Collectively or individually, they do not, nor are they intended to, resolve all problems, particularly in the short-term. Even if the financial benefits of all the recommendations are fully realized, the city may still face a FY04 revenue shortfall in the range of \$6.8 million under House 1 provisions. (See Appendix B).

Although this projected shortfall represents only 1.7 percent of last year's budget, balancing the FY04 budget will require further workforce reductions. To address the entire potential FY04 shortfall with additional staff reductions translates into approximately another 180 to 200 layoffs. Since these reductions would be effective over the full fiscal year, the effect is less than the impact necessary to offset the \$3.4 million 9C reductions that occurred almost three-quarters of the way through FY03.

In this context, our recommendations provide the city with a blueprint to secure long-term fiscal stability. Looking to FY05 and beyond, cumulative levy expansion through the phased-in restoration of new growth and the potential to shift net school spending dollars can generate increasing new general fund revenue. The financial flexibility afforded by the final payoff of the city's hospital deficit bonds in FY06 and the health insurance amortization in FY08 represents

other areas of potential gain. Budget dollars previously directed to these costs can then be used for other municipal purposes. (See Appendix C).

Now, entering a period of contraction in government, the Mayor has begun to demonstrate the political will to reverse past trends. However, with elections in the fall, a new mayor and city council must act with consensus in favor of forward-looking, fundamental changes in the way municipal finances are managed. Benefiting the city in this effort are experienced finance officers, who in the past have shown they are capable of working through difficult periods.

For its part, the state looks to continue its long-term working relationship with the city. Since 1989, through the Division of Local Services, the state has assisted Springfield on matters of organization, deficit bonding, tax rates and overall financial management. In the pursuit of these new goals, the formation of a finance advisory board represents the next logical level of state involvement and an important element in the city's long-term fiscal recovery.

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## ***REPORT FINDINGS***

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### Background

DOR oversight of Springfield finances began in earnest in 1989 when the city faced a \$6.4 million deficit arising from group insurance and public safety training programs. With the adoption of Chapter 656 of the Acts of 1989, the city was allowed to amortize the deficit over five years, which in 1991 was extended to ten years. In each case, the city was placed under certain controls. Among them, further borrowing necessitated the approval of the Commissioner of Revenue, department heads were made personally liable for overspending, a system of quarterly expenditure reports was set-up, as was a restricted use fiscal stability fund with a minimum and increasing balance requirement. The special act also created a chief financial officer position to oversee and direct the city's budget and financial administration.

Some relief came in 1996 with the establishment of the Springfield Water and Sewer Commission under Chapter 40N. In addition to removing the water and sewer operation from the municipal budget, the city benefited from a one-time reimbursement of \$7.3 million related to the transfer of infrastructure. With DOR encouragement, the proceeds were used to retire the previously deferred costs and the 1992-1993 teachers' summer pay deferral obligation.

Later in 1996, however, year deficits arising from operation and closure of the Springfield Municipal Hospital were identified and led again to special legislation. Under Chapter 112 of the Acts of 1996, the city issued \$21.4 million in debt to cover primarily hospital and other minor deficits. The remaining balance of \$7.0 million is scheduled to be paid in installments ending in FY06.

Other deficits are associated with the city's self insurance and capital project funds. Since 1989, the city had shifted to a premium based program and in response to, what it perceived to be, excessive cost increases, returned to self-insurance. As of June 30, 2002, the insurance claims deficit totaled \$6.7 million. Large capital project fund deficits have also built due to a policy decision not to issue bond anticipation notes prior to June 30. This allows the city to defer initial debt service payments on new projects to a subsequent fiscal year, but causes it to run-up deficits in its capital projects fund (\$33.5 million in FY02). Both are major contributors to the city's negative free cash status (negative \$57.5 million as of 7/1/02).

Given the city's precarious bond rating and the adverse impact frequent cash flow borrowings have in the financial market, the city sought and received \$96 million in emergency local aid advances from DOR between FY98 to FY03. The advances, typically transferred two-to-four weeks before their normal distribution date, became necessary when revenue collections were inadequate and cash flow insufficient to meet the city's financial obligations.

While the above state interventions were effective in dealing with specific financial problems, they have not provided an effective framework to bring about changes to the city's budgeting and spending practices. Currently, DOR exercises its oversight of the city's budget during the tax rate setting process which for Springfield occurs in mid-to-late December just prior to the December 31 deadline for issuing actual tax bills.

### Fiscal Year 2003

As with all Massachusetts communities, seven months into the 2003 fiscal year (FY03), the city of Springfield was forced to deal with reductions in yet-to-be distributed state aid. Section 9C cuts totaled \$3.4 million for the city.

In response to the 9C cuts, most Massachusetts communities tapped into reserves in the form of certified free cash, stabilization balances, overlay surplus or emergency reserve accounts. In fewer instances and in typically smaller amounts, other current-year income sources were identified, i.e., confirmed budgetary turn-backs.

