BUFFALO FISCAL STABILITY AUTHORITY

BFSA

Review of Four Year Financial Plan

September 16, 2003

BUFFALO FISCAL STABILITY AUTHORITY

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EXECUTIVE SUMMARY

Introduction

In July 2003, in response to the State Comptroller's assessment and report, the New York State Legislature determined that the City of Buffalo was faced with a severe fiscal crisis, one that could not be resolved without the assistance of the State. The Legislature found that the City's fiscal condition threatened the provision of services to residents and the well-being of the region and State as a whole. The City had repeatedly relied on extraordinary annual increases in State aid to balance its budget, and the State concluded it could no longer take such actions on the City's behalf. Declaring the maintenance of a balanced budget by the City of Buffalo a matter of overwhelming State concern, the Legislature passed the Buffalo Fiscal Stability Act.

The Act created the Buffalo Fiscal Stability Authority (BFSA), and vested it with powers to review and approve spending of the City and covered organizations, and borrow money to assist them in closing their structural budgetary imbalances. The Authority was also vested with the power to review and vote on collective bargaining agreements, contracts, and all other proposed settlements in excess of $50,000.

The Buffalo Fiscal Stability Act required the City and covered organizations to provide the following to the BFSA in a modified 2003-04 budget and four-year financial plan:

- ❖ Budget gap details and recurring programs to eliminate the gap;
- ❖ Base year budget modifications and projections based on reasonable revenue and expenditure assumptions;
- ❖ Projected employment levels;
- ❖ Collective bargaining agreements and other actions related to employee costs;
- ❖ Capital construction spending
- ❖ Actions and funding related to federal and State mandates; and
- ❖ Provisions for adequate reserves, including a reserve unpaid taxes, and cash resources to meet ongoing needs.

The City and covered organizations submitted their financial plan on September 2, 2003. After careful review of each of the proposals included in the City, School District and covered organizations' programs to eliminate the gap, the Authority is unable to approve the current plans on the following bases.

City of Buffalo Financial Plan

- ❖ Information provided to date does not enable the Authority to complete a thorough, fair and accurate assessment of the implications of its proposals.

- ❖ Reliance on additional County sales tax revenues in each year of the plan does not conform to the standard of reasonableness the Authority set for revenues and expenditures last month.
- ❖ The Authority believes the attrition assumptions presented in the police contract are uncertain, and that the contract will serve to drive up pension costs beyond the City's ability to pay.
- ❖ The Authority disagrees that additional functional responsibilities justify firefighter wage increases, particularly as these other responsibilities are already being performed without the increased cost and because retirement/disability payments will drive costs of such a settlement beyond the City's estimates.
- ❖ Wages, fringe benefits and head count are inextricably linked and to a great extent accountable for spiraling municipal costs resulting in structural budgetary imbalance. This issue must be addressed further in the City's plan.
- ❖ The financial assistance the Authority is empowered to provide to the City is contingent on its being part of a balanced financial plan and the City's declaration of need for it. Neither of these conditions has been met, making such a borrowing impossible at this time.
- ❖ The nature of the City's budget gap is truly structural, with the size of projected gaps overwhelming even the City's optimistic outside revenue assumptions beginning in the plan's final year. The City's plan does not yet sufficiently address the structural factors of the imbalance.
- ❖ While it is not the responsibility of the BFSA to lobby for changes in State or local regulations on the City's behalf we acknowledge that these changes are critical to the long term fiscal stability of the City. The Authority encourages the City to work on its own, and together with other groups to achieve mandate relief and reforms to other policies that constrain its ability to ensure cost-effective government management.

School District Financial Plan

- ❖ The District acknowledges the plan's inability to provide for the basic educational needs of the children of the City.
- ❖ Information provided to date does not enable the Authority to complete a thorough, fair and accurate assessment of the implications of its proposals.
- ❖ Reliance on additional County sales tax revenues, additional State aid and additional City revenues in each year of the plan does not conform to the standard of reasonableness the Authority set for revenues and expenditures last month.
- ❖ The School District does not detail or provide financial impact estimates for management actions it indicates it has already taken in the interests of efficiency.
- ❖ Wages, fringe benefits and head count are inextricably linked and to a great extent accountable for spiraling municipal costs resulting in structural budgetary imbalance. This issue must be addressed further in the School District's plan.
- ❖ General themes of financial mismanagement, inadequate oversight, fragmented record keeping and poor accountability continue to pervade outside audits and reviews of District processes, and the District has not sufficiently addressed these issues in its plan.

Housing Authority and Urban Renewal Agency

- ❖ In both cases, information provided to date does not enable the Authority to complete a thorough, fair and accurate assessment of the implications of its proposals.
- ❖ In both cases, the Authority considers the plans proposed to close the structural imbalances to be inadequate and devoid of actions capable of generating recurring savings.
- ❖ In the case of BURA, the Agency acknowledges that revenues it would depend on to close its gap likely will not materialize.

Recommendation

The Authority hereby requests the City, School District and covered organizations to submit modified financial plans by October 1, 2003, consistent with the State legislation that created the BFSA. The areas of the financial plans the Authority is particularly concerned with are detailed in this report. This report should serve as a guide in the revision of the City, School District and covered organizations' plans, directing attention to issues which the Authority believes require further discussion and development.

We strongly encourage better collaboration/cooperation/coordination among the Mayor, School District and City Comptroller's Office. This effort is essential to reduce the amount of short-term cash flow borrowing, implement investment policies and assure the maximum gain and availability of funds when needed.

