

**CITY MANAGER'S
BUDGET MESSAGE
2011-2012**



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March 7, 2011

Dear Mayor Rohde and Members of the City Council:

This budget proposal demonstrates that all of our efforts to control expenditures have produced real results, but that the impact of the national economic situation and the State's fiscal problems continue to resonate at the local level. This proposal cuts spending, excluding the cost of employee benefits, by \$952,769. Twelve of fourteen department budgets would be lower than the current year. Thirty-three of the forty-three different cost centers in the general fund budget would be decreased. If this proposal is adopted, the budget for general government operating expenses, excluding education, would be reduced for a fourth consecutive year. Nonetheless, increases in the funding of employee pensions and retiree health benefits will raise overall spending by 1.19%. Although the recent changes to those benefits negotiated with the employee unions will resolve the pension funding issue in the future, inadequate funding in the past and investment losses in the recent stock market downturn make this increase necessary. Combined with flat revenues from sources other than local taxes, that will require an increase in the tax rate to balance the budget.

The most significant revenue changes are likely to result from whatever budget is ultimately adopted by the State. The Governor's budget recommends the defunding of the Payment In Lieu of Taxes on manufacturing machinery and equipment. That would cause an estimated revenue loss of \$1,010,199 from that source alone. Some increases in other State revenues from prior year budget levels are anticipated, so that the year over year decrease in State funding is estimated to be \$313,241. I have not included in the budget proposal any revenue from the additional revenue sources proposed by the Governor. Some of those proposals, like the local conveyance tax option, would not result in additional revenue even if adopted. Others, like the new taxes on boats and airplanes, will not be effective until the year after this. Proposals such as the additional .1% of sales tax and the additional hotel tax are too speculative to be included in the budget proposal at this point. The former is an addition on top of a proposed increase in the sales tax rate and in prior years has been discussed as a regional tax, not one that would benefit the City directly. The latter has been proposed previously but never approved.

The Governor also has proposed bringing ECS funding back up to 2009 levels, continuing present funding levels for special education and increasing funding for magnet

schools. The proposed ECS funding would restore \$7,673,053 in funding cut by the State that was replaced by federal stimulus funding received directly by the Board of Education during the last two years. Although that proposal is certainly welcome, approval by the State Legislature is not certain and will most likely not occur, if at all, until after adoption of a final budget by the City. Therefore, I have included that additional funding in revenues but have placed it for expenditure purposes in the contingency fund, earmarked for the Board of Education. That ensures that the City will not be required to appropriate and fund that additional sum until receipt of the additional revenue is assured. The impact on Meriden of the additional magnet school funding is not clear at this point. Continuation of the present funding level for the special education excess cost grant should impact the Board of Education estimate of special education costs.

Revenue estimates included in the proposed budget are intended to be reasonable and as accurate as possible, but a few are more optimistic than in past years. Notably, the estimates for collection of delinquent revenue and interest on unpaid taxes will be very difficult to achieve, if for no other reason than that our success in collecting such revenues has decreased the amounts available to be collected. The budget assumes an increase in the tax collection rate, calculated in accordance with our financial policies based on last year's increase in the rate. Nonetheless, maintaining the tax collection rate in this economic period will be a challenge. Also included in the budget is a significant increase, over \$125,000, in E911 revenue. That increase is dependent on the City handling medical dispatch with its own forces, a change that has not yet been implemented and which is opposed by some members of the Council. (It should be noted that full implementation of medical dispatch potentially could bring in even more revenue in addition to what is included in the budget.) The amount included for city clerk fees is lower than the prior year, but could reasonably be lower still unless there is an unexpected turn around in the housing market. Building permit fees have been increased in this budget based on the last and current year receipts, but remain an area of concern because there are few new projects currently being proposed. The proposed budget does not yet take into account the impact of assessments that may be lowered by the Board of Assessment Appeals or the potential impact of outstanding assessment appeals. These factors should be kept in mind as you deliberate over revisions to the proposed budget.

You will note that I have proposed increasing the use of undesignated reserves from the \$1 million budgeted the past two years to \$1.5 million. The City's total undesignated reserves should increase after the current year to an amount in excess of the level recommended in our recently adopted financial policies. In the 2009 year, we were able to control expenditures to such a degree that we did not need to use the reserves that had been included in the budget. The additional revenues received from the expired CRRA contract this year will allow us to build up the reserve level. The past two budgets pegged the use of reserves to the amount of increase in retiree health benefit funding (OPEB). Although we have done this without a negative impact on the reserve level, it should be borne in mind that the use of undesignated reserves automatically creates a revenue shortfall for the following year. That problem could be compounded if revenue projections in other area prove to be overly optimistic.