The City of Springfield, because of past spending practices, was not one of these municipalities. The absence of reserves, perennially tight budgets and the tendency to spend whatever money it has, leaves the city with little ability to produce emergency cash in any meaningful way.

- ◆ Free Cash - Springfield has no certified free cash to draw on. As of July 1, 2001, the city's free cash was negative \$30 million and has been negative in each of the last five years. Free cash as of July 1, 2002 was certified at negative \$57.5 million.
- ◆ Stabilization - The stabilization fund, traditionally maintained as an unrestricted special purpose revenue source, has a balance of zero and has had a zero balance in each of the last ten years.
- ◆ Chapter 656 Fiscal Stability Fund - By special legislation enacted as Chapter 656 of the Acts of 1989, the city is required to maintain a stabilization balance within the general fund equal to 1 percent of its annual budget. If used, the fund must be replenished. Any portion of the \$4 million balance available on January 31, 2003, could have been transferred for use, but as a one-time revenue, its use would have further exacerbated the city's situation.
- ◆ Contingency - In its \$400 million FY03 budget, the city appropriated \$500,000, or 0.1 percent of the total, to a contingency reserve. As of January 31, 2003, \$250,000 remained, but was not used to offset 9C cuts.
- ◆ Overlay Surplus - Increased reliance on overlay surplus to supplement the budget has resulted in depleted overlay reserves and fund balance. Between FY98 and FY03, the city used \$17.8 million in overlay surplus. Given the growth in tax liens and possessions account balances and the reduced annual overlay reserve levels, the city cannot expect to generate surplus revenue for use elsewhere as in the past.



Against this backdrop, little choice was left in addressing 9C cuts other than to look for cost savings through reductions in FY03 operating budget line items. The city's expenditure report, as of January 31, 2003, presents its financial condition at approximately the same time as the local aid reductions were released:

- ◆ Out of an appropriated budget of \$399,134,091 for FY03, the amount remaining, after expenditures and encumbrances, to be expended when 9C reductions were imposed and with five months left in the fiscal year was \$124,475,000;
- ◆ Since the city is frequently aggressive in estimating its local receipts and fails to meet projections, any expectation of excess revenue would have been unjustified;
- ◆ Of the \$124 million, no cuts could be made to the remaining \$70,200,208 in school costs in order to keep Springfield at its net school spending requirement;
- ◆ Of \$54,274,792 in remaining city-side expenditures, \$20,206,352 was attributable to fixed costs (debt service, county assessments, retirement, unemployment and health insurance) and was not a source of potential cuts;
- ◆ As of January 31, the city's remaining obligation for non-school salaries and operating expenses was \$34,168,440;
- ◆ Of that total, 86 percent, or \$29,440,866 represented salaries. Non-personal service related costs totaled \$4,727,574;
- ◆ The city's FY03 9C reduction in local aid was \$3,400,000. Associated unemployment compensation costs due in FY03 accounted for an estimated \$492,000.

The Mayor's response to the 9C cuts was to implement \$3,892,565 in budget reductions from four general areas, excluding school and fixed costs.

Workforce layoffs	287 positions	\$2,495,387
Reduced employee hours	35 positions	360,901
Other than personnel services		556,030
Grant programs*		<u>480,248</u>
Total		\$3,892,565

\* Reflects general fund savings when positions were moved into grant programs.

Also in play was the city's credit rating. Quick, decisive action was regarded as essential to avoid jeopardizing the city's bond rating, which at Baa3 (Moody's) is already at the lowest investment grade. It is our understanding that the Mayor was advised as much by the city's financial advisor and, after the fact, in a New York City meeting with Moody's representatives.

## Fiscal Year 2004

Looking forward, the city faces a shortfall that may be as large as \$13 million entering the FY04 budget process.

- 1) Projected annualized savings from the FY03 workforce reductions are eliminated by increases in the city's fixed costs in FY04.
  - ◆ Projected FY04 non-school fixed costs are \$9 million higher than in FY03 and reflect increases in pensions, net debt service, unemployment compensation, health insurance and account for cost of living adjustments for city employees.
  - ◆ The city realizes a net savings of \$8.1 million which is the remainder of \$11.5 million in annualized savings resulting from the FY03 workforce reductions less \$3.4 million in 9C local aid cuts brought forward to FY04.
- 2) Decreases in general purpose State Aid, totaling \$14 million, are partially offset by gains in the tax levy and reductions in local effort toward education, but a \$6 million shortfall remains.
  - ◆ Under House 1, Springfield receives \$11 million less in lottery and additional assistance, and no longer receives \$3 million in transportation reimbursements.
  - ◆ This is partially offset by a \$4 million increase in the city's levy limit, and an additional \$4 million the city does not have to pay because its local contribution to net school spending would be reduced.
- 3) An additional \$7 million of one-time revenue used in FY03 will not be available in FY04.
  - ◆ Unavailable for operations in FY04 will be \$3 million in overlay surplus, \$1.5 million in a Federal grant reimbursement related to the court house and \$2.6 million from a settlement with AT&T.

