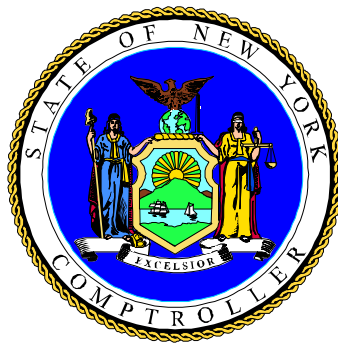


**OFFICE OF THE NEW YORK
STATE COMPTROLLER**

**BUDGET REVIEW
CITY OF BUFFALO**

May 2003



**Alan G. Hevesi
Comptroller**

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Executive Summary

The Speaker of the Assembly requested that the Office of the State Comptroller conduct a study of the state of the finances of the City of Buffalo to assist state leaders in determining whether the City needs special temporary financial assistance from the state government to close current and future budget gaps. This report contains the results of that study.

The Comptroller's analysis looks at the City's budget without including special temporary financial assistance, such as the acceleration of revenues passed by the Legislature and a borrowing plan of the type proposed by the Governor. This approach allows state and local officials to understand the full extent of the City's problems and assess what is needed to deal with those problems.

Buffalo's fiscal problems are rooted in the long-term weakness of its economy. Between 1990 and 2000, the City of Buffalo lost 35,000 people, a decline of 10.8 percent, the largest population drop of any major upstate city. Meanwhile, New York State grew by 5.5 percent and the United States grew by 13.2 percent. From 1990 through 2002, employment in the Buffalo-Niagara Falls Metropolitan Statistical Area (MSA) declined by an average of 0.2 percent per year and private sector employment fell 1 percent per year, while statewide jobs grew 2.8 percent. Current projections indicate the City will continue to lose population.

The City has been operating with a structural deficit for several years. Only increasing state aid and the use of its reserves have allowed the City to fund its operations. For fiscal years 2000-01 and 2001-02, Buffalo had a combined deficit of \$23.8 million, which was covered with reserves. As adopted, the City's 2002-03 budget was initially balanced by using up the rest of its savings. Now, with the reserves gone and state aid no longer expected to grow, the City must deal with its severe underlying problems. The School District is using accumulated reserves and significant workforce reductions to close its budget gap.

Although the City's 2002-03 fiscal year is not yet completed, City officials currently estimate a budget shortfall of around \$1.3 million. This estimate does not include any provisions for potential retroactive pay raises for the police or fire unions' contracts for the 2002-03 fiscal year. If they included estimates for those liabilities, the City would likely end the 2002-03 fiscal year with a budget deficit of more than \$7.5 million.

If the City's 2003-04 budget is enacted as currently proposed, including implementing the proposed police contract but with no special assistance from the State, it would end the year with a budget deficit of between \$10 million and \$15 million, an accumulated negative fund balance of as much as \$18.5 million, and be very near its property tax limit. It will enter the 2004-05 fiscal year with virtually no local resources to fund either the continued restructuring of the City's police and fire departments or to assist the School District with any increased expenditures.

At the request of the Comptroller's Office, the Mayor's Office provided long-term financial projections that show budget balance in the years from 2004-05 through 2006-07. Those projections are intended to reflect the Mayor's proposed budget and multiyear restructuring plans, some parts of which are well described, while others are still only vague plans. However, there are serious problems with a number of important estimates in the Mayor's projections. For example, projected increases in the property tax levy appear to exceed Buffalo's constitutional operating tax limit by a substantial margin. Benefits assumed from re-engineering police and fire contracts are uncertain. The projections assume zero growth in City support for the Board of Education's Budget, and the Board is already projecting budget gaps of \$30 million to \$43 million in the out-years.

The Comptroller's evaluation of Buffalo's budget finds that a continuing and serious structural imbalance exists. While temporary assistance could bring the City through the coming year without a deficit, higher levels of state support would be required in the years following, or the City's finances could collapse, just as they will this year without temporary assistance.

Absent any special assistance, the City faces a 2004-05 deficit ranging from \$30 million to \$48 million. Adding a \$30 million expected gap in the Board of Education's budget pushes the potential shortfall to \$60 million to \$78 million. This structural imbalance grows substantially in the two years following, with potential gaps, including education, of \$93 million to \$127 million in 2006-07.

The conclusion of Comptroller Hevesi's review is that Buffalo is not currently in a position to address its continuing budgetary imbalance. The Mayor's restructuring proposals, though they move in the right direction, may not produce all the savings or revenues he projects and may not be implemented. Moreover, even if his proposals are implemented and successfully produce the savings projected, those savings would not be sufficient to overcome the City's chronic and worsening mismatch between expenditures and revenues. With a worsening fiscal crisis and a City budget that can only be kept afloat by extraordinary temporary measures, it is evident that a new approach must be taken to restore fiscal integrity.

Recommendations

The Comptroller recommends and is presenting legislation to establish the City of Buffalo Oversight and Recovery Board, a new financial reform mechanism to ensure that effective long-term restructuring takes place in Buffalo. The Board would have strong powers to be exercised during an "oversight period," designed to help bring about lasting reforms that improve the quality of life for all the residents of the Buffalo region.

This exercise of extraordinary state powers must be carried out in a manner that preserves the ability and authority of City officials to determine programs and expenditures within available resources. A credible and comprehensive plan to restore Buffalo to fiscal health must include local actions as well as state assistance and oversight.

The powers and duties that would be given to the Board would be similar to those previously given to boards for Yonkers, Troy, New York City and Nassau County.

We recommend that the Board have seven voting members: the Governor, (serving as Chair), the State Comptroller, the Erie County Executive, the Mayor of Buffalo, the City Comptroller, the Speaker of the Assembly and the Majority Leader of the Senate, or their designees. To provide for broader local involvement, the Board should also have several non-voting participants: the President of the Buffalo Common Council, the Chair of the Erie County Legislature, a representative of the school system, and a representative of each of the following: the business community, unions, and the not-for-profit/social services community. The Board should have an Executive Director appointed by the Governor who would be responsible for hiring staff to carry out the Board's responsibilities.

The City should be provided with \$20 million in state aid 'spin-up' resources. The funds should be applied to re-engineering efforts and other initiatives to assist the City in bringing recurring expenses in line with recurring revenues. A portion of this \$20 million should be set aside to cover the costs for the first year of the Oversight and Recovery Board staff and overhead (an estimated \$1.5 million).

Similar to the Governor's proposal, the City would be allowed to borrow from the Municipal Bond Bank Agency, but only at times and amounts authorized by the Board. The borrowing must be used as a transitional tool to allow realistic long-term actions to bring recurring expenses in line with recurring revenues.

The Board would have approval authority over a required four-year financial plan to be submitted by the Mayor, prescribe its form, and could, where appropriate, require modifications in the plan. City budgets would be required to be consistent with the plan, and revenue estimates would have to be certified by the Board.

The Oversight and Recovery Board must be given authority to access all the books, records and other financial documents of the City and the Board of Education necessary to carrying out its oversight responsibilities. This authority should include access to necessary staff of the City and the Board of Education.

Further, the Comptroller's legislation would require that the City postpone ratifying any major new contracts or obligations until the Oversight and Recovery Board has reviewed and approved them. The Board may also freeze future wage increases in the event of a Board-declared fiscal crisis.

The City of Buffalo and Erie County possess the resources to solve these fiscal problems. The City must provide financial information and plans that instill greater confidence from all stakeholders. The Mayor and the Board should work aggressively to improve relationships and cooperation between the City, the School District, the County and the State. They will also need the cooperation and support of the unions and the business community. The Mayor and the Board must use these improved relationships to forge a

consensus that will make it possible to reduce costs, increase revenues and preserve and improve essential services.

INTRODUCTION

The purpose of this budget review is to provide an analysis of the current condition and future prospects of the City of Buffalo's budget. The Speaker of the Assembly requested this review to assist state leaders in determining whether Buffalo needs special temporary financial assistance from the state government to close current and future budget gaps. (See appendix)

In a May 6 letter to Comptroller Alan G. Hevesi, Assembly Speaker Sheldon Silver wrote, "I believe the legislature would benefit from your thorough review of the current budget, potential budget gaps, trends in disbursement and receipts, fiscal capacity, and financial management. It is imperative that everyone has the best information possible prior to making decisions about the role of the state in assisting the City of Buffalo. Your office is uniquely situated to provide that information."