BFSA insists that trend information be provided over the previous <u>three</u> years through the years of financial plan with the quarterly report due on February 1, 2004. BFSA expects revenue and expenditure trends by major category within funds. Since this information is vital to the achievement of structural budgetary balance, BFSA requests that the Mayor also provide a summary of this information which includes the City and the three covered organizations currently reporting to the BFSA. The analysis of such trends will enable an understanding of the City's financial situation as a whole and enable better planning for the future. BFSA encourages the City and the County to begin an expedited process to assess opportunities for savings, inefficiencies and enhanced service provision. The Authority will welcome progress reports on this effort

BFSA staff will be available to work with those in the Budget offices of the City and covered organizations to ensure adequate budget modifications can be made by the October 1 deadline.

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BUFFALO FISCAL STABILITY AUTHORITY OVERVIEW

The population of the City of Buffalo has declined by 35,475 or 11 percent over the period 1990 – 2000 (an average of 295 people per month). Since 1997-98, the taxable assessed value has declined by $2.8 billion. These dramatic statistics should be viewed in the context of a City which has increased its property tax levy by nearly $9 million in the current fiscal year, has entered into an extraordinarily rich contract with one union and is proposing a similar contract with another. It should come as no surprise that the State Legislature asked the State Comptroller to dispatch an experienced team of local auditors to the City to assess the City's fiscal condition.

In response to the State Comptroller's assessment and report, in July 2003, the New York State Legislature concluded that the City of Buffalo was faced with a severe fiscal crisis, one that could not be resolved without the assistance of the State. The Legislature found that the City's fiscal condition threatened the provision of services to residents and the well-being of the region and State as a whole. The City had repeatedly relied on extraordinary annual increases in State aid to balance its budget. The State found it could no longer take such actions on the City's behalf. Furthermore, the Legislature declared that maintenance of a balanced budget by the City of Buffalo was a matter of overwhelming State concern.

Therefore, the Legislature intervened to provide a means where the long-term fiscal stability of the City would be guaranteed, the confidence of investors in the City's bonds and notes could be assured, and the economy of both the region and the State as a whole could be strengthened. The Buffalo Fiscal Stability Authority Act, (the "Act") was signed into law on July 3, 2003 as Chapter 122 of the Laws of 2003.

The Buffalo Fiscal Stability Authority (BFSA), as established by the State of New York, is vested with: control and advisory authority to oversee the City's budget, financial and capital plans; to issue bonds or other obligations to achieve budgetary savings through debt restructuring; to finance short-term cash flow or capital needs; and, if necessary, to develop financial plans on behalf of the City if the City is unwilling or unable to take the required steps toward fiscal stability.

Nine directors constitute the administration of the Authority. Seven were appointed by the Governor and will serve a term of four years. While the directors serve without compensation, they are reimbursed for actual and necessary costs incurred in performing their official duties. Five directors complete a quorum for the transaction of business and the exercise of power. Accordingly, no action can be taken without a favorable vote of at least five directors.

By force of the Act, the Authority immediately has "control powers" over the City. During the control period, the Authority has a wide range of powers, including: the power to limit the spending of the City or any covered organization; impose a hiring and/or wage freeze; periodically evaluate the suspension of salary or wage increases; and review and approve any collective bargaining agreement to be entered into by the City or any covered organization. The Authority may also act jointly with the City in selecting binding arbitration panelists and present information regarding the City's fiscal condition to the panel. BFSA may take any action necessary to implement the financial plan, review and approve contracts and require the City to undertake certain actions to advance serious in-depth explorations of mergers of services with Erie County. The Authority has the right of review and approval over all proposed settlements in excess of $50,000, and can perform audits and issue orders to City officials to accomplish the goals of the Buffalo Fiscal Stability Authority Act.

The control period will terminate once the City of Buffalo has achieved three sequential balanced budgets without financial assistance from the Authority and when the City is assured access to the financial market, at which point the City would operate under an advisory period. However, if the City should, at any point during an advisory period, fail to submit a reasonable financial plan, incur a budget deficit, or lose access to the financial market, a control period would be reimposed for a period not beyond June 30, 2037.

Under the Act there are specific expectations of the City of Buffalo, the School District, the Buffalo Municipal Housing Authority and other covered organizations. For the purpose of such expectations, by law, the term covered organization is defined to mean any governmental agency, authority, or public benefit corporation which receives or may receive monies directly, indirectly or contingently from the City. For the purposes of the City's first financial report, the Authority has determined to include Buffalo Urban Renewal Agency to those listed above.

The Act requires the Mayor to annually submit a four-year financial plan for the City, the School District and covered organizations. This plan must show that operating expenses do not exceed revenues for each fiscal year. In light of the enormity of the City's budgetary imbalances, the Act provides an opportunity for the City to take advantage of funds from the issuance of BFSA bonds as a supplement to the actions the City itself takes to produce recurring savings and facilitate budgetary balance.

In order for the City to take advantage of the borrowing assistance from BFSA, the following conditions must be met:

- The City must adopt, and the Authority must approve, recurring actions to close the City's budgetary gap in the following proportions:

    - 35 percent to 40 percent in 2003-04;
    - 45 percent to 50 percent in 2004-05;
    - 60 percent to 65 percent in 2005-06; and
    - 80 percent to 85 percent in 2006-07.

- The Mayor, with Common Council concurrence, must issue a declaration of need for financing assistance to the City, consistent with the adopted budget and financial plan.

- The Authority must approve the financing and enter into related agreements with the City by the Mayor and approved by the Common Council.

The amount of financial assistance that is available to the City at any one time is limited to a bond issuance cap of $175 million, although the Authority may refinance any Authority or City debt in any amount beyond that bond cap, subject to its discretion. These bonds are paid through BFSA's revenues: intercepted sales tax and State Aid to the City for the duration of the Authority's existence. From these resources, the Authority is required to: first, pay the debt service on its bonds; second, pay the Authority's operating expenses not otherwise provided for; and lastly, transfer the balance of revenues to the City. One year after the Authority first issues bonds, notes, or obligations, the Authority must report to the Common Council, City Comptroller, the Director of the Division of Budget, and the State Comptroller on the amount of financing and cost savings for the City over the past year.