Because the final amount remains uncertain, not included as an extraordinary expense is the current year snow and ice deficit which is likely to range between \$800,000 and \$1,000,000.

Under House 1, a net increase in school-related state aid leaves the school with \$4.6 million in additional funds for education. This is not available to help offset the local aid cuts or to otherwise support the non-school budget.

Based on the above, the city enters the FY04 budget process facing a deficit that could be as high as \$13 million. (See Appendix A for details).

Since spending on schools and other fixed costs are not areas where cuts can be made, the deficit must be closed through reduction in remaining city expenditure accounts. The city's total budget projection for FY04 less net school spending and less various fixed costs leaves approximately \$80 million from which as much as \$13 million may have to be cut.

### Conclusion

For reasons outlined, justification exists for the Mayor's decision to execute workforce layoffs to meet FY03 9C revenue reductions. To his credit, the Mayor demonstrated the political will to act decisively and in a fiscally responsive manner. However, the city is not without failings.

In Springfield, past practices and the absence of sound financial policies have left municipal government wholly unprepared for any fiscal crisis. Instead, spending on a budgetary basis has entirely consumed revenue collections. Reserves that accumulated in overlay accounts - a non-revenue source - have steadily been depleted for spending purposes. Uncollected taxes and deficit spending create enormous obstacles to generating positive free cash and are major contributors to the decline in fund balance in recent years.

To date, city finance officers have effectively utilized available management tools to keep the books in order and meet audit requirements. The Mayor has acted as well, most recently and in the past, to address various financial issues of concern brought to his attention by DOR. However, the trends are clear. It is becoming increasingly more difficult to keep the city in the black at year-end. If current practices persist, the city will continue to experience a decline in fund balance and will reach a point where it fails to meet the accepted tests of fiscal stability.

## ***TRENDS***

**Fund Balance Decline** - Fund balance (fund equity) provides one measure of the municipality's fiscal health and, over time, demonstrates whether it's condition is improving or deteriorating. In Springfield, the annual increases in property tax receivables and tax title accounts and the release and appropriation of overlay surplus are major reasons why expenditures and other uses of resources exceed revenues and contribute to a decline in fund balance.

<b>Changes in Fund Equity</b>	<b>6/30/98</b>	<b>6/30/99</b>	<b>6/30/00</b>	<b>6/30/01</b>	<b>6/30/02</b>
Revenues	\$307,170,656	\$334,210,080	\$376,426,339	\$395,143,273	\$420,290,915
Expenditures	304,197,681	336,605,597	376,849,057	402,564,191	420,949,943
Other Financing Sources (Uses)	(3,075)	(3,260,000)	(711,557)	(490,000)	(69,432)
Excess (deficiency) of revenues/other sources over expenditures/other uses	2,969,900	(5,655,517)	(1,134,275)	(7,910,918)	(728,460)
Fund Equity, June 30	\$26,080,133*	\$20,424,616	\$19,290,341	\$11,379,423	\$10,650,963

\* as restarted, July 1

**Increasing Receivables, Tax Titles and Foreclosures** - Receivables, or delinquent tax accounts which have not yet been placed in tax title, have increased 70 percent over the last five years and exceeded \$14.9 million in FY02. Uncollected property taxes, interest and charges related to tax title accounts dating back to 1990, together with foreclosed properties, total another \$26.8 million, which reflects a 40 percent, or \$7.5 million, increase since 1998.

<b>FY</b>	<b>Receivables</b>	<b>% of Levy</b>	<b>Tax titles &amp; Foreclosures</b>
1998	8,870,737	9.3%	19,225,541
1999	12,282,762	12.4%	21,377,422
2000	12,976,950	12.7%	23,121,442
2001	16,170,026	15.2%	22,015,149
2002	14,982,976	13.5%	26,810,851

**Negative Free Cash** - High receivables not only tie up overlay reserves, but are a significant contributor to the city's negative free cash status. In each of the last five years, the city's free cash has descended from negative \$6.9 million in 1998 to negative \$57.5 million as of July 1, 2002. The capital project deficit (\$33.5 million) and health insurance deficit (\$6.7 million) are also major factors.

<b>FY</b>	<b>Free Cash as of 7/1</b>
1997	(6,851,035)
1998	(9,250,464)
1999	(14,902,314)
2000	(21,268,293)
2001	(30,777,226)
2002	(57,510,507)

Reliance on Overlay Surplus as a Source of Cash - The city has had reasonable success in moving receivables into tax title which secures its lien on properties for monies owed and allows for a higher interest charge. However, because this transfer also relieves the pressure to maintain overlay reserves, the city has come to rely on overlay surplus as a revenue source, (i.e., as a non-cash item which is used to fund the annual budget). Since 1998, the city has released and appropriated \$17.8 million in overlay surplus primarily for funding recurring operating expenses in the annual budget. This creates the problem that the city is spending real cash and balancing the budget with a non-cash accounting entry. Since the city's tax lien and property tax receivables continue to grow, the release and appropriation of overlay surplus also has the effect of lowering fund balance. To reverse this trend, overlay surplus should not be spent, but released to fund balance.