State policymakers are very concerned about Buffalo's financial situation and have proposed various measures to assist the City in its current situation. In his Executive Budget released in January, the Governor proposed allowing the City to borrow funds through the Municipal Bond Bank Authority (MBBA) for the next three years and to use those funds to pay for restructuring efforts. Shortly following the Mayor of Buffalo's introduction of his budget proposal on May 1, the State Legislature passed a measure accelerating state aid payments to the City that will result in it receiving \$20 million more in funds during its 2002-03 fiscal year. The Mayor of Buffalo has counted on both types of support in his budget, saying that the City needed special temporary support to fund the up-front costs of his restructuring plans.

On May 1, when the budget was released, officials in the Mayor's Office said they needed \$15.7 million in "front-end" assistance, covering the costs of restructuring police and fire services that could occur during the 2002-03 fiscal year, plus the Governor's proposal allowing Buffalo to borrow \$29 million in 2003-04 and lesser amounts in the two following years.

Buffalo's Mayor has said that if the City does not receive special temporary support, he will have to abandon his major restructuring initiatives and revise his budget to make a number of immediate cuts, including layoffs for police officers and firefighters, and reduced education funding. He further said that if he could not get those cuts enacted by the Common Council, he would request that a strong financial control board be appointed.

Although the Mayor's budget proposal technically covers only the 2003-04 fiscal year, it was presented as the first step in a restructuring plan that takes place over a multiyear period. At our request, officials in the Mayor's Office provided us with budget projections through the 2006-07 fiscal year, which are analyzed in this report. In addition to a budget analysis, this report provides contextual information on the Buffalo region's population, economy, fiscal and governmental environment.

Perhaps the most dramatic recent indication of Buffalo's financial plight is that several weeks ago one of the major credit rating agencies, Moody's Investor's Services, put Buffalo on a credit watch for possible downgrade. This means there is a 50 percent or greater chance it will be downgraded from its current rating (Baa2) within the next 90 days. In placing Buffalo on a credit watch, Moody's cited challenges the City and its dependent school district will face maintaining adequate liquidity and reserves given the expected use of fund balances in fiscal 2002 and 2003, as well as significant obstacles to adoption of a balanced budget. Moody's already has a "negative outlook" for the other major cities in the State, and Syracuse and Yonkers share Buffalo's Baa2 rating. If Buffalo's current rating were to drop two more notches, its general obligation bonds would become non-investment grade, making them ineligible investments for many purchasers and possibly making bond insurance difficult to obtain. Standard and Poor's, another credit rating agency, has a similar rating for Buffalo, although it has rated Syracuse and Yonkers slightly higher.

Inasmuch as this budget review concludes that the City is not currently in a position to address these problems, it presents Comptroller Hevesi's recommendation for a new financial oversight and reform mechanism to ensure that effective long-term restructuring takes place. Credit analysts have said that oversight boards can often help local governments address their budget problems, especially when the problems are severe enough that the solutions involve changes that are difficult to achieve through traditional policy and political mechanisms.

Population, Economy and Governmental Environment

Between the 1990 and 2000 Census, the City of Buffalo experienced a decline in population of more than 35,000, or 10.8 percent. During the same period, New York State's population grew by 5.5 percent and the United States grew by 13.2 percent. Population within the Buffalo-Niagara Falls MSA (or Metropolitan Statistical Area, including Erie and Niagara Counties), but outside of the City, grew by 1.9 percent, resulting in an overall population decline in the region of 1.6 percent. Buffalo had the largest population decline of any major upstate City during this period, and ranked 238 out of 243 in population growth nationwide for cities with populations over 100,000. According to a forecast by Global Insight, it is projected that the population decline will continue in the present decade.

During 2002, total employment in the Buffalo-Niagara Falls MSA declined by 0.6 percent and the number of jobs in the private sector declined by 1 percent. This was the second consecutive year employment in the region declined and since 2000 the total number of jobs has declined by 2.1 percent, while private employment has fallen by 2.9 percent. Since 1990, the region has declined in both total employment (0.2 percent), and employment in the private sector (1 percent). In comparison, total employment Statewide grew by 2.8 percent during this period, and the number of jobs in the private sector increased by 3.2 percent. During the economic expansion from 1992 through 2000, both total employment and private employment in the Buffalo MSA grew over the eight years

by a total of 5.6 percent. This rate was lower than all metropolitan areas of the State except Binghamton, and each growth rate was less than half the statewide growth rate.

Declining manufacturing employment has hampered the Buffalo regional economy. Since 1990, the region has lost more than one fifth of its manufacturing jobs, and during the past two years there has been a considerable loss in manufacturing employment (14 percent). In many areas of the State, losses in manufacturing jobs have been offset at least in part by increased employment in education and health services, the fastest growing industries in the State since 1990. Whereas the number of education and health jobs increased by 35.7 percent between 1990 and 2002, the rate of growth in Buffalo for this period was only 11.9 percent. Since 2002, Buffalo was one of only three metropolitan areas where these jobs declined.

Buffalo's persistent budget and cash flow problems have produced new management initiatives. Each initiative is being assessed by City and County officials on its own merits. For example, the consolidation of the City cellblock operation with Erie County is nearing completion. In his budget proposal for 2003-04, the Mayor also proposed merging several other City operations with County programs, including youth programs, senior citizen recreation services, and advocacy for the disabled, and discussions are ongoing for these cooperative ventures. The Erie County Executive had also proposed a merger of the Buffalo City Police and the Erie County Sheriff's Department.).

Another frequent suggestion offered to address Buffalo's fiscal condition is for Erie County to share a larger percentage of sales tax receipts with the City. This issue has a long history in the region. In 1985, an additional one percent sales tax was imposed by Erie County as a temporary fix to deal with a \$75 million County budget deficit. This "temporary tax" has been renewed annually for the past 18 years. Sales tax agreements between cities and counties vary considerably, but proponents of providing the City a larger share often point to the disparity in sharing between Buffalo and Erie County in comparison to Monroe and Onondaga Counties' arrangements with their central cities, Rochester and Syracuse. While all three of these central cities represent about 30 percent of the population in each county, Buffalo and its component school district receive only 19 percent of the county sales tax collections, while Rochester receives 34 percent and Syracuse receives 38 percent.

Sales Tax Distributions for Major Upstate Cities
(Fiscal Years Ending 2001)

	Buffalo	% of County Receipts	Rochester	% of County Receipts	Syracuse	% of County Receipts
Total County Sales Tax Receipts	\$461,883,533		\$280,823,735		\$137,813,690	
City Share	\$58,549,708	12.68	\$72,945,464	25.98	\$48,142,830	34.93
City School District Share	\$29,486,796	6.38	\$22,845,408	8.14	\$3,856,229	2.80
City/School Total	\$88,036,504	19.07	\$95,790,872	34.12	\$51,999,059	37.74

Annual financial reports of Erie County indicate a general fund operating deficit in both 2001 and 2002: \$9.4 million, or 1 percent of gross expenditures, and \$42.4 million, or 4.4 percent of gross expenditures, respectively. Although the County has had a very healthy fund balance totaling \$205 million at the end of fiscal 2000, that balance had declined to \$153 million in fiscal 2002, and is expected to decline materially this year as well. This decline coincides with the impacts of increased Medicaid costs and other fiscal pressures.

BUDGET OVERVIEW

Buffalo and its dependent school system are a combined \$1 billion fiscal operation. Being a dependent school system means that the Buffalo School District does not have independent taxing authority but relies upon the City to provide funds from the property taxes the City levies, for local funds to support the schools. In 2003-04 that local support is proposed to be \$51.2 million (exclusive of STAR reimbursements), out of a total School District proposed budget of approximately \$504 million.

It is important to keep the nature of the relationship between the City and the School District in mind, since local support for both are subject to a constitutional tax limit, and the City is running up against that limit (see discussion under Long-Term Budget Outlook). Thus the City has a very limited local capacity to deal with the expenditure pressures of a \$1 billion operation.