In order to facilitate and accomplish the goals of the four-year financial plan and the Act, the Authority has the right to seek and request any information from the City to satisfy its review and approval process. The BFSA must evaluate the reasonableness of revenue and expenditure estimates to form a basis for approving or disapproving the City's financial plan. The Mayor is required to make fiscal projections on a quarterly basis and alter the City's financial plans as necessary. Since the Act prohibits the City from operating under a budget that is inconsistent with the approved financial plan, the Authority is required to impose its own plan if any financial plan, or modification, is not approved.

What the BFSA Act requires the City to provide

The BFSA Act requires the City to submit to the Authority a 2003-04 fiscal year budget modification and four-year financial plan. The Act requires that the financial plan be submitted for the City's major operating funds, including the City general fund, City enterprise funds, Board of Education special project funds and other relevant funds, including all grant funds (such as Community Development Block Grants) of the City or covered organizations.

For the initial plan, the Authority requested financial plan reports for the following covered organizations: the School District, the Buffalo Municipal Housing Authority and the Buffalo Urban Renewal Agency. Other covered organizations are defined by the Act to include the Joint Schools Construction Board and any other governmental agency, public authority or public benefit corporation which receives (or may receive) monies directly, indirectly or contingently from the City, excluding the BFSA and Public Employee Relations Board.

The BFSA Act defines the reporting requirements of the City and covered organizations to include submission of the following:

- Projected employment levels;
- Collective bargaining agreements and other actions related to employee costs;
- Capital construction spending;
- Actions and funding related to federal and State mandates; and
- Provision for adequate reserves, including a reserve for unpaid taxes, and cash resources to meet ongoing needs.

In addition, each entity is required to provide to the BFSA a report of summarized budget data – that is, projected revenues and budgeted expenditures – depicting overall trends, by major category within funds, for the entire budget. Since the people of the City of Buffalo experience the collective impact, the various financial plans independently developed by the City and covered organizations – through both the costs of services and the quality of service provision – BFSA is requiring the Mayor to provide a series of reports that detail the above information for the City and covered organizations collectively.

What BFSA has specifically requested from the City

Consistent with the BFSA Act, the Authority requested a 2003-04 budget modification and four-year financial plan from the City, the School District, the Buffalo Municipal Housing Authority and Buffalo Urban Renewal Agency. Through a combination of recurring actions and BFSA assistance over a four-year period, the objective of the plans is to restore structural balance to the City and its covered organizations.

For a financial plan to be complete and meaningful, it must include details on both the factors that resulted in the base gap *and* a program to eliminate the gap. The value of each item contributing to the gap must be indicated as a variance from the 2002-03 budget as modified, and the program to eliminate the gap (PEG) must be presented within the context of the City's adopted 2003-04 budget. New PEG proposals are required to include specific details on actions needed to implement those initiatives, as well as a value in the current and out-years of the plan.

As part of its plan, the City must also submit to the Authority current and out-year projections for expenditures, revenues and debt.

The City and the three covered organizations failed to provide the cash flow information required by the Act in a timely fashion for analysis to be included in this report. The City has maintained that cash flow projections fall under the responsibility and purview of the City Comptroller. Nonetheless, the Authority notes that the Comptroller relies upon the City and the School District to provide the necessary data for his reports.

In addition to cash flow submitted with the budget and budget modifications the City and School District are also expected to provide updated quarterly cash flow projections of receipts and disbursements with a comparison to those submitted with the budget. Any variation must be explained and include recommendations from the Mayor to the Common Council detailing remedial actions needed to resolve any unfavorable budget variance. Quarterly reports are due within 30 days of the end of the quarter. Further, the Authority insists that trend information be provided over the previous three years through the years of financial plan, commencing February 1, 2004.

While the Mayor's office, School District and City Comptroller have variously attempted to shift cash flow responsibility away from their own offices to the others, in reality each has a significant responsibility in its development, and the Authority will hold all three parties responsible for the cooperation necessary to ensure cash resources are available to pay the City's obligations. We strongly encourage better collaboration/cooperation/coordination among the Mayor's, School District's and City Comptroller's offices. This effort is essential: to reduce the amount of cost of short-term cash flow borrowings; to enable the implementation of investment policies to keep unused funds not only secure but invested to maximize yield; and to ensure the availability of funds when needed.

The other information that was notably absent from the plans provided by the City and all covered organizations was revenue and expenditure trends by major category within funds. This information is vital to the achievement of structural budgetary balance. It is the analysis of such trends which enables planning for the future. To the extent systems are not in place to produce this information, the City and covered organizations must put them in place immediately. BFSA insists that trend information be provided over the previous three years through the years of financial plan with the quarterly report due on February 1, 2004.

The "reasonableness standard"

It is essential that the financial plan of the City and School District, as well as those of other covered organizations, be based on reasonable revenue and expenditure assumptions. The reliance of the plans on unsubstantiated revenue or expenditure initiatives, or even unrealistic timeframes for implementing reasonable assumptions, brings an unacceptable level of risk to the financial plan. In order to minimize this risk and ensure the soundness of the financial plans, the Authority will hold all revenue and expenditure assumptions to a "reasonableness standard."

For BFSA purposes, unless the exact amount of a revenue line is known and verifiable, the amount estimated in the plan should be no more than the actual amount collected or accruable in the base year (the last completed fiscal year) or approved to be budgeted in the current fiscal year, whichever is less, unless justification can be provided to the Authority for some different amount. For expenditures, unless the exact amount of an expenditure for any item is known and verifiable, the amount estimated in the plan should be no less than the actual amount paid or incurred in the base year or the amount approved for appropriation in the current fiscal year, whichever is more, unless justification can be provided to the Authority for some different amount.