<b>FY</b>	<b>Overlay surplus appropriated</b>
1998	3,500,000
1999	3,500,000
2000	2,300,000
2001	2,500,000
2002	3,000,000
2003	3,000,000

Declining Overlay Reserves - The likelihood that surpluses will diminish is evidenced by the trend in the amount of overlay set aside in the last five fiscal years. The provision for overlay was set at \$5.2 million or 5.4 percent of the levy in FY98, but only at \$2.5 million or 2.2 percent of the levy in FY03.

<b>FY</b>	<b>Annual Overlay Provision</b>	<b>As % of Levy</b>	<b>Cumulative Overlay Balance</b>
1998	5,202,337	5.4%	15,812,034
1999	4,392,193	4.4%	16,269,664
2000	3,995,111	3.9%	16,392,832
2001	3,212,186	3.0%	17,834,097
2002	2,411,107	2.2%	13,266,220
2003	2,498,585	2.2%	

**Break-Even Community** - On a budgetary basis, the city is a break-even community, but just barely. The margin that separates year-end revenues from expenditures is diminishing and provides no opportunity to build free cash or fund balance. This method of accounting can be misleading as it credits net property tax revenue as 100 percent collected which is rarely the case.

FY	Variance: Budget vs. Actual		Excess (Deficiency)
	Revenues	Expenditures	
1998	370,419	458,551	826,970
1999	440,034	372,749	812,783
2000	713,201	(290,502)	432,699
2001	384,792	(255,328)	129,464
2002	(693,639)	737,941	44,302

The city's financial performance is more accurately measured on a cash-in/cash-out basis. Through an analysis of year-end fund balance (assets versus liabilities), and a comparison to prior years, a clearer picture of the city's fiscal strength emerges. The city's declining tax collections and use of cash reserves, like overlay surplus, are also more apparent.

As noted earlier, Springfield's fund balance declined by \$15.4 million between FY98 and FY02, or by \$3.86 million per year, on average. Clearly, despite showing budgetary balance, the city has a cash spending deficit averaging \$4 million annually over this period.

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## ***RECOMMENDATIONS***

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### **Revenue Related**

- 1) Allow the city to amortize its current self-insurance deficit.

According to the independent auditor's report, the city's liability for accumulated claims against its health insurance trust fund was \$6.7 million, as of June 30, 2002. Normally, the entire amount would be reported and raised in the following year's tax rate. As an existing deficit, it affects free cash in a negative way.

Rather than require that the city raise the accumulated health insurance trust fund deficit of \$6.7 million in FY04, we recommend the city be allowed to amortize it over future years. For instance, on a five-year amortization schedule payments would average \$1.3 million annually. This requires special legislation. If acted upon immediately, the city could be relieved of this burden by FY08.

- 2) Permit the city to recapture taxing capacity denied in prior years when its levy limit collided with its levy ceiling to cover the amortized payments for the self-insurance deficit.

Under Proposition 2½, a community's levy limit - the amount of revenue it is allowed to raise through property taxes - increases from one year to the next on the basis of a calculation. Simply stated, the prior year levy limit, plus 2½ percent, plus new growth (i.e., tax value for construction being taxed for the first time) establishes the new limit. The overriding restriction on local taxing ability, the levy limit cannot exceed a levy ceiling which is annually calculated by multiplying the total assessed value of property within the community by 2½ percent.

Typically, the inflation rate of property values exceeds year-to-year levy limit adjustments, so cities and towns are able to fully realize the taxing capacity allowed by Proposition 2½. However, this was not the case between FY91 and FY96 in Springfield when city's total assessed value dropped by \$1.7 billion, or 31 percent. Because of this sharp decline in property values, levy limit increases out-paced levy ceiling growth. When the gap closed, Springfield was no longer allowed to add 2½ percent or new growth to its prior year levy, and as a result, lost taxing capacity. (See charts below).

In FY03, as a result of property value increases, the city's levy limit is \$115,884,518 and its levy ceiling is \$8.1 million higher at \$124,000,617.

While we do not advise creating a circumstance where the city's levy limit once again approaches its levy ceiling, we recommend the city be allowed to access, on a phased-in basis, \$4.7 million in Proposition 2½ levy growth from new construction not realized between FY96 and FY00. Such action would require special legislation. In the alternative, the Mayor and City Council city could approve a Proposition 2½ override to raise the same amount or more by a city-wide referendum.