In addition to its tax limit, Buffalo also has a debt limit. These limits are imposed on Buffalo as well as other large cities by the State Constitution. Both limits are expressed as a percentage of property value (measured by a five-year average full valuation of taxable real property). The tax levy for operating purposes may not exceed two percent of property value; this limit is imposed on taxes levied for budget appropriations, but appropriations that support certain capital debt service or capital expenditures are excluded from the calculation. The debt limit applies to total outstanding debt, including school district debt, but excludes certain types of short-term debt and other financing. For example, the Governor's proposal to allow special short-term borrowing through the Municipal Bond Bank Agency, were it to take place, would not be included. Total debt may not exceed nine percent of property value.

The Buffalo City Charter establishes the process and deadlines for how a budget is to be developed, reviewed and approved by City officials. By February 1, all administrative unit heads must prepare and submit to the Mayor estimates of proposed expenditures and revenues for the upcoming fiscal year. After conducting hearings with all unit heads, the Mayor makes revisions and notifies the chair of the Common Council Finance Committee. The Mayor must formally submit his proposed budget to the Common Council by May 1. The Charter calls for the City Comptroller to review the proposed budget and submit an assessment of the accuracy of the Mayor's revenue and expenditure estimates to the Council by May 10.

If the Council makes no changes to the Mayor's budget at its next meeting after receiving the budget, the budget is considered approved and deemed adopted without further action by the Mayor. If the Council makes changes to the budget, the City Clerk must present those changes to the Mayor by May 22. However, on May 19 of this year, the Mayor and the Common Council agreed to delay the usual process by two weeks until June 5 to give sufficient time for completion of this review.

When he receives the budget, if the Mayor approves the changes made by the Council, he signs a statement to that effect and returns the budget to the City Clerk. The budget is then deemed adopted. The budget is also deemed adopted if the Mayor fails to return the budget with objections to the City Clerk within 10 days of receiving the Council's changes.

If the Mayor objects to any changes, he must list the changes he is vetoing and the reasons for his vetoes. A two-thirds vote by Council members is needed to override the Mayor's vetoes. In the event the Council fails to act before June 8, the Mayor's vetoes are upheld and the budget with all the Council additions the Mayor did not veto becomes the operating budget for the ensuing year.

The Charter requires that within 45 days of the close of the first, second and third quarter of the City's fiscal year, the Director of the Budget submit a report to the Mayor and the Council comparing actual revenues and expenditures to budget estimates. The Director must also project probable fiscal year-end results based on any material revenue and expenditure trends or other factors, and project the impact of those trends or factors on the following fiscal year and future years, as appropriate. Prior to submitting the report to the Mayor and the Council, the Director must submit a draft report to the City Comptroller for review and comment. If the City Comptroller believes the final report raises any substantial issue, he must promptly submit a statement describing such issues to the Mayor and the Council.

The requirement in the Charter for the Budget Director to project the financial impacts on future years, "as he deems appropriate," is a very weak financial planning tool. Most budget decisions have financial impacts years into the future. Without a multiyear financial plan it is very hard to readily determine the future consequences of today's budget decisions. A formal, required multiyear financial plan would contribute greatly to more transparent, readily understandable City finances.

Labor Environment

One of the potential impacts on the City's and School District's financial condition will be the effect of negotiated labor agreements with unions representing the City and School District employees. In addition to the police and fire union contracts that are discussed later in this review, the City is currently in negotiation with several of its unions whose contracts have expired. For example, the contract with AFSCME Local 264, which covers Department of Public Works and blue-collar employees, expired in June 2002. Water Department employees covered by the contract with Teamsters Local 264 and Engineers represented by Local 71 of the AFL-CIO have also been without a contract since June 2002. In addition, two other recently signed contracts will be in effect until the end of the 2003-04 fiscal year. The contract for the City's white-collar employees was signed in April 2003. It resulted in no wage increase for fiscal year 2001-02 and increases of 2.5 percent for both fiscal years 2002-03 and 2003-04. AFSCME Local 2651 which covers City inspectors, agreed to a contract in January 2003 that resulted in

wage increases of one percent for fiscal year 2001-02, 1.25 percent for 2002-03 and two percent for 2003-04.

Likewise, the School District has several contracts that will expire on June 30, 2004. These include contracts with the Buffalo Teachers Federation (which includes a salary increase of two percent effective July 2003 and 1.5 percent in January 2004), and the blue collar, white collar, food service and administrators unions. In addition, the School District is currently negotiating with unions for bus aides, substitute teachers, teacher aides and engineers.

2002-03 FISCAL YEAR¹

City Operations

Buffalo's budget increases since 1997-98 have generally been funded by increasing state aid, which rose from \$67 million in 1997-98 to \$123 million in 2002-03. Even with this increased state aid, the City has not had sufficient funds to pay for its ongoing operations for the past several years. For the two fiscal years ended June 30, 2002, the City had an accumulated deficit of more than \$23.8 million, \$11.4 million in the 2000-01 fiscal year and \$12.4 million in the 2001-02 fiscal year. As a result, the City's accumulated fund balance declined from \$41.6 million to \$17.8 million as of July 1, 2002, the beginning of the current fiscal year.

In 2002-03, the City's adopted budget called for \$271.5 million in expenditures supported by \$263.9 million of revenues and \$7.6 million of the City's accumulated fund balance. Since the City had reserved the rest of its \$17.8 million fund balance for other purposes, the 2002-03 budget used up almost all the City's remaining unreserved fund balance. In effect, the City's budget was initially balanced as adopted for 2002-03 by using the rest of its savings.

During the year the City entered into an agreement in principle with the police union that contained a variety of work rule changes while granting salary increases of \$5,000 per officer in 2002-03 and salary increases of 3.4 percent per year for four years starting in 2003-04 (see discussion under 2003-04 Budget for a more detailed discussion of this agreement).

Although the fiscal year is not yet completed, it appears that the City will again incur a deficit. City officials currently estimate that they may have a budget shortfall of around \$1.3 million. This estimate does not include any provisions for potential retroactive pay raises for the police or firefighter's unions contracts for the 2002-3 fiscal year. The tentative police contract calls for a payment of \$5,000 per officer to approximately 900 officers, or a total of \$4.5 million. City officials conjecture that firefighters might get \$2000 per person paid for approximately 850 firefighters, for a total of \$1.7 million. Factoring in estimates for those liabilities, the City would likely end the 2002-03 fiscal year with a budget deficit of more than \$7.5 million. For purposes of this analysis, we assume that the City would still implement the agreement with the police union, although

¹ The City's expected financial results for the 2002-03 fiscal year presented in this review are based on information and estimates provided to us by City officials from May 7 to May 19, 2003. In the limited time available for this review, we were only able to briefly assess these estimates and determine that they were reasonable based on the information provided. There was not enough time to perform a thorough and complete examination of the books and records of the City. With six weeks left until the end of the City's fiscal year, events are likely to occur that will alter the final reported year-end results. Future reporting envisioned under the Buffalo Oversight and Recovery Board Act should provide publicly available financial information that is more easily understood.

the agreement has a provision that it is voided if the State does not provide funding necessary to implement it. We believe this approach provides a clearer analysis of whether special assistance from the State is needed to implement the City's preferred operational changes.

The following table shows how the City's Fund Balance was used during 2002-03, resulting in a projected negative unreserved fund balance at the end of the year.

	(in millions)
Total Fund Balance 7/1/02	\$17.8
Reductions to Fund Balance During 2002-03	
Fund Balance Appropriated and Spent	\$7.6
Projected Deficit	7.5
Estimate for Reserve for Liabilities	<u>6.2</u>
Ending Unreserved Fund Balance 6/30/03	<u><u>(\$3.5)</u></u>

As a point of reference, we generally recommend that local governments maintain an 8 to 10 percent positive fund balance. For Buffalo, that would be between \$24 million and \$30 million.

At the time he introduced his budget proposal, the Mayor was seeking \$15.7 million in "restructuring aid" and \$29 million in borrowing authority (which was to have been provided through the Governor's MBBA plan). Of the \$15.7 million in restructuring aid, \$8.1 million was to pay for some initial costs of the tentative contract with police officers, and the remainder was to pay for a similar, but not yet negotiated contract agreement with the firefighters. The source of the \$15.7 million was never specifically identified, although when it became apparent that the City would potentially receive \$20 million in accelerated state aid payments, City officials stopped referring to the \$15.7 million figure.

