Citizens Budget Advisory Committee
County Board of Legislators
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Key Principles and General Comments on 2014 Budget and Trends

Report Prepared by the CBAC for the County Board of Legislators

November 25, 2013

The CBAC met monthly throughout the year, including meetings with the Budget Director and the Charter Revision Committee. This culminated in a report to the BOL in October 2013. As always, between release of the Budget and today's testimony the committee had a very intensive meeting schedule.

We are pleased to present our comment today on the 2014 Budget. CBAC Priorities are the financial soundness and integrity of the County Budgets. Our philosophy and approach are reflected in the four principles. Note: We do not and have not taken a position on the programs and policies that expenditures reflect.

CBAC Priorities are:

- Pay current operating expenses from current revenues;
- Preserve and enhance reserves;
- Maintain low debt ratio; and
- Restore credit rating.

I. 2014 Proposed Operating Budget

In the County Executive's Proposed Budget for 2014 two of the primary goals enumerated are: (1) not to increase the tax levy and (2) safeguard the County's Aaa bond rating. It has been the philosophy of the CBAC that as the current economy impacted other revenue sources, no increase in the tax levy and protecting the County's credit rating are not compatible. Borrowing for current operating expenses while exhibiting an unwillingness to raise taxes may injure the County's long term financial options. Increasing the debt or using reserves have been cited as threats to the County's AAA rating.

The proposed 2014 budget does not use any of the current fund balance, however the fund balance has declined significantly over the last 8 years. This trend combined with the continued policy of borrowing for current pension payments has resulted in a downgrade by Moody's of the County's debt rating, negating one of the major goals the proposed budget was to accomplish.

A. Revenues:

- Sales Tax - CBAC is concerned that the projected sales tax revenue is aggressive and recommends that this revenue line be reduced by $7M to $501M. This represents 3% growth vs. the 6% used. It is the CBAC belief that the 2013 Sales Tax projection has exceeded budgeted as a result of Hurricane Sandy related purchases as well as high gas prices. The lower rate is based on concerns regarding 4th Quarter 2013 and 1st Quarter 2014; the sales tax received in 2013 may be inflated by a one-time circumstance.
- Mortgage Tax – CBAC is concerned that the revenue estimate may be aggressive. As mortgage rates have begun to increase significantly in 2013, mortgage refinancing and other activity driven by the historic low rates will cease. There may be a negative impact on this revenue, though stabilization in the real estate market give hope of better collections than earlier years. The CBAC recommends a revenue estimate of $17.5M.
- State Aid is flat year to year.
- Federal Aid is up 6% budget to budget at $215.6M with Federal Medicaid Assistance Percentage (FMAP) contributing an additional $9M of the increase.

B. Expenditures:

- Retirement - The County is in the third year of borrowing for current pension payments in the amount of $24M. Borrowing to cover retirement payments to NYS is enticing, but as this strategy continues it will increase costs for the County. Off balance sheet borrowings will degrade debt ratios and this has had a direct, negative impact on the County's debt rating. Generally, borrowing to pay "current expenses" is viewed as a negative by the financial community and rating agencies.

- Health Insurance - Health care costs will continue to increase, but the rate of increase is expected to be lower than in the recent past lower rates. As the CBAC has recommended for years, most County employees now contribute to health care. The press release describing the 2014 budget mentions employee contributions will total $4M, however this is not evident in our examination of Health Insurance expenditures. CBAC recommends that transparency be increased so the items impacting health insurance expense can be easily identified. These items should be identified as a separate line item.

- The 2014 Budget includes $60.1 Million for Health Costs for Retirees which represents 28% of total fringe costs. It is acknowledged that as retirees age Medicare will become the primary insurance for this population. While under current CSEA agreements all current retirees will remain covered, the CBAC recommends that going forward, the CSEA's and other collective bargaining agreements should be amended so that future retirees contribute to this expense. This should be a key point when these contracts are negotiated.

- Community Based Initiatives is a new line item in the Miscellaneous budget (see page 609). This is a new expenditure appropriation in the budget in the amount of $1.3M in 2014. We question the need for new programs in the budget, and would recommend greater transparency and a rationale for this expenditure.

- County Executive's Office is budgeted for a 16% increase, while other administrative functions, including the Board of Legislators remain flat. This is unusual, in 2013 the budgets for both functions remained relatively flat to 2012.