FY	Prior Year Levy Limit	Add 2.5%	Add New Growth	New Levy Limit	Levy Ceiling	Diff: Limit vs. Ceiling	Lost Levy
1996	93,226,062	2,330,652	710,935	96,267,649	93,599,069	(2,668,580)	(2,668,580)
1997	93,599,069	2,339,977	1,900,008	97,839,054	95,165,798	(2,673,256)	(2,673,256)
1998	95,165,798	2,379,145	1,029,633	98,574,576	95,838,489	(2,736,087)	(2,736,087)
1999	95,838,489	2,395,962	1,324,702	99,559,153	99,052,502	(506,651)	(506,651)
2000	99,052,502	2,476,313	1,512,879	103,041,694	102,496,730	(544,964)	(544,964)
2001	102,496,730	2,562,418	1,633,083	106,692,231	108,638,410	1,946,179	
2002	106,692,231	2,667,306	1,963,162	111,322,699	115,774,684	4,451,985	
2003	111,322,699	2,783,067	1,778,752	115,884,518	124,000,617	8,116,099	
<b>Current Levy Capacity</b>						<b>8,116,099</b>	
<b>Total Lost Levy</b>							<b>(9,129,537)</b>

FY	Amount 2.5% Unused	Amount New Growth Unused	Total
1996	1,957,645	710,935	2,668,580
1997	773,248	1,900,008	2,673,256
1998	1,706,454	1,029,633	2,736,087
1999	0	506,651	506,651
2000	0	544,964	544,964
2001	0	0	
2002	0	0	
2003	0	0	
<b>Total</b>	<b>4,437,347</b>	<b>4,692,191</b>	<b>9,129,538</b>

Exploring this option, it is also our strong recommendation that the potential to gain additional recurring revenue only be granted with stipulations or restrictions on its use. In particular, the city should not be allowed to return all or most of any new found revenue to general operations or to reverse recent decisions to cut expenditures in FY03 or FY04.

Constraints, incorporated into legislative language, should first have the underlying purpose to eliminate the health insurance deficit and to work toward rebuilding fund balance. (See chart below)



	FY04	FY05	FY06	FY07	FY08	FY09
Insurance Deficit	(1,300,000)	(1,300,000)	(1,300,000)	(1,300,000)	(1,300,000)	
New Growth Recapture*	1,600,000	3,240,000	4,921,000	5,044,025	5,170,126	5,299,379
<b>Net Gain in Revenue</b>	<b>300,000</b>	<b>1,940,000</b>	<b>3,621,000</b>	<b>3,744,025</b>	<b>3,870,126</b>	<b>5,299,379</b>

\* Includes compounding by 2½ percent

3) Establish a state finance advisory board in Springfield

The long-term relationship between the state, acting through the Division of Local Services, and the City of Springfield on municipal finance matters has reached a point where it needs to become more constant and formalized. As discussed in this report, the city's financial condition is worsening. It looks forward to the prospects of further reductions in state aid with no reserves, a declining fund balance, high fixed costs and a low bond rating. Other recommendations in this report offer opportunities and tools to confront financial hurdles and improve the city's fiscal position, but they come with conditions. The city must acquiesce to the oversight of a state finance advisory board.

Such boards typically comprise three members from state government, plus the mayor and the city council president or their respective designees. Working with the Mayor and City Council, the board would develop and implement a long-term plan to secure the city's financial stability. It would oversee the city's finances, ratify fiscal decisions and ensure sound practices. It would approve all appropriations, transfers and would authorize borrowing. The board would also have the authority to set fees or charges.

State finance advisory boards have limited life spans, and have worked effectively in other Massachusetts communities. At this junction for the city of Springfield, the establishment of the board is an important element in any plan for fiscal recovery.

4) Permit the city to reallocate a portion of its net school spending requirement to cover debt service on school-related capital projects.

To fund school programs and operations, the city's Chapter 70 aid rose from \$100.5 million to \$208.6 million between FY93 and FY03. At the same time, its minimum local contribution to education rose a nominal \$2 million to \$27.8 million and declined as a percent of the net school spending requirement from 20.4 to 11.8 percent. Under House 1, the city's minimum contribution decreases to \$23 million, or 9.9 percent of net school spending. Springfield would still receive more school aid from the state on a percentage basis than any other municipality, with the exception of Lawrence.

As a city obligation, debt service for school capital projects represents a major expenditure in the budget. In an effort to rebuild its school system and to take advantage of 90 percent cost reimbursement rates, the City of Springfield has initiated 20 projects to build, renovate and repair educational facilities since FY96. By the end of FY03, the City of Springfield will have \$271.4 million in school-related debt compared to \$46.7 million at the end of FY96. All other outstanding debt totals \$46.5 million. Accounting for \$16.6 million in SBA cost reimbursements, the city's school-related debt service will be \$11.0 million in FY04 and its non-school debt service obligation will amount to \$5.2 million.

Although Springfield receives a net increase in total school aid under House 1, because of cuts in other local aid accounts, the municipal side (non-school) shortfall may be as high as \$13 million. To provide some municipal side relief, we propose that the city of Springfield make application under existing legislative provisions that would allow a shift of the cost of financing school capital projects from the city to the school budget,

Outside sections within supplemental budgets in 1998 (Section 44 of Chapter 319) and in 2002 (Section 208 of Chapter 184) allow a qualified city or town to establish and maintain a school construction reserve account through 2007. The reserve account is funded through year-end transfers of all or a portion of any unexpended appropriation for school department operating expenses. In the aggregate, the transfers cannot exceed five percent of the net school spending budget and require the approval of the Commissioner of Education. Use of the funds require the approval of the Commissioner of Revenue and are restricted to financing the direct cost of DOE approved school construction, renovation or repair projects.