School District Operations

The District's proposed budget for 2003-04 uses over \$5.6 million of accumulated fund balance to pay for operations. Our review of the School District's operations show that it should end the 2002-03 fiscal year with no operating surplus or deficit. Therefore, the accumulated fund balance of over \$5.6 million would be available to fund the 2003-04 budget, as planned. School District officials told us that they still have over \$9 million owed to them by the State for adjustments to prior-year state aid claims. In the event that they end the 2003-04 year with a deficit, they plan to offset that amount by borrowing against the retroactive amount owed to them.

2003-04 BUDGET - CITY²

Revenues

The proposed budget for 2003-04 contains revenue estimates totaling \$293 million, which include increased property tax rates and increased fees for various City services, permits and licenses. The revenue estimates also assume the City will receive authority to borrow \$29 million under the Governor's MBBA borrowing proposal (providing \$25 million in net proceeds for 2003-04 after debt service costs).

With the exception of the borrowing proceeds, which we have removed for purposes of this analysis, our review of the City's revenue estimates contained in the proposed budget found that the estimates generally appear to be based on reasonable assumptions

Interfund Transfers

The 2003-04 budget includes a planned net transfer of about \$93.4 million from the City's general fund to other funds, mainly the Board of Education and the Capital Debt Service fund. This includes an additional \$2 million to the Board of Education and \$3.8 million to the Capital Debt Service fund. Our analysis shows that these amounts are reasonable.

Expenditures

The budget proposed by the Mayor for 2003-04 contains \$293 million in expenditures, a growth of eight percent from the preceding year. Most of the projected growth occurs in fringe benefits for such things as increased health insurance costs, pension costs and anticipated increases in employee salaries and retroactive salary payments as a result of anticipated labor agreements.

The proposed budget also included some cuts, such as:

- Eliminating approximately 120 City positions for a total cost savings of about \$4.5 million
- Merging a number of City operations with County programs for an estimated net savings of over \$700,000.

² The expected financial results of the City for the 2003-04 fiscal year presented in this review are based on information and estimates provided to us by City officials from May 7 to May 19, 2003. In the limited time available for this review we were only able to briefly assess these estimates and determine that they were reasonable based on the information provided. There was not enough time to perform a thorough and complete examination of the books and records of the City. Events are likely to occur throughout the year that will alter the final reported year-end results. Future reporting envisioned under the Buffalo Oversight and Recovery Board Act should provide publicly available financial information that is more easily understood.

- Eliminating nine high-level appointive positions to save \$540,000. Also, a previous public referendum reduced the number of Common Council members (the Council President position and 3 at-large seats), which will save at least \$187,000 in direct salary costs for the three at-large Council seats eliminated and potentially more pending a restructuring of the Council President's office.

Most of the estimated expenditures in the 2003-04 budget are based on reasonable or known assumptions. For example, the City's estimate for pension costs is based on the established contribution rate for 2003-04. Employee health insurance costs are projected to rise nearly 20 percent based on specific estimates provided by the City's insurance providers. We evaluated the reasonableness of these estimates with national health care organizations. We were also able to verify projected personal service costs against existing payroll records and established labor contracts.

However, the proposed budget has several areas where we are concerned as to whether the City's projections will actually occur.

Inter-Municipal Agreements

The City proposed merging a number of City operations with County programs, including youth programs, senior citizen recreation services, and advocacy for the disabled. The City estimated that these mergers would result in the elimination of \$1.35 million in costs. The City would pay the County \$300,000 to provide these services and the City would lose more than \$300,000 in related revenue. Therefore, the City estimated net savings of more than \$700,000 by merging these services with the County's operations. However, while negotiations are ongoing, they may not be completed for 2003-04. As a result, the projected cost savings of more than \$700,000 may not occur.

Police Contract

A major cost savings initiative in the proposed budget is a new labor agreement reached in principal with the police union. The contract would provide salary increases of \$5,000 per officer retroactive to July 1, 2002 (approximately a 10 percent salary increase) and 3.4 percent wage increases per year starting in the 2003-04 fiscal year and continuing through fiscal 2006-07. In return, the police union agrees to the implementation of one-officer patrol cars, a five-shift workday and the use of civilians for some functions currently performed by higher-paid uniformed officers. The five-shift workday allows for overlap on shifts and is designed to reduce overtime. These changes potentially allow the City to reduce the uniformed police force from 877 officers to 675. It is assumed these reductions will occur over time primarily through retirements. City officials have portrayed this contract (and a contract still to be negotiated with the firefighters union) as a major piece in restructuring the City's operations in the years ahead.

The salary increases contained in the contract result in a nearly 26 percent pay hike from 2002-03 to the end of the agreement in 2006-07. Using the City's projections, total police department costs will increase by 17 percent by 2006-07 (from \$64.7 to \$75.7 million),

even after reducing the number of police officers on the force by 23 percent. City officials estimate that, because of the contract, by 2006-07 the police department will cost about \$11 million less than it would cost if no work rule changes were made.

There are important management reforms in the tentative police contract, although it costs money up front to implement. The contract will not by itself address Buffalo's long-term financial problems, nor was it portrayed by City officials as so doing. We have several concerns with the proposed contract. Actual attrition may not achieve the City's police force reduction target. Moreover, the proposed contract limits the City's future flexibility because it locks the City into just one approach for changing the police department's operations and forecloses discussion of other options. It prohibits layoffs and does not contain any language that would allow City officials to renegotiate elements in case the hoped-for attrition does not occur. Future pay raises occur whether or not the planned reduction in force is achieved. These provisions will limit the City's ability to revise operations to reflect changing financial conditions in future years.

However, as this report was being prepared, the news media in Buffalo reported that the police union has ratified the agreement. This ratification, together with the provision of special temporary assistance in the state budget, may in essence mean that this is an approved agreement. If not, the agreement should be submitted to the oversight board recommended in this review, for their consideration and approval.

Impact of Contract on 2003-04

To determine the impact of the proposed contract on the City's budget, we reviewed the City's analysis of costs and resulting savings. The cost savings that the City projects will occur are based on certain assumptions regarding how quickly police officers will retire under the agreement. City officials think the large retroactive pay settlement and future reductions in available overtime hours will make this year the highest paid year for many officers. Since retirement benefits are based on the highest year of earnings for officers in the Tier 1 retirement bracket, City officials believe this high earnings year will provide some officers more incentive to retire now. They also believe that the change of having only one officer in a patrol car will result in some officers leaving who may not like to work under those changed conditions.

On the other hand, the salary increases in the coming years, that according to City officials will boost the average salary from \$50,052 to \$65,533, could encourage officers to delay their retirement, as could the continuing decline in jobs in the general Buffalo economy and thus the opportunity for alternative employment for officers after they retire from the Police Department.

Realizing cost savings is dependent upon the attrition rate actually achieved. The City's estimate of cost savings assumes attrition rates of 60 officers in 2003-04, 60 officers in 2004-05 and 82 officers in 2005-06. If this attrition rate does not occur because of the competing incentives contained in the proposed contract that we noted above, the impact on the budget could be significant. As an example, we calculated the contract's costs if

the attrition rate in the first year was 60 (the historical average) and this attrition occurred throughout the year and declined each year thereafter because of the increased pay rates for officers. This more conservative estimate results in \$2.6 million more in salary, FICA and health insurance costs in 2003-04 than City officials estimated and nearly \$16 million more in such costs through the 2006-07 fiscal year.

If the City's budget is enacted as it is currently proposed, and it implements the proposed police contract but does not receive any special assistance from the State, the City would likely have a budget deficit of between \$10 and \$15 million in 2003-04. Combined with its accumulated budget deficit at the start of the year, the City will end 2003-04 with an accumulated negative unreserved fund balance of as much as \$18.5 million and will be very near its property tax limit. It will then enter 2004-05 with virtually no local resources to fund either the continued restructuring of the City's police and fire departments or to assist the School District with any increased expenditures.