With this in mind, the Authority requires that the first-year of the plan be "iron clad" – all revenues and expenditures estimated therein must meet this standard of reasonableness to be approved. Revenues from the federal, State or County government greater than the amount received in the base year are therefore not acceptable for inclusion in the City or School District budgets, unless approved by the Authority for inclusion in the current fiscal year or certified by an agent of the federal, State or County government. In general, all actions – especially legal requirements such as federal, State, County and Common Council legislative authorization – must be in place prior to inclusion in the budget year for them to be considered for approval by the Authority.

At the same time, the Authority recognizes that some proposals which would require legislative changes, cooperative agreements or other multilateral actions are worth proposing and working toward. Introducing such initiatives into the out-years of the program to eliminate the gap may be appropriate. For this reason, it may not always be possible to certify all revenues and expenditures in the out-years of the financial plans. However, such proposals must necessarily be discounted in the plan due to their inherent risk. Therefore, alternatives must be included with the plan as a safeguard, should efforts to bring about implementation of the proposal(s) fail.

CITY OF BUFFALO FINANCIAL PLAN

The Budget Gap

The City and School District face recurring structural imbalances in their budgets. Growth in expenditures is outpacing revenues, creating annual deficits that are projected to intensify in the coming years. The City estimates its own deficit in 2003-04 to be $24 million.

The importance of defining the gap

Estimating the true value of the budget gap in the City and School District is a vital step in beginning to identify the scale of the structural imbalance both entities are currently operating under. Accurately estimating the base gap (and properly projecting the out-year imbalances) is a necessary step in determining: a) the efficacy of the City and School District programs to eliminate the gap; and b) the amount of BFSA aid that may be relied upon to close budget gaps.

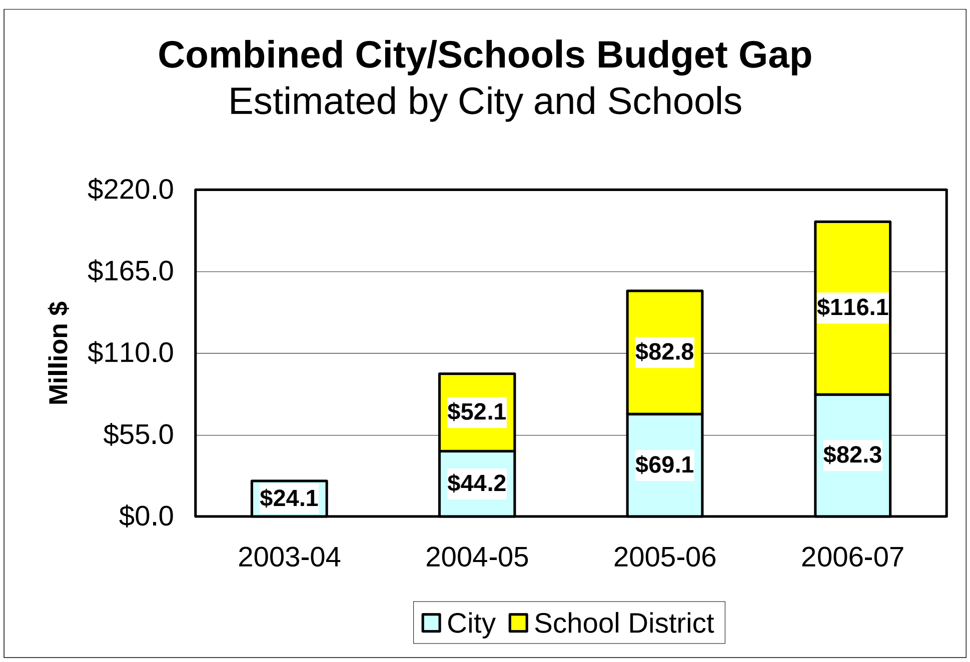
The Office of the State Comptroller noted the importance of accurately defining the gap in its May 2003 report:

"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 or 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."

City/School District estimates

The City and School District both note the presence of structural imbalances in their budgets and financial plans. The City currently estimates its gap to be $24.1 million in the 2003-04 fiscal year; $44.2 million in 2004-05; $69.1 million in 2005-06; and $82.3 million in 2006-07. The gap is projected to grow to $99.4 million in 2007-08.

The School District has closed its gap in the current fiscal year; and estimates its gaps to be $52.1 million in 2004-05; $82.8 million in 2005-06; and $116.1 million in 2006-07.



Together, the combined City/School District imbalance is projected to reach $24.1 million in 2003-04; $96.3 million in 2004-05; $151.9 million in 2005-06; and $198.4 million in 2005-06.

City Initiatives to Close the Gap

The City presents a series of actions in its program to eliminate the gap, including the introduction of additional County sales tax revenues; the use of State aid to reengineer the police department and implement a new fire initiative; and proposals to merge a number of functions with Erie County, specifically audits, assessment, purchasing and maintenance of the City's parks and recreation programming.

Sales Tax

One of the major components of the City's plan is to assume a sales tax sharing arrangement with Erie County that is considerably more favorable to the City than the current arrangement. The City plan cites the Office of the State Comptroller in pointing out that the City and the Buffalo Public Schools receive 19 percent of County sales tax proceeds, while Rochester and Syracuse receive 34.12 percent and 37.74 percent, respectively. The City contends that a more favorable sharing arrangement regarding the additional one-cent County sales tax, which Erie County currently retains exclusivity over, would enable it to close its budget gap in the current year and significantly reduce budget gaps in the out-years.

The City's sales tax proposal would increase revenues by as much as $62 million in 2004-05, although the City's plan uses "only enough to balance" the budget gap in each of the plan's first four years.