To qualify, school facilities must, in the judgement of the Commissioner of Education, be inadequate to meet educational needs and the community must lack the fiscal capacity to finance the municipal share of school construction, renovation or repair costs. To be effective, management of any such reserve account requires close cooperation between the Mayor and School Committee.

Any funds that flow to the reserve account would reflect the remainder of annual school appropriations not fully expended. Any balance accumulated in the reserve account effectively frees-up an equivalent amount in the general fund, which then becomes available for other municipal purposes.

5) Place priority on improving tax collections and reducing tax titles.

Uncollected property taxes for current and prior years, accounted for as receivables, tax titles and foreclosed properties, largely represent money already spent, but not collected. In each of the last five years, first year tax collection as a percentage of the gross levy has diminished. Subsequent collections have not been sufficient to prevent the annual escalation of tax title and possessions accounts. At the same time, less is committed to overlay reserves.

On a cash basis, the city is spending more than it is taking in. The net effect is a declining fund balance and free cash delving deeper into the negative. (See chart on following page).

The city's tax title committee, with representation from housing, planning and finance departments, works to prioritize and target delinquent properties for fast track treatment. By identifying housing, commercial and community development goals, appeal is created for well-located properties thereby maximizing auction value. Other properties that consume city resources are also identified and moved quickly toward auction. However, the committee faces obstacles at the Land Court which apparently limits foreclosure petitions to 20 per month and averages 13 months for disposition.

	FY98	FY99	FY00	FY01	FY02
Gross Levy	95,833,183	99,042,372	102,485,491	106,688,937	111,317,506
Overlay	(5,202,337)	(4,392,193)	(3,995,111)	(3,212,186)	(2,411,107)
as % of levy	5.4%	4.4%	3.9%	3.0%	2.2%
Collections at FY end	90,692,105	94,033,719	94,834,827	98,490,380	102,434,759
as % of levy	94.6%	94.9%	92.5%	92.3%	92.0%
Receivables at FY end	5,141,078	5,008,653	7,650,664	8,198,557	8,882,747
as % of levy	5.4%	5.1%	7.5%	7.7%	8.0%
Tax Titles & Possessions	19,225,541	21,377,422	23,121,442	22,015,149	26,766,398
Fund Balance as of 6/30	26,080,133	20,424,616	19,290,341	11,379,423	10,650,963
Free Cash as of 7/1	(9,250,464)	(14,902,314)	(21,268,293)	(30,777,226)	(57,510,507)

Although effective in what it does, the tax title committee has a limited mandate, which is not sufficient to prevent more properties from annually entering delinquency status than leaving it. To reduce receivable and tax title accounts, the city must do more including the following.

Expand the role of the tax title committee - Comprehensive review of the tax title and possessions lists is essential to identify accounts that are truly uncollectable, qualify as land of low value, have bad addresses, deceased or unknown owners. With this information in hand, the city can devise a strategy for taking advantage of established DOR procedures for removing these properties from the tax title status.

More aggressive tax collection program - The city appears to have been more successful in property tax collections in FY98 and FY99 than in more recent years. In any event, the city should review the mandate of the tax title committee to ensure that its program is not retarding or pre-empting the collection responsibilities of the treasurer/collector. A multi-pronged approach that advances the goals of the committee and the duties of the treasurer/collector might emerge.

Municipal tax amnesty program - To induce the payment of outstanding taxes, recent legislation (Chapter 4, Section 73 of the Acts of 2003) allows communities to waive, some or all, interests, fees, charges and penalties on delinquent property taxes, motor vehicle or boat excises. The program must end by December 31, 2003. It can only be locally enacted by the City Council with the approval of the Mayor and is subject to DOR guidelines (IGR No. 03-207, March 2003).

Excise taxes from prior years received after July 1, 2003 can be included as an estimated receipt for use in FY04. However, we recommend the City petition the Director of Accounts to allow similar treatment for collections of all interest, fees, charges and penalties received prior to setting the FY04 tax rate. Otherwise, the receipts are reflected in the FY04 fund balance and, given the city's deep negative free cash status, would effectively disappear. All collections of prior year property taxes would be reflected in the city's fund balance.

Bulk sales of receivables - On completion of the municipal amnesty program, we suggest the city devise and follow-up with a bulk sales program (DOR IGR No. 97-201, May 1997). Building on work completed by the city's tax title committee, an analysis of remaining receivable and tax title accounts should be viewed with an eye toward petitioning the Division of Local Services for greater flexibility than the current bulk sale regulations allow. In any event, the city should increase its effort to separate-out receivables and tax title accounts which are not truly collectable. It should have a firm

grasp of all monies owed the city and look for ways to remove properties, which fall outside the tax title committee's priority rankings, from the tax title or foreclosure lists.