2003-04 BUDGET – SCHOOL DISTRICT

Revenues

The projected revenues for the School District for 2003-04 total approximately \$504 million, nearly 85 percent of which is funded with state aid, the City's tax levy, or the District's share of sales tax revenue. Our review of the amounts included in the District's current budget proposal found that the estimates are reasonable or based on known factors. For example, the State's budget is now enacted and provides reasonable assurance that the District will receive anticipated state aid of more than \$331 million.

Expenditures

The School District proposes to cut more than 708 full-time equivalent (FTE) positions, including 413 teachers and 210 teacher aides, to balance the 2003-04 budget, and an even higher number of layoff notices have been prepared, in the event that the increase provided in the Mayor's budget is rescinded. These reductions come on top of eliminating 469 FTEs in 2001-02 and 211 FTEs in 2002-03. In three years the School District will have eliminated nearly 1,400 employees. In 2003-04, it plans to have about 3,600 employees, a 28 percent decrease in three years.

The District is currently in the process of identifying the positions that will be eliminated and plans to have layoff notices out by the end of May as required in order to have each position eliminated by the end of June. Therefore, we believe that the District will achieve the cost savings projected in its budget plans and that its expenditure estimates for 2003-04 are reasonable and achievable.

Our review did not include a programmatic analysis to determine the impact this series of cuts has had, or will have, on the academic programs in the School District. Reductions of this magnitude should be cause for concern. School officials have told us that they will have little ability after this latest round of cuts to reduce their workforce further without exceeding maximum allowable class sizes and other state educational mandates.

According to press reports, State Education Commissioner Richard P. Mills has recently criticized the School District for low scores on fourth-grade and eighth-grade English assessment tests and said Buffalo's schools were falling far behind those in the state's other big cities. This is before any impact from the next round of budget cuts.

Improving the City schools must be a major part of any plan to revive Buffalo. It is unrealistic to assume the schools will not need additional aid from the City. Buffalo's future depends on an educated workforce and on being a place families want to live. Both require good schools. We cannot allow the children of Buffalo to be the long-term victims of today's fiscal problems.

LONG-TERM OUTLOOK

In considering whether and how to provide short-term budget relief for Buffalo, both the state Legislature and the Governor have indicated that they view such relief as a temporary measure that is to serve as a bridge to a restructured City budget that is fiscally sustainable. For example, the Governor's MBBA borrowing proposal would require the City to submit a self-evaluation of its fiscal affairs to the Comptroller and other state officials, describing how it could restore structural budgetary balance by 2006. The Legislature focused on this issue in the request to the Comptroller to review Buffalo's budget situation and its bill accelerating \$20 million in aid payments required that these funds be used for re-engineering.

This question has also been the focus of debate in Buffalo, with the County Executive and a prominent business group arguing that the Mayor's budget proposal and restructuring plans are not sufficient to address the long-term structural budget imbalance.

In his May 1 message accompanying the 2003-04 budget, the Mayor stated that his budget plan would allow Buffalo to "survive over the short term and thrive in the long run." Although his budget proposal technically covers only the 2003-04 fiscal year, it is based on assumptions about changes that are to take place over a multiyear period, including the proposed re-engineering of the police and fire services.

The City does not publicly present long-term projections with its budget. However, following our request, officials in the Mayor's Office on May 6 provided us with expenditure and revenue projections running through the 2006-07 fiscal year that correspond to the Mayor's budget proposal and his multiyear restructuring plans.

The long-term projections provided by the Mayor's Office at our request show budget balance (no operating surplus or deficit) from 2002-03 through 2006-07. Those projections are intended to reflect the Mayor's proposed budget and multiyear restructuring plans, some of which are well described, while others are, at this point in time, only vague plans.

It should be noted that the Mayor's current long-term projections differ dramatically from others prepared earlier, that were also shared with us by officials in the Mayor's Office. Earlier multiyear projections, apparently prepared following the 2nd Quarter of the fiscal year, showed budget gaps exceeding \$50 million in 2003-04 and beyond. This situation is not unusual, however, because baseline projections are designed to show what the budget situation will be absent any action to close a gap. When a budget gap is closed through a variety of cost cutting and revenue actions, the gaps in out-years are often reduced and sometimes eliminated. A central issue for our analysis is whether the proposed plans to address Buffalo's gap and the associated long-term projections are reasonable.

Buffalo's budget projections for 2003-04, as well as for the three years following, are based on the assumption that temporary assistance from the State will be received. However, to present a clear picture of the City's financial situation, we have not included the impact of either the borrowing or the aid acceleration in our presentation of Buffalo's budget outlook.

While temporary assistance such as the acceleration of revenues passed by the Legislature and a borrowing plan of the type proposed by the Governor could eliminate the budget gaps projected for 2002-03 and 2003-04, the gaps would return beginning in 2004-05. Deficit borrowing, moreover, can worsen gaps in future years when the proceeds have been spent and the debt payments remain.

Long-term projections are a fundamental tool for budgeting at all levels of government, and in a situation such as Buffalo's, where both previous and current budgets have been balanced through the use of one-time resources, such as borrowing or revenue "spin-ups," they are even more important. That said, it is important to understand that all long-term projections are forecasts that may not necessarily be precise. They are based on assumptions that may or may not hold true. In evaluating such projections, the central question must be whether they are reasonably constructed and based on rational assumptions. One way to evaluate a projection is to look at whether the actual results could be expected to reasonably vary in either direction. In other words, all projections contain risk, but a balanced projection contains risk in both directions. Thus, revenues could come in reasonably higher or lower, and the projection is somewhere in the middle of the reasonable range.

Unfortunately, the long-term projections provided with the City of Buffalo's budget fail this test of reasonableness. Despite a projection of balance, in every significant area there is a high risk that substantial variations from the plan will occur, and that these variations will be in the direction of deficit. For example, revenue growth is projected that is unrealistic given recent trends in and relevant projections of economic growth. In the most extreme example, projected increases in the property tax levy appear to exceed what Buffalo's constitutional operating tax limit would allow by a substantial margin. On the expenditure side as well, there are benefits assumed from re-engineering police and fire contracts that are more than uncertain. In addition, the budget assumes zero growth in support for the Board of Education's Budget, whereas the Board is already projecting budget gaps of \$30 to \$44 million in the out-years.

Our evaluation of Buffalo's projections, combined with our analysis of its budgetary situation in the current year, demonstrate that a continuing and serious structural imbalance exists. While temporary assistance could bring the City through the coming year without a deficit, higher levels of state support would be required in the years following, or the City's finances could collapse, just as they will this year without temporary state assistance. The Mayor's restructuring proposals are not sufficient to produce continuing structural balance, and the long-term projections that purport to show balance following two years of temporary assistance are not realistic. A more reasonable

projection shows a growing structural budget imbalance that cannot be met within the City's current plans or revenue streams.

The Mayor's projections show a zero balance (neither surplus nor deficit) for each of the budget years from 2003-04 to 2006-07. However, as a starting point for this analysis, we have removed the expected impact of the temporary borrowing proposed under the Governor's Budget proposal (which has not been enacted). We have also excluded the impact from the acceleration of state aid passed by the Legislature. This approach gives a clear picture of the magnitude of assistance that would be required in each year.

**Buffalo's Out-Year Budget Gaps
Comptroller's Revisions to the Mayor's Long-Term Projections**

	2004-05	2005-06	2006-07
	-- Millions of Dollars --		
Mayor's Initial Projection	0	0	0
Comptroller's Adjustments:			
MBBA Borrowing Impact	-8	+0.3	+7
Property Tax Held to Limit	-7 to -19	-9 to -22	-15 to -29
Sales Tax Projection	-1 to -2	-2 to -4	-3 to -6
Pension Contributions	-4 to -5	-17 to -19	-22 to -24
Police Restructuring	-2 to -3.1	0 to -6.7	0 to -3.6
Fire Restructuring	-3	-4 to -6	-4 to -6
Fire Department Revenues	-1	-2	-10
Health Insurance Costs	-4.2 to -6.7	-4.4 to -9.8	-3.1 to -11.9
Range of Out-Year Structural Budget Gaps (City Only)	-30 to -48	-38 to -69	-50 to -84
Buffalo City School District Projected Funding Gap	-30	-38	-43
Out-Year Gaps Including Board of Education	-60 to -78	-76 to -107	-93 to -127
Source: Estimates prepared by the State Comptroller's Office, using independent estimating techniques, with input data provided by officials in the Mayor's Office. School district gap provided by the Buffalo City School District at the request of the State Comptroller's Office.			