Health Insurance

Health insurance represents a large portion of the City's budget. The City's 2003-04 budget modification proposes a modest adjustment of current benefits. The plan would have the City continue to pay 100 percent of the lowest cost plan, while employees would pay 100 percent of the difference between the cost of this plan and any other higher cost plan they elect. If all City unions accepted this plan for active employees during the next open period, the City estimates, 2004-05 savings could reach $3.5 million.

Functional Reengineering

Among a series of unilateral actions to help close the gap is the City's proposal to reengineer the police department and fire services. The current police contract requires the institution of one-officer cars, shift schedule changes, providing more exempt supervision and the elimination, through attrition, of 202 sworn personnel. In exchange, the City has agreed to increase officers' base salaries by $5,000 and to provide annual raises of 3.4 percent on July 1, 2003 through and including July 1, 2006 and refrain from laying off any police personnel during the five-year term of the contract.

The City's plan to restructure the fire department (still being negotiated with the union) includes permanently closing and eliminating 5 fire companies; constructing 4 new fire stations and consolidating some existing companies at the new facilities; eliminating at least 136 positions through a reduction in the number of firefighters assigned to ladder companies; and increasing base salaries by $3,500 as part of a plan to certify firefighters as Emergency Medical Technicians. The plan would provide for an additional $1,500 base salary increase for approximately 56 firefighters to receive training as Advanced Life Support paramedics.

As part of the fire proposal, the City estimates generating annual revenues of more than $232,000 as of 2004-05 for medical transports by a private ambulance company, with firefighters trained as paramedics stabilizing patients prior to transport. The revenues would accrue from the City charging the ambulance service provider $75 per transport.

The City also proposes to cross train firefighters as building inspectors: "Fire companies that are not responding to calls will be in the field performing building inspections in their respective Districts. The entire company with fire apparatus will go into the field so that if a call comes in, they will be able to respond immediately." The City estimates this plan would enable a reduction of 12 building inspectors and 1 chief building inspector, and increase inspection activity revenues by $400,000 annually.

In addition to police and fire restructuring, the City's plan includes privatization of towing and storage operations. This would result in the elimination of 8 positions, and generate savings estimated by the City at $49,000 in the first year and as high as $146,000 in 2006-07. The City estimates one-shot revenues of $1.4 to $1.7 million through the sale of its Tonawanda Street auto impound facility.

Functional Mergers with Erie County

The City's multi-year financial plan also calls for the merger of several functional responsibilities with Erie County.

-- Audit and Control

The City proposes to partially adopt a consolidation plan developed by the Erie County Comptroller in 2003. The City's plan would abolish its Department of Audit and Control, with the County Comptroller assuming the function. Minus contractual costs, the City estimates savings of $277,000 in 2005-06 and $286,000 in 2006-07 through the elimination of 17 positions.

-- Assessment and Collections

The City proposes to merge its Department of Assessment and Division of Collections, in part, with Erie County. It also calls for the County to guarantee the City's tax levy as it does for towns, thereby enabling the City to eliminate staff in its Collections Division. The plan assumes after-contractual cost savings of $417,000 in 2004-05, increasing to $512,000 in 2006-07.

-- Purchasing

The City proposes to merge its purchasing function with the County, enabling an elimination of 5 positions and generating recurring savings (after contractual costs) ranging from $60,000 in 2004-05 to $76,000 by 2006-07.

-- Parks and Recreation

The City proposes consolidating all City parks, including neighborhood parks and playgrounds, into the County parks system. As part of this initiative, the City would consolidate and reduce the number of recreation centers it operates, and privatize the three City ice rinks. In addition, the City would close 7 outdoor pools and 1 indoor pool. The City estimates first-year savings of this initiative at $435,000 for recreation and $1.58 million for parks. By 2006-07, recurring savings are estimated at $505,000 and $1.95 million, respectively. The initiative would eliminate 29 positions.

-- Other Initiatives

The City plan proposes a series of additional initiatives as part of its program to eliminate the gap. They include: increased County payment to the City for maintenance/plowing of County roads within the City; further exploration of the long-term implications of a water system merger; mandate relief, particularly regarding the Taylor Law; a revised State pension contribution framework for public employees; an enhanced residency requirement for City employees; and Smart Growth policies.

BFSA Review of City's Program to Eliminate the Gap

The City was required to submit its 2003-04 budget modification and four year financial plan by September 2, 2003 and the Authority was required to respond to this submission by September 16. The Buffalo Fiscal Stability Authority has found that the financial plan submitted by the City is unacceptable according to the guidelines established in the BFSA Act, in that major elements of the plan were incomplete and, based on the information that was provided, revenues and expenditures were not found to be based on reasonable and appropriate assumptions. The basis on which the plan was determined to be unacceptable are detailed below.

Incomplete information provided to assess implications of proposals

The BFSA Act explicitly notes that the City is required to submit a comprehensive financial plan. The Authority is empowered to disapprove a financial plan on the following grounds:

"(If) such plan (i) is incomplete; (ii) fails to contain projections of revenues and expenditures that are based on reasonable and appropriate assumptions and methods of estimations; (iii) fails to provide that operations of the City and the covered organizations will be conducted within the cash resources available; or (iv) fails to comply with the provisions of this title or other requirements of law." (Public Authorities Law §3857)

As part of the financial plans the City and its covered organizations were required to submit via the BFSA Act, the Authority requested information from the City and covered organizations vital to its review and approval responsibilities, including the following:

- Projected employment levels;
- Collective bargaining agreements and other actions related to employee costs;
- Capital construction spending;
- Actions and funding related to federal and State mandates; and
- Provision for adequate reserves, including a reserve for unpaid taxes, and cash resources to meet ongoing needs.

In addition, each entity is required to provide to the BFSA a report of summarized budget data – that is, projected revenues and budgeted expenditures – depicting overall trends, by major category within funds, for the entire budget. Cash flow projections of receipts and disbursements on a monthly basis must also be submitted.