As noted at the beginning, general fund spending excluding employee benefits would decrease under this budget proposal. The budget contains no funding for wage rate increases for police, fire and public works union employees. Contracts for those unions are in negotiation. The City's position is that these employee groups should receive no wage increase in the first year, as has been the case for other bargaining units and management employees. The budget for health benefits has not been increased based on the savings which should be achieved by the change in health benefit administration and other health related initiatives. While health related savings would have been greater if the change in administration had not been unsuccessfully opposed by the teachers union and two of the Board of Education clerical unions, those changes should offset the increase in health costs, barring an unusual level of significantly costly illness. Payments on bonded indebtedness will decrease by \$649,380, a result of the refunding at lower costs due to our improved bond rating and low interest rates. The capital equipment budget has been lowered by shifting some vehicle purchases to the current year's budget. That is another strategy that will impact the 2013 budget.

The savings achieved by these and many other measures taken over the past few years are more than offset by increases in funding for employee pensions and retiree health benefits. That these are the areas of concern is similar to the situation in many other state and local budgets, as has been widely publicized recently, although the City addressed these issues earlier than many other jurisdictions. The increased focus on these costs is even more reason to ensure that we continue to do so. This is important to our efforts to maintain and possibly improving our bond rating, which is particularly critical as we begin funding the high school renovation projects in the near future.

Actuarial evaluation of the pension funds is performed every two years. The last review occurred prior to the stock market crash. New valuations taking those market losses into account require an increase in our annually required contribution. The municipal pension plan covers all city employees, more recently hired police officers and fire fighters and Board of Education classified employees. An increase of \$1,224,636 to a total of \$1,631,897 is necessary to fund that pension to the annually required level. The police and fire pension plans were not funded or were funded inadequately in the past. The City adopted a plan to amortize the underfunded amounts over a thirty year period, to which it has adhered over the last decade. Despite again reamortizing the shortfall over the full thirty years, maintaining funding at the actuarially required level increases police pension funding by \$345,825 to a total of \$4,028,938. Fire pension funding increases by \$179,290 to \$2,620,905. The total increase in pension funding is \$1,749,751.

Alluded to above is the planned \$1,500,000 increase in OPEB funding. That increase is necessary to satisfy the actuarial assumptions by which the City's overall obligation for post employment retiree health benefits is calculated. To offset the impact of that increase, I have recommended that the cost to the general fund, \$1,144,000, be funded from undesignated reserves. The City's enterprise funds will pay the balance of the increase attributable to their employees. The City's commitment to increase funding over a five-year period to the actuarially required contribution level resulted in a decrease of over \$100 million in the calculation of the City's obligation. That commitment needs to

be maintained. Not doing so will negatively impact our bond rating and over time would place the City in a position where its obligations exceeded its assets.

These increases highlight the significance of the changes in pension plans and retiree health benefits negotiated in the past year. Going forward, new city employees and Board of Education classified employees will be shifted to 401(a) plans to which the City will contribute a set amount not impacted by investment losses. New employees will not be entitled to retiree health care benefits. Current employees will contribute an additional percentage of their wages to cover the future costs of retiree health benefits. Similar changes remain to be negotiated with regard to newly hired police officers and fire fighters. These changes will significantly reduce the cost of future employee benefits and make budgeting more for those expenses more predictable. In this regard, as with funding pensions to required levels, the fiscal situation of the City in the future will be improved and sustainable without the large tax increases that otherwise would be necessary.

Almost all departmental budgets, as indicated above, are at least slightly lower. The major increased operating expense, which impacts the Building Maintenance Division the most, is the cost of heating oil. In the current year, we negotiated an extremely favorable price. Market conditions will increase that cost by somewhere between seventy-five cents to a dollar or more per gallon. That cost will need to be reassessed during the budget review process. Funding for overtime costs in the Police Department budget is reduced based on past trends. The police patrol budget line is funded to a total of 120 officers, two fewer than the authorized amount. The department historically has not achieved the authorized level. Should that change during the course of the next year, the means to fund the additional cost can be better determined at that time. The proposed budget does not fund any additional city positions nor does it eliminate any currently filled positions. Increased funding for workers compensation and hypertension claims is included in the proposed budget.

With regard to the Board of Education budget, I am recommending that funding be maintained at the current year level for a second consecutive year. Assuming that the additional ECS funding proposed by the Governor is approved, that amount would be added to the Board appropriation. The Board of Education budget contains a certain amount of flexibility, as was demonstrated again last year. The Board returned \$500,000 in unspent funds at the end of the last fiscal year. It prepaid \$500,000 from that year's budget for current year health costs. It also prepaid approximately \$750,000 or more in other expenses. Those amounts were approximately equal to the surplus in the Board budget expected based on the City's projection of the Board's budget and our estimate of the appropriate funding level for the current year. The new administration has undertaken a number of cost saving measures and shown that it will continue to seek ways to control costs. Nevertheless, the Board has requested additional funding of approximately \$2.7 million. Like last year I continue to feel that an increase in funding is not necessary to maintain services at an acceptable level.