The table above shows the Comptroller's Office analysis of the Mayor's long-term projections and our estimates of more likely outcomes, which are described further in the

following narrative. Our analysis focuses on areas where we found a significant risk that the Mayor's projections were unduly optimistic. We made alternate projections in those areas, producing a reasonable range of outcomes. Our projections use reasonable estimating techniques and are based on information provided by officials from the Mayor's Office. We chose to present a range of outcomes in most areas, in part because of the short time frame and limited information available. In those areas where we present a range, the first figure is the difference from the City projections based on an optimistic projection; the second figure is the variance based on a more conservative projection (and so produces a greater potential gap).

Our revisions to the Mayor's projections show a growing structural imbalance. In 2004-05, absent special assistance, we would expect a deficit ranging from \$30 million to \$48 million for the City budget without considering educational needs. If we add to that the deficit expected by the Board of Education, the potential gap becomes \$60 million to \$78 million. As the table shows, the structural imbalance grows substantially in the following two years, with potential gaps exceeding \$100 million.

MBBA Borrowing Plan

The Mayor's Budget projections assume enactment of the MBBA borrowing plan contained in the Governor's budget legislation, but not enacted by the Legislature. This proposal would have allowed Buffalo, as well as other large cities in the State to access Municipal Bond Bank Agency (MBBA) borrowing to avert budget gaps for the next several years. Under the proposal, the cities could access funding through MBBA bonds issued in amounts equaling up to 10 percent of their general fund operating budget (for fiscal years ending in 2004), phasing out over the next two years (up to five percent of operating budget for 2005, and 2.5 percent in 2006). The cities would be required to enter into a "special purpose agreement" with MBBA providing for the repayment of the bonding over 10 years; the cities borrowing would also have to describe a plan for returning to structural balance and adhere to various reporting requirements. This borrowing would essentially be a new kind of backdoor deficit borrowing, outside of the cities' debt limits. Buffalo was the only one of the Big Five cities to discuss accessing this financing.

Since the Governor's proposal has not been enacted, and the Legislature has asked for the Comptroller's assistance in determining how much temporary assistance Buffalo may need, we have removed the impact of the assumed borrowing from the Mayor's long-term projections. The City had planned to borrow \$29.3 million in 2003-04, \$14 million in 2004-05 and \$7 million in 2005-06. The City assumes that each borrowing would be financed over 10 years at 3.54 percent. In the Mayor's projections, the payments in 2003-04 would be \$4.3 million, and so the net benefit to the City's budget would be \$25 million. In 2004-05, \$14 million would be borrowed, offset by \$6 million in borrowing costs for a net benefit of \$8 million. In 2005-06, another \$6.7 million would be borrowed, but the repayments by that year would exceed the amount borrowed by \$0.3 million, and so the net effect on the budget would be negative. In 2006-07, debt service costs of \$7 million would continue, but with no new borrowing, the full impact would be felt on the

budget. The borrowing costs would continue, in declining amounts, until 2014, with total payments exceeding \$61 million, which adds substantially to budget problems in those years.

Property Taxes

Buffalo's budget projections assume large property tax increases over a number of years, starting with the Mayor's 2003-04 budget proposal calling for an increase of \$9.5 million, or 7.2 percent, which some Common Council members have already said they will not support. In 2004-05, the projections show an even larger increase of \$15.9 million, or 11.3 percent. Over five years, the total projected increase is \$36.6 million, or 28 percent. Assuming property values are flat, these tax increases would raise Buffalo's overall full value tax rate from 2.48 percent to 3.17 percent, a change that would place its tax rate above both Rochester and Syracuse, to a rate that may not be sustainable given its weakened economy.

Furthermore, the City is governed by a constitutional tax limit for its operating levy, and its projected levies would clearly exceed this limit beginning in 2004-05. Under the City's constitutional limit, the operating levy (the full property tax levy less excludable amounts such as capital expenditures and debt service) cannot exceed 2 percent of the five-year average full valuation of taxable property, which is a complex calculation based on special equalization ratios determined by the Office of Real Property Services (ORPS). Note that it is possible for the overall full value tax rate described above to exceed two percent because after exclusions, which have been in the area of \$40 million in recent years, the levy for operating purposes represents a lower percentage of property value.

Although a precise estimation of what Buffalo's tax limit will be in future years is not possible, it is clear that the levies contained in the City's projections would exceed even an optimistic estimate of its limit. We created a reasonable range estimate for Buffalo's operating tax limit in the years 2004-05 through 2006-07. The more optimistic limit of the range is based on a projected five-year average full valuation provided by ORPS, which shows a modest increase between one-third of one percent and one percent. The more conservative estimate assumes no growth in full valuation, which is not unreasonable, given that full valuation has declined in each of the last four years.

Our estimate of a reasonable property tax projection for Buffalo is based on our projection of the tax limit, as well as an assumption that the City would not tax up to the absolute dollar level of its limit, but would have to preserve some comfort level in the tax margin, such as 10 percent (to be reasonably conservative), or at the very least, five percent (at the optimistic edge of the range). Our range of estimates differs from the Mayor's projections by between \$7 million and \$19 million in 2004-05, between \$9 million and \$22 million in 2005-06 and between \$15 million and \$29 million in 2006-07.

Our estimates are based on the proposition that that the City could not prudently set its tax levy to the full amount of its tax limit, because there are too many uncertainties in the

calculation of the limit each year, including fluctuations in five-year average full valuation, equalization ratios, assessments, and exclusions to the tax limit. In fact, the City has not exhausted more than 90 percent of its tax limit in the last decade. However, even if we assumed the City could use 100 percent of its limit, the Mayor's projections would exceed that limit in 2004-05 (although by a smaller amount).

Obviously, it is not prudent to base future plans on levy amounts that may exceed a tax limit, as the City could then run up against its tax limit and face the potential loss of state aid, as state law provides. Further, the City of Buffalo's lack of tax margin was described by Moody's as one of the major factors behind its placement of the City on a negative credit watch. Credit analysts view the loss of tax margin as very important to financial viability, particularly when a local government has little flexibility to increase other revenues.

Officials in the Mayor's Office are aware that the property tax levies they have projected for Buffalo are above the likely tax limit for the City. They have characterized the property tax levy shown in their projections as a balancing figure, intended to bring the projected years' budget gaps to zero. In a written explanation, the Mayor states that he is prepared to ask the State to raise Buffalo's constitutional tax limit from 2 to 2.5 percent. Currently, only New York City has a 2.5 percent limit, while other cities with a population over 125,000 have a 2 percent limit. A change in the tax limit for Buffalo, aside from the question of whether it is economically sustainable, would require an amendment to the State Constitution. Such an amendment would require passage by two separately elected state legislatures before being placed on the ballot for voters statewide. Therefore, the amendment could not be put before the voters until 2005, and if ratified by the voters, would take effect for 2006-07. Under the City's projections, Buffalo would exceed its limit in 2004-05.

Sales Taxes

Buffalo's sales tax projections for 2003-04 assume growth over actual 2002-03 receipts of 1.3 percent. This rate may be reasonable, even if it is more optimistic than Erie County's projection for 2003 of zero growth. However, the City's assumption of 3 percent growth for the 2004 to 2007 period does not appear to be realistic given the expected population decline and poor economic climate. Erie County, for example, is expecting growth below 2 percent during this period. New York State, in its out-year projections is expecting overall sales tax growth near 3 percent for a portion of this period. However, Erie County taxable sales have generally lagged those of the State as a whole, growing at roughly one-third of the rate of New York State taxable sales (based on the most recent published data, prior to the introduction of an exemption on clothes sales, which Erie did not opt into). A reasonable projection for out-year growth would be 1.3 percent (which is identical to the growth rate the City is using for 2003-04 receipts). Zero growth is also a distinct possibility, and represents the more conservative range of our projection.