In particular, information has not yet been provided to BFSA detailing the provision of adequate reserves (as required by the Act); cash flow projections; plans for the City's enterprise funds; personnel totals and projections on an aggregate and departmental basis; and electronic budget information required to complete a proper and thorough review of the City's financial plan.

The information which, according to the Act, must be submitted to BFSA is required, not only to allow for BFSA's complete analysis of the City's budget and financial plan, but more importantly as critical tools for the City to develop and manage its budgetary and financial planning functions for operating and capital purposes, and for ensuring sufficient funds are available on a daily basis for necessary payments. The City's inability to deliver this information in a timely fashion (even with the requirements detailed in law readily available for the review of local officials and staff since July 3, 2003), illustrates the insufficiency of City systems to address the immediate budgetary and long-term financial issues the City faces. BFSA must insist that the City take whatever immediate steps are necessary to make the required information available now, and on an ongoing basis.

The Authority will continue to require the City and School District to comply with the legal requirement that they provide expenditure, revenue and cash flow projections on a monthly basis, along with the budget. These projections must be accompanied by a certification that the budget is balanced within the submitted financial plan and that operations will be conducted within the City's available cash resources.

Reliance on additional sales tax revenue

BFSA believes it essential that the financial plan of the City and School District, as well as those of other covered organizations, be based on reasonable revenue and expenditure assumptions. This will serve to minimize the risk introduced into plans for closing the base gap in the current and out-years of the plans.

Consistent with the reasonableness standard outlined previously, unless the exact amount of a revenue line is known and verifiable, the estimated amount should be no more than the actual amount collected or accruable in the base year (FYE 2002) or approved to be budgeted for in the (then current) fiscal year when a budget is being developed (FYE 2003), whichever is less. Similarly, unless the exact amount of an expenditure line is known and verifiable, the estimated amount should be no less than the actual amount paid or incurred in the base year or the amount approved for appropriation in the current fiscal year, whichever is more.

The reasonableness standard is absolute for the plan to close the gap in the current year, with the Authority requiring that year's expenditure and revenue assumptions to be ironclad.

The City has proposed revenues from additional sharing of the fourth cent of the County sales tax as its primary means for closing the current year budget gap – assuming an additional $16.5 million from that source this year. The current combined City and School District share, of County sales tax totals 19.07 percent. Beginning with the first year of the plan and extending to all out-years, that share is assumed to increase to a combined 34.12 percent. The inclusion of this revenue as a component of the program to eliminate the gap, particularly in the current year, runs counter to the Authority's reasonableness standard.

Absent any approved written agreement to alter the current County sales tax sharing arrangement, the amount of County sales tax projected into the current-year plan is not permitted to exceed the total amount of County aid from 2002, or the amount budgeted in 2003. Further, in order for this revenue to be included in any of the plan's out-years, an agreement to alter the current relationship would need to be in place prior to the adoption of that year's budget.

Given that County sales tax is an "outside" revenue source (out of the City's direct control), an alteration of the current sharing arrangement would require multilateral action by the County legislature (which would need to act on such a plan), perhaps other municipalities in the County (which could perhaps be disadvantaged in a plan to provide additional benefits to the City of Buffalo, or which may seek similar concessions themselves) and the State (which has complete discretion in authorizing the additional sales tax). The actions of any of these entities are beyond the City's direct control, and, in some instances may take some months (if not years) to finalize. For these reasons, the Authority does not consider the inclusion of dramatically higher levels of County sales tax revenue a reasonable revenue assumption as part of the City's program to eliminate the gap.

The City is required to substitute some different action to balance the budget in 2003-04 and in 2004-05. In order to include revenues related to increased sales tax sharing in the future, the Mayor will have to engage in viable discussions with the County Executive to bring about all necessary levels of approval (State and County legislative action).

Reasonableness of police contract assumptions

According to the City's numbers, police personnel costs (not including fringe benefits) represent 22 percent of the City's 2003-04 budget, making it a significant cost center for the City. Under the 2003-2007 contract agreed to in March 2003, the average annual salary per officer increases from $63,148 to $79,081, or 25.2 percent over the five-year period of the contract – an average of more than 5 percent per year. Estimated savings (beginning in 2005-06, according to the City's Table 1.5) is a function of anticipated (but not guaranteed) retirements. The gross cost over the period is $13.8 million – an amount the City offsets with $10 million in "reengineering" funds provided by the State at the end of the City's 2003 fiscal year.

It is hard to justify wage increases of 5 percent a year, given the City's dire financial condition. While no resolution is possible to the debate regarding the amount of savings over the five years, it is possible to cite a number of other problems with the contract, as follows:

- There is likely to be a precedential impact, as other unions seek contracts with similar increases;

- Increased salaries also drives up pension costs; and
- If retirements do not occur as anticipated, there is no way to achieve savings, since the contract included a “no layoff” clause.

Reasonableness of fire restructuring assumptions

In his budget modification, the Mayor proposes entering into a contract with the firefighters union. The proposal would not provide parity with the PBA, a contract that would cost $8.2 million after the offset of $10 million in reengineering fund provided by the State.

By comparison, the base cost of the Mayor’s proposal (which assumes a headcount reduction from 823 to 687, a reduction of 16.5 percent) is $8 million. With added pension costs and the same offsets included in the parity analysis, the City expects to realize nearly $4 million in savings. The average salary per firefighter increases over the five-year period of the proposed contract from $59,567 to $72,552 (21.8 percent over five years, or more than 4.3 percent a year).

The City believes utilizing firefighters to provide other City services, such as inspections and EMS, justifies the added annual wage increases. BFSA does not agree, for the following reasons:

- These services are being provided now by the City and the private sector without the increased cost;
- Wage increases similar to those agreed to for the PBA further the argument that parity (or an amount close to it) is the key factor in collective bargaining; and
- Retirement and disability payments will leverage the cost of this settlement beyond amounts included in the calculation.