The Board of Education takes an approach in formulating the Board budget request that it admits is conservative. This is done to ensure that the Board does not overspend its appropriated budget. Historically, actual expenditures in many areas have been significantly less than the amounts appropriated in the Board budget, and appropriated amounts have been significantly less than the amounts requested. The Board request and my recommendation should be examined from a perspective that keeps the above factors in mind.

Certified and classified wages are an area that historically has been overestimated and which should be closely examined. In the tuitions line, the Board has requested an increase of \$881,750 to a total of \$16,414,246. That request appears to be based on an anticipated increase in those expenses and an estimate of the revenue from the excess cost grant which clearly does not reflect recent experience or the funding level recommended in the Governor's budget. It is noteworthy that the amount requested for tuitions two years ago was \$14,793,560, the amount appropriated was \$14,227,563 and the actual amount expended was \$12,856,548. The difference between the amount requested and the amount spent was \$1.937 million. The increase requested was more than \$2 million. The actual increase was only \$85,000 higher than the prior year. While it is true that in years prior to that year tuitions exceeded budget, more recent experience is just the opposite. The Board's request in other areas does not reflect the historic ability to pre-purchase and prepay significant portions of its expenses for retirement obligations, supplies, textbooks and other items.

I look forward to reviewing the Board request during the budget process. However, to somewhat restate what I said in that regard last year, given the lack of growth in non-tax revenues, the fact that non-education operating expenditures would decrease for a fourth consecutive year while funding for education has been either been increased or maintained in each of those years, the lack of significant growth in the grand list, the prospect of decreased State funding in the next year, the reality that pension and retiree health benefit costs, a portion of which is attributable to Board of Education employees, have increased significantly and will continue to increase in future years, and the need to use undesignated reserves and to increase the tax rate to keep the budget in balance, it is again my recommendation that the City Council decide that maintaining the current funding level for the Board of Education is the most that is affordable to City residents and taxpayers.

Increasing the tax rate even marginally during a period of time when City residents continue to struggle financially is not a course easily recommended. Every effort has been made to limit expenditures without decreasing services that residents reasonably expect the City will provide. To fund the unavoidable increase in spending attributable to employee benefits, the general mill rate must be increased by .48 of a mill, a 1.6% increase in the tax rate. The additional inner district mill rate will be decreased by .08 from 1.90 to 1.82 mills because of reduced costs for solid waste disposal due to increased recycling rates. For a home with the median value of \$202,000 as of the last revaluation in 2006, the outer district tax would increase by \$68 and the inner district tax would increase by \$57. This will be the last budget before next year's revaluation date.

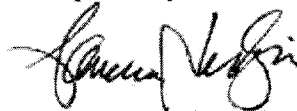
Remarkably, given the economic issues which the City has grappled with and the fact that we have taking all necessary steps to fund fully past obligations the cost of which had been ignored, if this budget is adopted, the average annual increase in the mill rate during that period of five years would be 0.74%, less than three quarters of one percent.

Every effort also has been made to control water and sewer division expenditures. There is no increase in either water or sewer rates. Funding for an additional position in the tax office has been included to allow a changeover to quarterly billing. Quarterly billing will improve cash flow, make it easier for ratepayers to budget and make payments and more quickly inform customers of leaks or other problems that affect the amount of their bills.

Included in the budget presentation is the Capital Improvement Plan (CIP), including capital funding requests for the next year. The improvement in the capital planning process and our strict adherence to the City's self imposed bond authorization limit have resulted in a \$5.1 million decrease in our debt payment over the past five year. That has offset expenditure increases in recent budgets. Each year that bonding authorizations are decreased lowers the cap for the succeeding year. This year's proposed Capital Improvement Plan, exclusive of authorizations for the Board of Education (\$192,000) and the water and sewer enterprise funds (\$581,000) totals \$4,558,333. That is \$212,669 below the new, greatly reduced cap. The Capital Improvement Plan also further also sets out planned capital projects contemplated for the succeeding five year period, providing a solid basis for future financial planning.

The proposal that I submit to you today is one that I believe appropriate given the difficult economic times in which we continue to live. It funds essential city services, fully funds City obligations, provides necessary and desirable capital investment and maintains the tax rate as affordably as possible. That is not said to minimize the difficult decisions you will need to make as you consider this budget proposal. As always, City staff and I stand ready to assist you in your deliberations.

Respectfully submitted,



Lawrence J. Kendzior
City Manager