6). Consider implementing a trash fee

In the face of financial obstacles, the city must consider all new revenue generating opportunities, including a trash fee. Currently, trash pick-up is a city service, the cost of which is included in the tax rate. Action by the Mayor, with the approval of the City Council, could establish a separate fee for the weekly pick-up of trash. Potential revenues could range between \$3 million to \$4 million.

A \$10 per pick-up charge to take away bulk items is already planned and is expected to produce an estimated \$500,000 in new revenue. Currently, this is an on-demand, free service.

A separate trash fee might be assessed only to single family residences and multi-unit residential properties with less than five or so apartments. Larger apartment buildings, commercial and industrial property owners are typically expected to arrange for private trash pick-up.

## Financial Management

7) Formalize policies that establish guidelines for funding and maintaining reserves

Even for the city of Springfield, the period of economic growth between FY94 and FY02 represented one of government expansion. Among the 17 largest cities in Massachusetts, municipal general fund expenditures increased 48.6 percent per capita. In Springfield, expenditures per capita rose 48.2 percent. In FY 02, 13 of 17 cities reviewed had positive free cash and 11 had money in stabilization.

Clearly, with the knowledge of DOR, the administration made choices to paydown deferred costs and retire teachers' deferral obligations. However, in spite of DOR advice and that of its financial advisor, the city made other spending choices as opposed to building up reserves. Now, facing severe budget reductions, and a dangerously low bond rating, the city must think about strategies to build even minimal reserves.

Therefore, we recommend that some portion of any new revenue that emerges from the recommendations in this report be placed in stabilization under MGL Ch. 40, §5B. We also recommend the Mayor, with the approval of the City Council, consider a policy that directs some or all of one-time revenues to stabilization and restricts the use of the funds to one-time expenditures, or emergency needs.

8) Take steps to improve the city's bond rating.

Building a reserve is a step toward a stronger bond rating, but other action can also be taken. Accordingly, we recommend that the Mayor, in consultation with the City Council, establish a debt policy that guides future borrowing decisions and works to preserve and improve the city's credit rating. An effective debt policy should provide guidelines that, among other considerations: specifies purposes for which long and short-term borrowing will be permitted and sets goals for the average maturity of long-term debt.

In considering factors that influence the city's credit rating and are within control of city management, the administration should recognize that rating agencies (Moody's, Standard & Poor's) consider the following as positive factors:

- Revenue forecasting and the ability to anticipate future events;
- Interim financial reporting and monitoring;
- Contingency planning policies (reserves);
- Policies on the use of non-recurring revenues;
- Debt management policies; and
- Capital planning.

9) Make realistic revenue projections.

Historically, the city's revenue projections, primarily in the form of local receipts, have been generally aggressive when compared to actual revenues at the close of the fiscal year. In addition, because communities are permitted to spend 100 percent of the projected property tax revenue (net of overlay), when actual tax collections fall short, deficits can occur.

The city must cease the apparent practice of adjusting estimated revenues upward to avoid making expenditure reductions. Instead, revenue projections must be the product of careful analysis which reflects past trends in actual revenue, economic circumstances and anticipated financial events. Recognizing that the development of a municipal budget is a revenue driven process, to artificially inflate income to support higher expenditures is fundamentally unsound and compounding in its negative effects.

10) Redesign the budget process.

Entering a period of economic constraints, the city's budget process must begin sooner so that sufficient time can be devoted to the task of establishing priorities and consensus. On the revenue side, realistic projections should be completed. Once

established, the Mayor should share the projections with the City Council and come to preliminary agreement on the budgetary parameters for the ensuing fiscal year.

A procedure to solicit, receive and review departmental expenditure requests should be established and executed. Given the financial hurdles ahead of the city, any process that fails to include department heads, early-on, and a line-by-line analysis of budget requests is flawed. A date for presentation of the Mayor's appropriation request to the City Council must also be set and adhered to, so that the council can adequately fulfill its oversight responsibilities.

In our interviews, we received mixed messages as to the level of participation and involvement in the budget process in recent years. Whatever the case, the city's present fiscal condition and the prospects for future revenue shortfalls requires nothing less than an open and thorough budgetary process.

11) Cease using non-recurring revenue sources to fund recurring expenditures.

In the last six fiscal years, the city has used \$17.8 million in overlay surplus as a means to fund the operating budget. In projecting FY02 and FY03 local receipts, it has also relied on \$4-6 million of one-time revenues. The reasoning behind utilizing these revenue sources to support the operating budget is self-evident. However, the practice has down-stream impact and merely forestalls difficult budgetary decisions. The practice has also worked to reduce fund balance and allowed the city to spend at levels it cannot afford.

The city should resist using one-time revenue to support the operating budget. As noted earlier in this report, one time revenues are best directed to reserves, to one-time costs or simply allowed to become part of fund balance.