BFSA would have preferred to see a proposal similar to that reported from Denver, Colorado recently. Denver fire fighters overwhelmingly agreed to a $4,200 per year reduction in pay , and other contractual concessions, in response to Denver’s $117 million deficit.

City employees, wages and structural budgetary balance

The conclusions by the Denver firefighters exemplify the kind of management/union cooperation that has resulted in economic recovery and growth nationally through the 1980’s and 1990’s. It is clear that the recent wage increases granted or proposed by the city should never have been on the table, given its dire financial condition (even assuming savings in the third and fourth years of the plan.

Until the recent police contract, most City workers had been receiving wage increases in the 2 percent to 2.5 percent range – roughly the rate of inflation. It is unfortunate the City has begun a new and unacceptable trend in wage increases with the 5 percent average annual increases for police and an average 4 percent annual increase for firefighters.

Employees: Employees and retirees, through their wages and benefits, represent the largest cost to the City (90 percent of all City spending, or $284 million). The City also bears a substantial responsibility for retiree health benefits and police and fire disability costs. Given the City's extensive financial responsibility for its employees, the City ought to carefully consider and seek to limit the number of employees on the payroll. Otherwise, it will be impossible to control costs. The City itself notes on the second page of its financial plan submission that, "Only two expenses account for 81 percent of this increase (in the gap): Health care and Pensions."

In recognition of these undeniable facts, BFSA must insist that the City provide complete information on past, present and future projected employee levels as required by the Act (Section 3857, paragraph 4). In addition, BFSA would like the City to develop a plan to reduce employment levels to an affordable level over the term of the four-year plan.

Wages: Wages, fringe benefits and head count are inextricably linked and to a great extent accountable for spiraling municipal costs resulting in structural budgetary imbalance. This issue must be addressed immediately in the City financial plan.

The City has recently entered into a contract with its police union that includes significant wage increases over the period being examined by BFSA. The City compares potential costs under binding arbitration with the contract (including assumed, but unverifiable savings). When BFSA reviewed the Opinion and Award in PERB Case No. IA 201-003; M200-238 between the Police Benevolent Association and the City (signed in September, just one year ago), the Authority found a very eloquent description of the City's fiscal condition by the arbitrator: "Buffalo budget development is a high wire act executed while hovering over insolvency and grasping State aid as a balancing pole." And further, "We do not concur in the Union view that available money has been concealed in the past and that the practice continues at this time." In granting 2.25 percent increase in the fiscal years ending 2001 and 2002, the arbitrator concludes, "It may be necessary to fund this increase through staff reduction to effect an offsetting saving" and later on, "if the cost is to be offset solely through staff reductions, it may be necessary to borrow."

In light of the arbitrator's clear understanding of the dire state of the City's finances, BFSA finds it difficult to believe, and in fact rejects, the City's argument that (contractual) savings should be calculated from presumed additional arbitration awards, especially in the face of a State-created Authority with control powers to bring about fiscal stability to the City.

Furthermore, as the City looks to revise its financial plan to comply with the objections found in this report, BFSA expects that no wage or salary increases will be assumed for employees where they are not currently required. Instead, BFSA will expect to see savings in the financial plan that will result from a wage freeze where contractual agreements do not require other assumptions.

Closed gap in current plan constrains BFSA borrowing capacity

In each of the first four years of the City's plan, the base gap is closed through a series of proposed reorganizations, functional consolidations and new revenues. Irrespective of the likelihood of those reforms reaching full implementation by the year they are introduced into the plan, the plan proposes to close the base gap each fiscal year from 2003-04 through 2006-07. As a result, BFSA borrowing is not relied upon to close any of the gaps until fiscal year 2007-08.

According to the legislation creating the Authority, "the City shall determine and declare whether it requests the Authority to undertake a financing of costs… Any such financing shall be consistent with the adopted budget and financial plan of the City…" (§3861)

Under the current financial plan the Authority would not be in a position to provide borrowing assistance to the City in any fiscal year prior to 2007-08. Reliance on Authority assistance before that point would be inconsistent with the City's plan, which proposes to close the gap each fiscal year through 2006-07. Whereas a "declaration of need" is required on the part of the City for Authority borrowing to commence, the current version of the four-year plan indicates a complete lack of such need, with the exception of FY 2007-08.

The Authority is in a position to offer the City a benefit – that is, borrowing and debt restructuring – to enable short-term budgetary relief as the City introduces management actions to ensure structural budgetary balance and long-term fiscal stability. While the bonded assistance BFSA is able to offer helps with only short-term budget balance, this assistance has proven successful in restoring fiscal stability when most recently employed in Nassau County. BFSA assistance, however, is contingent on its being part of a balanced financial plan and the City's declaration of need for it by the Mayor, upon the approval of the Common Council. None of these conditions has been met, making such a borrowing impossible at this time.

It should be noted that, if the City does not cure the imbalances in the current budget and financial plan by October 1, 2003, the Authority is required to impose a plan upon the City, and that the plan the Authority would be required to impose would not be able to include any borrowed revenues.

The structural nature of Buffalo's budget gap

It is apparent to the Authority that the budget gap contained in the City's current budget – and the imbalance projected for out-years – is structural in nature. For this reason, tapping a finite revenue source without sufficiently containing the costs driving that increasing structural imbalance will provide the City with only a short-term fix to its gap problems.

The structural nature of the imbalance is seen in the steadily increasing size of the City's annual deficit through the 2007-08 fiscal year. The City-side portion of the gap is estimated at $24.1 million in the current year, and projected to grow to more than $82 million in 2007-08. Employee-related health insurance and pension costs are noted by the City to be the largest contributors to that growing imbalance, accounting for a full 81 percent of the increase.