Pension Contributions

The City's estimated pension contributions were based on limited information available earlier in the year, prior to passage of the Comptroller's reform package; they appear to reflect an unrealistic expectation that pension contribution rates could be frozen at a low level. Based on the current law, and assuming that Buffalo avails itself of the option to amortize pension contributions in excess of 7 percent of salary over the next several years, we estimate that the City will need between \$22 million and \$24 million more by 2006-07 than it has planned on in its projections.

Police Restructuring

The tentative police contract and restructuring plans are described in detail in a preceding section of this report (2003-04 Budget – City). As described there, a key consideration in the cost of police services in the out-years is whether the planned levels of attrition are attained. The Mayor's projections assume a reduction in the number of police officers from the current 877 to 675, with 60 officers leaving in 2003-04, 60 in 2004-05 and 82 in 2005-06. This plan is based only on assumptions about the numbers of officers that will choose to retire or otherwise leave service, as the City has no means under the contract to compel separation. While the City's attrition assumptions may certainly be attainable, we calculated the impact of a more conservative attrition assumption: that 60 officers will leave in 2003-04, 50 in 2004-05, 40 in 2005-06 and 30 in 2006-07 (this would result in a total reduction in force by 2006-07 of 180, rather than 202). This more conservative scenario could result if attrition numbers drop off after an initial surge in retirements, because the substantial salary increases provided over the term of the tentative agreement may well induce many officers to stay. Our attrition assumptions also include officers leaving throughout the year (rather than all at the start of the year). These more conservative assumptions produce variances from the Mayor's projections of \$3.1 million in 2004-05, \$6.7 million in 2005-06 and \$3.6 million in 2006-07. These variances are included in our more conservative estimates; the more optimistic projection assumes only a slower startup in the Mayor's attrition assumptions.

Fire Restructuring

The Mayor has outlined a variety of changes desired for the Fire Department, but these changes are at this point only a general plan. No tentative contract has been negotiated with the firefighter's union, and the City is awaiting a consultant's report on re-engineering in this area. The strategies described for Fire Department re-engineering include:

- A change in fire attack strategy, permitting closure of fire companies. Although there are no definite plans, there has been discussion of closing six companies at 20 firefighters per company. This would allow for a reduction of 120 firefighters over time. Like the police reduction in force, this would probably be accomplished through attrition.

- Changes in practice, new fees and additions to firefighters' duties creating additional revenue streams. City managers believe that firefighters can train for and perform additional services, including providing advanced life support (ALS) during medical transport, providing medical transport itself (a function now handled entirely by ambulance companies) and also taking over routine building and fire safety inspections (allowing a staff reduction among building inspectors). This plan is based on an earlier consultant's report that used changes in the City of Albany as the model.

The City's projections assume that the firefighters receive parity raises similar to police, although with a smaller lump sum adjustment in 2003-04, and agree to the duties and staffing changes outlined above. At this point, however, there is no agreement with the firefighters, or even a tentative agreement, but there are already some areas of contention, most notably the size of the lump sum adjustment.

As an alternative to the City's projections, we calculated the impact of no reductions in force for the Fire Department, with annual raises of 2.25 percent (similar to previous arbitration awards). We also removed the savings projected from reducing the number of building inspectors. These assumptions produced a variance of \$3 million in 2004-05, which we used in both our conservative and optimistic estimates, because of the extremely tentative nature of the discussions. In 2005-06 our no-attrition projection produced a variance of \$5.8 million, and in 2006-07, \$6 million. For those two years we used the assumption for the optimistic scenario that only a portion of the variance would occur.

Fire Department Revenues

The Fire Department restructuring proposals face a variety of legal and collective bargaining hurdles, and may not come to pass. The proposals include plans to train more firefighters to provide Advanced Life Support (ALS), which is the continuing support sometimes provided during medical transport, after first response services, and to bill insurance carriers and Medicaid for ALS services beginning in 2004-05; plans for the firefighters to take over routine building inspections for fire safety and rental certificates of occupancy, beginning in 2005-06; and essentially having the Fire Department take over ambulance services now provided privately beginning in 2006-07. The City's revenue estimates are based upon:

- ALS: 19,000 ALS calls annually at a reimbursement rate of \$75 for an estimated \$1,425,000/year revenue stream, with net revenues after costs of \$1.1 million; the anticipated start year for this initiative is 2004-05.
- Building Inspector Initiative: the City anticipates having firefighters performing 27,000 inspections annually and instituting a \$75 per inspection fee. This projection anticipates that firefighters will perform a greater number of inspections than the current building inspectors, as certificates of occupancy will be required for all rental units, not just apartment buildings. The plan is to inspect

all residences every three years at a fee of \$75 per residence, generating \$2 million annually, starting in 2005-06. Net annual revenues, after costs, are expected to be \$1.2 million.

- Medical transport: plans call for the Fire Department to take over transportation services now provided by ambulance companies, charging a fee of \$280 for 29,000 calls, producing an estimated revenue stream of \$8 million. This initiative faces substantial legal, as well as collective bargaining hurdles.

Health Insurance Costs

The City's projections for health insurance costs assume \$4.3 million in savings, beginning in 2004-05 that we do not believe are attainable. The savings are loosely based on an idea from a study by the Buffalo Niagara Partnership: that savings could be achieved if the lowest cost health plan was made mandatory for all City employees, except police and fire. Such savings can only occur if changes in health care coverage are negotiated with the City's collective bargaining units, and are therefore not likely to be realized within the time frame projected. Additionally, the City estimates that costs will escalate by 10 percent annually after 2004-05. While 10 percent increases may be attainable, there is anecdotal evidence of increases in the range of 20 percent, and 15 percent would be a more conservative figure to use. Our projections are also based on assumptions about the number of persons no longer requiring coverage each year (through death or separation from employment) based on historical trends and no additional hires. We were not able to examine the City's assumption in these areas. Our assumption of no new hires is somewhat optimistic, even given the City's fiscal situation and budget plans. Our optimistic projections assume costs increase by 10 percent annually, as the City expects, but that the \$4.3 million initial reduction does not occur. Our conservative estimate is for 15 percent growth in costs.

Board of Education Budget

The City's long-term projections contain no increase in funding for the Board of Education. The City's total tax levy contribution to the schools in 2003-04 will be \$68.7 million – an increase of \$2 million from the previous year, but an amount \$1.4 million lower than what was provided in 1998-99. The City's assumption of no increase being needed in funding can be viewed as extremely optimistic, particularly in light of the following factors:

- The State's fiscal condition makes it extremely unlikely that Buffalo will see the large school aid increases it has in the past, which have essentially allowed the City to maintain a relatively low contribution for its schools. For example, the City's contribution in 1985-86 was \$54.3 million; indexed for inflation, this would amount to \$93 million – meaning there has been a decline in real terms in City support greater than 25 percent.

- Buffalo's schools have endured staff reductions of nearly 1,400 since 2001-02, and the remaining staff of 3,650 is very thinly spread, leaving little room for additional reductions in force.
- Buffalo, like other large cities, has severe educational problems, and is facing an enormous task in attempting to bring its students to the higher standards imposed by the State Board of Regents. The Commissioner of Education has recently criticized the educational results being achieved within the Buffalo school system.

At our request, the Buffalo Board of Education prepared a multiyear budget plan, which attempted to project budget needs for the years 2004-05 through 2006-07. These needs were based on a scenario likely to underestimate the size of the gaps. It includes no additional cost of living raises for teachers after the union contract expires on June 30, 2004; teachers' retirement costs accelerating by 10 percent annually after 2004; and annual increases in state aid of 3 percent. Even with these assumptions, the Board projects it will need an additional \$43 million in annual support from the City by 2006-07.

Debt

Like other large cities in New York State, the City of Buffalo is subject to a debt limit imposed by the State Constitution. Under this limit total outstanding debt, including school district debt, may not exceed nine percent of property value, which is measured by a five-year average full valuation of taxable real property.