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## ***CONCLUSION***

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The fiscal circumstances facing the City of Springfield are of sufficient concern to warrant immediate action. In decisive fashion, the Mayor has put the city in a position to complete FY03 in budgetary balance. The solution has, however, served to reveal the city's fiscal shortcomings. As FY04 approaches, the city faces a possible \$13 million budget deficit and must also resolve a \$6.7 million health insurance trust fund deficit. There are no available reserves, few new revenue sources and downward trends in fund balance threaten the city's financial stability.

The recommendations offered in this report begin to address these major issues. We recommend that the city be allowed to amortize payment of the health insurance deficit over five years and propose restoring previously denied levy capacity under Proposition 2½ as a means to offset that cost. The opportunity is presented to generate new revenue under existing statutes allowing a shift in net school spending and through consideration of a trash fee. With improved tax collections and a focus to eliminate tax title accounts in a substantial way, the city's fund balance will reverse its downward trend. To improve financial management practices, we make recommendations relative to the use of one-time revenues, building reserves and executing a more effective budget process.

With a commitment of state support and its continued involvement through the establishment of a finance advisory board, we believe the city can take legitimate steps toward implementing a long-term plan to achieve fiscal stability.



***APPENDICES***

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## APPENDIX A

### City of Springfield FY04 Budget Analysis

#### Increase in Municipal (non-school) Fixed Costs (millions)

COLAs for FY04 @ 3%	\$4.0	-Police, Fire and DPW COLAs 3% for FY04
Pension	\$2.7	-Allocates 70% of budgeted increase to city
Net Debt Service	\$0.5	-Increase in debt service after SBA increase
Unemployment	\$2.0	-Additional unemployment for FY03 layoffs
Health Insurance	\$0.0	-Layoff savings offset by 14% FY04 increase, school increase allocated to NSS
<b>TOTAL</b>	<b>\$9.2</b>	

#### Net Impact of layoffs on FY04

Annualized Impact of FY03 layoffs	\$11.5
Less 9C aid reduction	-\$3.4
<b>TOTAL</b>	<b>\$8.1</b>

#### Impact of layoffs in FY04 is offset by increased municipal side fixed costs

#### Change in Municipal (non-school) Revenues

Decrease in City's State Aid	-\$14	-Lottery, additional assistance and transportation
Increase in FY04 Tax Levy	\$4	
Decrease in Local Contribution	\$4	
<b>Shortfall</b>	<b>-\$6</b>	

#### One-time Revenues used in FY03:

Overlay surplus	-\$3	
Settlement/Reimbursement	-\$4	-AT&T settlement \$2.6, federal reimb. \$1.5
<b>Total Potential Shortfall</b>	<b>-\$13</b>	

**APPENDIX B****Potential FY04 Budget Shortfall  
(assumes recommendations adopted)**

	<b><u>FY04</u></b> (millions)
Total Potential Shortfall	\$13.0
One-Fifth of Insurance Deficit	\$1.3
<b>Total Potential Shortfall</b>	<b>\$14.3</b>
 <b><u>Potential Revenue</u></b>	
One-Third of New Growth Recapture	\$1.6
Net School Spending Shift - at 1% *	\$2.4
Trash - Bulk Pick-up	\$0.5
Trash - General	\$3.0
<b>Total Potential Revenue Gain</b>	<b>\$7.5</b>
<b>Potential FY04 Revenue Shortfall</b>	<b>(\$6.8)</b>

## APPENDIX C

### Multi-Year Impact of Recommendations

	FY04	FY05	FY06	FY07	FY08	FY09
New Growth Recapture <sup>1</sup>	1,600,000	3,240,000	4,921,000	5,044,025	5,170,126	5,299,379
Net School Spending Shift <sup>2</sup>	2,400,000	2,400,000	2,400,000	2,400,000	2,400,000	
Hospital Deficit Bond Payment Savings <sup>3</sup>				1,938,000	1,938,000	1,938,000
Trash - Bulk Pick-up	500,000	500,000	500,000	500,000	500,000	500,000
Trash - General	3,000,000	3,000,000	3,000,000	3,000,000	3,000,000	3,000,000
Health Insurance Amortization Payment <sup>4</sup>	(1,300,000)	(1,300,000)	(1,300,000)	(1,300,000)	(1,300,000)	
<b>Potential Gain in Revenue <sup>5</sup></b>	<b>6,200,000</b>	<b>7,840,000</b>	<b>9,521,000</b>	<b>11,582,025</b>	<b>11,708,126</b>	<b>10,737,379</b>

1 Assumes restoration of \$4.7 million over three years, plus compounding by 2½ percent.

2 Assumes aggressive FY04 start, reserve at 1 percent of net school spending requirement and no annual change.

3 Reflects future year savings after full payoff of hospital deficit bonds by FY06.

4 Assumes 5-year payoff of self-insurance trust fund deficit of \$6.7 million as of June 30, 2002..

5 All FY04 recommended revenue enhancements and the health insurance amortization have been factored into the projected \$6.8 million deficit shown in Appendix B.