- Westchester Community College will receive $28.8M, a 4% increase in the County contribution. This is of great concern to CBAC as this flouts the principle of the State's tax cap; the 2014 tax cap is 1.66% and every government entity, including school districts are required to manage expenses to remain under this limit. This disproportionate increase puts additional pressure on the County's operations under the cap. The WCC Budget is adopted in August, so CBAC recommends that in 2014 the BOL require more detailed information and transparency regarding WCC's operating budget, their capital plan, and particularly the reserves and fund balances. Any other efforts the County can take to encourage WCC to embrace the spirit of the tax cap or provide a rationale for this excess is recommended.

II. Additional 2014 Budgetary Issues

- Reassessment: High levels of a certiorari are expected to continue unless an overall reassessment of property occurs throughout the County.

- Impact on Local Municipalities: No growth in the County Property Tax Levy does not protect the tax levies in the local municipalities, these may change based on local valuations and equalization rates.

- Federal Aid, Grants & Fines: An important area of concern to the CBAC is the lack of contingency planning for the potential loss of significant revenues from the federal government and the impact of possible fines. There is also serious concern that the County's pattern of interaction with the federal government and its impact on revenue and expenditures has negatively affected the county's bond rating.

- Potential threats to revenue expected in 2014 include the following:

  - Sequestration – at present there is no federal budget deal and if one is not reached then automatic sequestration would go into effect for 2014. This could mean a loss of revenue of approximately $24 million.

  - HUD – The County is still out of compliance with the Housing Settlement and is at risk of losing $11 million in aid.

  - Department of Transportation – Because of issues arising out of the renewal of the Bee Line Bus contract and the County's failure to originally put out an RFP for the operation of the County bus system the County stands to possibly lose $15 million in federal funding used to maintain our buses.
    While the County did eventually put out an RFP one of the requirements of the RFP was that bidders (other than Liberty) must include in the cost of their bids a bond for $20 million in the event Liberty sued the County over the contract renewal. At least one potential bidder has complained about this requirement. The Department of Transportation may find that this process was flawed and could still withhold funding.

- EPA – EPA claims that the County has failed to comply with certain sections of the 2006 Safe Drinking Water Act and that it has failed to reach an agreement with EPA on its implementation. At present EPA is suing the County with fines accumulating at the rate of $35,000 per day; to date these total roughly $13.3 million and the fines continue to mount. Compliance with the Act requires a Capital Project, cost estimates for several proposed solutions vary widely- from $8M to as high as $80M.

- The total of funds at risk– either through loss of revenue or in penalties – is $63 million with additional monies being spent on the infrastructure costs required to settle the EPA suit, see below:.
  - Second Year of Sequestration: $24M
  - HUD Impact: $11M
  - Transportation Aid: $15M
  - EPA Fines and Settlement: <u>$13M</u>

  TOTAL: $63M

- Long Term Impact of Pension Borrowing: 2014 will be the third consecutive year that Westchester County has financed a portion of the contribution to the NY State retirement fund by off balance sheet borrowing. The borrowing will total $94M for the years 2012 through 2014.

- Tax Levy: The CBAC commented in 2012 that maintaining current tax rates will limit the County's ability to raise revenue over the medium and long-term; we repeat this concern. The mechanics of the state-wide 2% tax cap present additional complexity, as the tax cap formula calculates the cap at 2% or lower based on inflation. In the second year of the tax cap the limited carry-forward and the lower cap for 2014 of 1.66% continues to tighten restrictions on revenue raising capacity.

- The Capital Budget contains programs totaling $275M. This Plan could require significant tax increases in the future which may impact the negative trend in the County's credit rating. The debt service and interest in the 2014 Budget is 11.5% higher than the amount in 2011.

- The CBAC would like additional transparency in the Capital Budget. More detailed information is needed regarding the costs of the planned borrowing over time. Detailed information on the amortization of current debt and the addition of new debt is requested to permit an analysis of the County's net debt position. The Capital Budget is a good example of the benefits of multi-year planning advocated by the CBAC during our October presentation to the BOL. To take this approach, a comprehensive 5-year debt analysis is required.

III. Conclusion

The CBAC still believes that continuing on the reliance upon borrowing can be described as "kicking the can down the road"; this will increase the tax burden in the future, and both the bond rating and the level of services provided to County residents will continue to be jeopardized..

The CBAC believes another approach is needed to ensure sustainable financial health. The approach we endorse rationalizes government spending with a multi-year approach to provide services and preserve the quality of life in the County. This approach is successfully used by many other government entities.

The County's budget has shown too much reliance on one-year stopgap measures to balance the budget. Reliance on these "one-shots" are negative indicators to the financial community and the rating agencies. Borrowing $28M in 2014 for pension payments continues this negative financial strategy.

The County needs to prepare a Financial Plan including an outlook for the second through the fifth year to implement a sustainable strategy for the delivery of government services. This will also allow the County to prepare a longer-term strategy to contain costs, preserve and enhance reserves and manage debt.