Certain types of debt may be excluded from the debt limit calculation, including short-term debt such as tax anticipation, revenue anticipation, and budget notes. Other types of debt may also be excluded, such as debt issued for water supply and sewage systems and self-liquidating debt. Also, the Joint Schools Construction Board is now authorized to finance school construction and rehabilitation projects through the Erie County Industrial Development Agency or the Municipal Bond Bank Agency. Because it is carried out by other agencies, this borrowing will not be charged against the City's debt limit. In addition, the Governor's proposal to allow special borrowing through the Municipal Bond Bank Agency, were it to take place, would not be included.

As of January 1, 2003, the debt limit for Buffalo was \$475 million with net indebtedness, after exclusions, of \$388 million or 81.7 percent of the debt limit exhausted. This calculation does not include \$79 million in additional borrowings that were authorized but not issued at that time.

To minimize any disruption in the City's annual budget process, this review was prepared under a tight timetable. A thorough review of the City's current and proposed borrowings by the City and school district was not possible. However, it is noteworthy that in his long-term projections, the Mayor assumed there would be no new debt issuances.

A new oversight board as recommended by the Comptroller (see the following section) can thoroughly review the City's debt program to ensure that it is being carried in a manner consistent with the City's financial plan. In addition, the City needs to systematically catalogue its assets to determine their current valuation and whether the City's continued ownership interests are essential to maintain services.

CONCLUSIONS AND RECOMMENDATIONS

This budget review concludes that Buffalo is not currently in a position to address its continuing budgetary imbalance. The Mayor's restructuring proposals, though they move in the right direction, may not produce all the savings or revenues he projects and they may not be implemented. Moreover, even if his proposals are implemented and successfully produce the savings projected, those savings would not be sufficient to overcome the City's chronic and worsening mismatch between expenditures and revenues. With a worsening fiscal crisis and a City budget that can only be kept afloat by extraordinary temporary measures, it is evident that a new approach must be taken to restore fiscal integrity.

For the City to expect significant participation in its financial affairs from the State in the long run it must adopt financial plans and practices that begin to bring recurring revenues in line with recurring expenses.

The Comptroller's recommendations address two questions:

- Does the City need additional state temporary financial assistance in order to achieve budget balance in 2003-04? If so, what is the level of the City's need?
- What should be the role of the State in determining how assistance is to be provided this year and beyond?

I. Buffalo's Need for Assistance

- Pursuant to the recently enacted state budget, the City should be provided with \$20 million in state aid "spin-up" resources. The funds should be applied to re-engineering efforts and other initiatives to assist the City in bringing recurring expenses in line with recurring revenues.

A portion of this \$20 million should be set aside to cover the first year costs for the Oversight and Recovery Board (as recommended below), including staff and overhead (an estimated \$1.5 million).

II. City of Buffalo Oversight and Recovery Board: Composition, Powers and Financing

The Comptroller recommends the creation of a new financial oversight and reform mechanism to ensure that effective long-term restructuring takes place in Buffalo. With this review, the Comptroller is presenting legislation to establish for the City of Buffalo an Oversight and Recovery Board for the City's finances. The Board should have strong powers to be exercised during an "oversight period" but designed to help bring about lasting reforms that improve the quality of life for all residents of the Buffalo region.

These powers should be similar to those given to boards established to oversee finances in New York City, Yonkers, Troy and Nassau County,

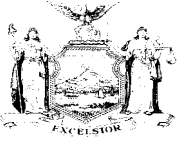
This exercise of extraordinary state powers must be carried out in a manner that preserves the ability and authority of city officials to determine programs and expenditures within available resources. A credible and comprehensive plan to restore Buffalo to fiscal health must include local actions as well as state assistance and oversight.

- The Comptroller recommends that the Board have seven voting members: the Governor, who serves as Chair, the State Comptroller, the Erie County Executive, the Mayor of Buffalo, the City Comptroller, the Speaker of the Assembly and the Majority Leader of the Senate, or their designees.
- To provide for broader local involvement, the Board should also have several non-voting participants: the President of the Buffalo Common Council, the Chair of the Erie County Legislature, a representative of the school system, and a representative of each of the following: the business community, unions, and the not-for-profit/social services community.
- The Board should have an Executive Director appointed by the Governor who would be responsible for hiring staff to carry out the Board's responsibilities.
- The Board would have approval authority over a required four-year financial plan to be submitted by the Mayor, would prescribe its form and could, where appropriate, require modifications in the plan. The mayor would be required to submit the first such plan early in the second quarter of the City's 2003-04 fiscal year. City budgets would be required to be consistent with the plan, and revenue estimates would have to be certified by the Board. These powers would exist only during the "oversight period" lasting from the effective date of the act until the Board determines that the City has had three consecutive years of budgets with no deficits (without using MBBA financing), and has market access.
- In a provision similar to the Governor's proposal, the City would be allowed to borrow through the Municipal Bond Bank Agency over the next several years. However, borrowing would be allowed only at times and for amounts authorized by the Board. The borrowing could only be used as a transitional tool to allow realistic long-term actions to bring recurring expenses in line with recurring revenues. The terms would be set by MBBA in consultation with the Board but would not exceed a 20-year repayment term.
- During the "oversight period," the Board would have approval powers over all contracts and borrowings, as well as disbursements. The Board may also freeze future wage increases in the event of a Board declared fiscal crisis.

- The Comptroller's recommended legislation requires that the City postpone ratifying any major new contracts until the Oversight Board can review them. It specifies that:
 - No contract or other obligation pending or proposed prior to the approval of the first financial plan and involving an expenditure exceeding \$50,000 shall be approved by city officials, and no liability shall be incurred or appropriation encumbered to fund any such contract or other obligation, unless the Board affirmatively determines that the obligation is affordable within the resources available.
 - If the Board has not yet convened its first meeting, the Governor would be responsible for approving pending contracts or obligations.
- The Board is authorized to review the operations of the City and its covered organizations and make recommendations for management improvements including, but not limited to, reports on potential cost savings and service improvements through intermunicipal cooperation and consolidation and other reforms of the City's relationship to current stakeholders.
- The Board is given authority to access all the books, records and other financial documents of the City and Board of Education necessary to carrying out its oversight responsibilities. This authority includes access to necessary staff of the City and the Board of Education.
- Once the oversight period is ended, the Board would continue operation as a fiscal monitor for up to five years, unless conditions emerge causing a reinstatement of the oversight period (if Buffalo has a deficit of one percent or more, loses access to the credit market or fails to pay debt service).

The purpose of this legislation is to empower the Mayor and his team to reach a new level of fiscal discipline. Further, the reforms will create greater certainty and transparency in City financial affairs, allow the Mayor and Council to identify and react to budget changes more quickly, and instill a higher level of confidence in Buffalo by all of its stakeholders. The Board and its staff will be required to assist the Mayor in this undertaking. The Board's operational purpose will be to bring the fiscal and political will needed to achieve structural balance in the City's finances and launch the City of Buffalo into a brighter future.

Appendix



SHELDON SILVER
Speaker

THE ASSEMBLY
STATE OF NEW YORK
ALBANY

Room 932
Legislative Office Building
Albany, New York 12248
(518) 455-3791

May 6, 2003

Honorable Alan Hevesi
Comptroller, State of New York
110 State Street
15th Floor
Albany, New York 12236

Dear Comptroller Hevesi:

The City of Buffalo is clearly faced with substantial fiscal problems. The legislature recognizes those problems and has provided for a \$20 million early release of state aid in an effort to assist the City. This assistance will enable the City to address some of the restructuring of services issues that it has endeavored to accomplish.

I am requesting that you review the City finances. I believe that the legislature would benefit from your thorough review of the current budget, potential budget gaps, trends in disbursements and receipts, fiscal capacity, and financial management. I would urge you to assemble a team to closely examine current practices.

I believe that the situation in Buffalo must be addressed with openness, candor, and seriousness of purpose. It is imperative that everyone has the best information possible prior to making decisions about the role of the state in assisting the City of Buffalo. Your office is uniquely situated to provide that information. I am certain that your assistance will be welcomed by the City of Buffalo and that you will have their full cooperation.

I look forward to your review and ask that you make the information available to all the elected officials in Buffalo and here in the state Capitol.

Sincerely,



Sheldon Silver

cc: Honorable Brian Higgins
Honorable Sam Hoyt
Honorable Crystal Peoples
Honorable Paul Tokasz
Honorable Anthony Masiello