CBAC continues to endorse actions to streamline government operation and departments, we attach our guidelines for this as Attachment B. Specific inefficiencies and potential solutions should be identified before making cuts.

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IV. Recommended Actions

While not a popular alternative, a modest tax levy increase is a responsible approach. When non-property tax revenue is not robust, modest tax increases can help keep the County from slipping into worse financial shape. A prudent approach would be to keep taxes stable even when other (non-property tax) revenues begin to grow. This allows the County greater flexibility which could be used for direct repayment of debt, additions to designated reserves or restoration of previously depleted fund balances. A small addition to the tax levy will also allow a more balanced approach to revenue, illustrating to the rating agencies the County's willingness to use other sources of revenue besides borrowing. This is especially important given the potential threat to certain budgeted revenue streams.

V. Summary of Projects Undertaken by CBAC During 2013

1. Research on Multiyear Financial Planning- An analysis of the pros and cons of this approach and ho it is used by other government entities.

2. Analysis of the DPW's decision to out-source much of the engineering staff: CBAC concluded that this trend may impact efficiency of the infrastructure projects, including costs, and we recommend that measurements be developed to track effectiveness of this approach. DPW may need a different mix of skills on staff to effectively manage multiple projects outsourced to the private sector,

3. Overview of Probation Department operations: Probation Department headcount may be impacted in 2014 budget, so further analysis may be required.

VI. Projects for CBAC in 2014

This may be an open question for Feb 2014 since the CBAC needs to reappoint and the composition and leadership of the B&A may change.

Respectfully submitted,

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Attachment A

Financial Impact of the Tax Cap on Westchester County

In the present economy - with almost all revenue fairly flat - the failure to raise taxes within the tax cap is putting enormous strain on the budget and the county's fiscal health.

While pension payments may be the biggest cost increase other costs continue to rise at more than 2% a year: Medicaid, healthcare costs, and Westchester Community College last year all had increases in their cost in excess of the 2% tax cap.

Even if the county had raised the property tax levy by 2 % that would have generated only $11 million, which is significantly less than the increases. This means that every year there is an ever-increasing deficit being built into the budget, which continuously impacts the county's ability to provide other services.

If we examine the debt repayment alone on the funds borrowed over recent budgets for pension payments we are confronted with an increasingly dire scenario.

The borrowing for pensions, including this year will total $94 million. Debt repayment in fiscal year 2015 will be $9.4 in principle and $2.8 million in interest (assuming 3% interest) for a total of $12.2 million. If the tax cap is 2% for 2015 that will raise only $11 million - thus we cannot even raise enough money to pay for the debit service on what we have borrowed.

Attachment B
Strategic Analysis Workflow Template

The following is a recommended framework developed to aid in the review of departmental mergers.

The base to be utilized for comparison purposes should be the 2014 adopted budget.

I. Categorize the activities as they relate to the Mission of the department activities which are required by:

- Federal mandate
- State mandate
- Westchester County mandate
- Non-mandated activities driven by Westchester County citizen needs- activities which can be categorized as “nice to do”
- All other

II. Establish a priority listing of the activities from Item I

A – top priority
B – high priority
C – low priority
D – discretionary

III. Determine the Headcount/Expenses/Revenues/Capital for Activities A-D within priorities A to D.

Identify all activities which are duplicative throughout the Departments reviewed. (For example administrative activities)

IV. Develop work flow chart for selected activities from I

V. Evaluate the impact of new technology, new processes or outsourcing of work on each activity from III and \IV.

For example:

- Decrease in expense/impact either positive or negative on service levels and quality.
- Impediments to implementation – labor issues, potential lost revenue, potential funding loss from grants.
- Space and Support Requirements before and after consolidation - How will the space and support required before consolidation be utilized after consolidation? Include space, support, equipment etc. that may not be needed after consolidation.
- Develop new estimate of headcount, two year operating expenses and capital for each activity assuming the optimum application of technology from #VI.
- Aggregate headcount, two year operating expense and capital from #VII to create two year pro forma Operating Budget for Departments in the scope of the review.

Management System

- Identify the new mission statement based on consolidation.
- Define the management system to provide adequate County oversight for tasks or activities to be outsourced.

- Map the skills required in the new organization to current skills in place.
- Develop the key management objectives and metrics for the department in the new organization.
- Capital Projects-Evaluate analyze and assess the impact of consolidation on
- Capital projects in the planning phases, engineering phases and construction phases.
- Consider completed projects, the outstanding debt on them and how will the projects they funded be utilized in consolidation.