In the absence of sufficient steps to control the factors driving the structural imbalance, the use of finite sources of revenue – such as sales tax – to plug the gap will merely provide a short-term solution to the problems the City faces. Consider: The City's plan provides for an increase in sales tax sharing with the County, increasing its share (City/School District) from 19.07 percent to 34.12 percent. By this arrangement, the City contends, it will be able to fill its increasing imbalances through 2006-07. Further, the City plan provides for using only as much of that 34.12 percent arrangement as is necessary to close the annual gap.

The problem with this strategy (and the truly structural nature of the gap) is apparent when examining 2007-08 and, presumably, the fiscal years beyond it. In 2007-08, the City proposes to use *all* of the 34.12 percent of the County sales tax to plug its gap, but *still* needs to rely on $758,000 BFSA bonding assistance to close its gap. In other words, even the City's plan of increased sales tax revenues becomes swamped by the steadily increasing size of the imbalance beyond the next several fiscal years.

The Authority's Role

The City's plan urges the Authority to lobby on its behalf for changes in current State pension rules, specifically to institute contributions for all tiers of the employee retirement system and police and fire retirement system. It should be noted that the State constitution prohibits any elimination or reduction of employee pension benefits once granted. While different pension benefits may be provided for new employees, it is not the responsibility of the BFSA to lobby for changes in State or local regulations on the City's behalf. The Authority encourages the City to work on its own, and together with other groups to achieve mandate relief and reforms in other policies that constrain its ability to ensure cost-effective government management, but would note that the City is obligated (per the BFSA Act) to operate and prepare its financial plans in accordance with current State and federal regulations:

"The financial plan shall include any information which the authority may request to satisfy itself that…(b) the City and the covered organizations are taking whatever action is necessary with respect to programs mandated by State and federal law to ensure that expenditures for such programs are limited to and covered by the expenditures stated in the financial plan." (§3857)

COVERED ORGANIZATIONS' FINANCIAL PLANS

What BFSA Requires of the Covered Organizations' Plans

As part of its control and advisory finance authority over the City's budget process, the Buffalo Fiscal Stability Authority is also required to review financial plans for covered organizations. For the initial plan, the Authority requested financial plan reports for the following covered organizations: the School District, the Buffalo Municipal Housing Authority and the Buffalo Urban Renewal Agency.

The Authority is empowered by the BFSA Act to exercise the same powers of review and approval over covered organizations as it does over the City. Covered organizations are therefore required to submit four year financial and capital plans summarized revenue and expenditure trends, and monthly cash flow projections for Authority review. The financial reporting standards that apply to covered organizations are identical to those applied to the City. They are also required to submit quarterly reports which compare revenue estimates and appropriations set forth in the budget and monthly revenue/expenditure projections with the actual revenues/expenditures made to date.

SCHOOL DISTRICT FINANCIAL PLAN

The School District indicates a balanced budget in the current year, but projects ever-increasing deficits through 2006-07.

The Big Picture: Revenues and Expenditures

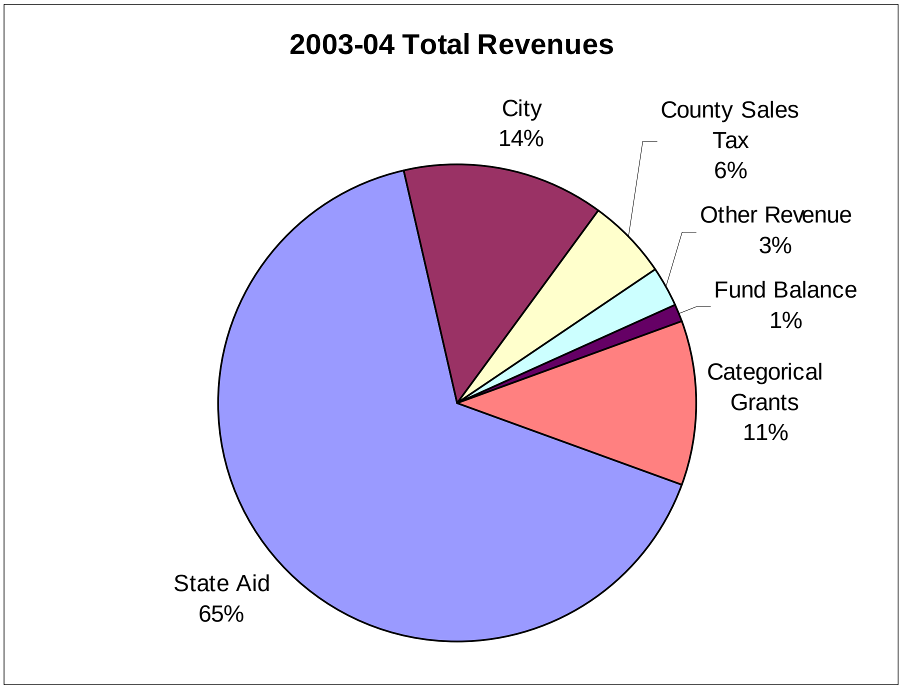
The School District relies on several major categories of revenue to fund its annual budget. The largest is State aid, which in the 2003-04 spending plan accounts for $334.8 million, or 65 percent of the District's total projected revenues for the year. When State categorical grants totaling $57.0 million are included for universal pre-K, class size reductions and maintenance, the State share of District revenues is 77 percent. As is the case with all large City School Districts in New York State, the District is also funded in part by the City itself. Buffalo Public Schools are scheduled to receive $68.7 million from the City in the current year, more than 13 percent of all School District revenues. Local funding is also provided through Erie County sales tax revenue. In 2003-04, the District is scheduled to receive $28.5 million in County sales tax aid. The remaining portion of the District's $507.5 total projected revenue for 2003-04 is appropriated fund balance from 2001-02 ($5.7 million).

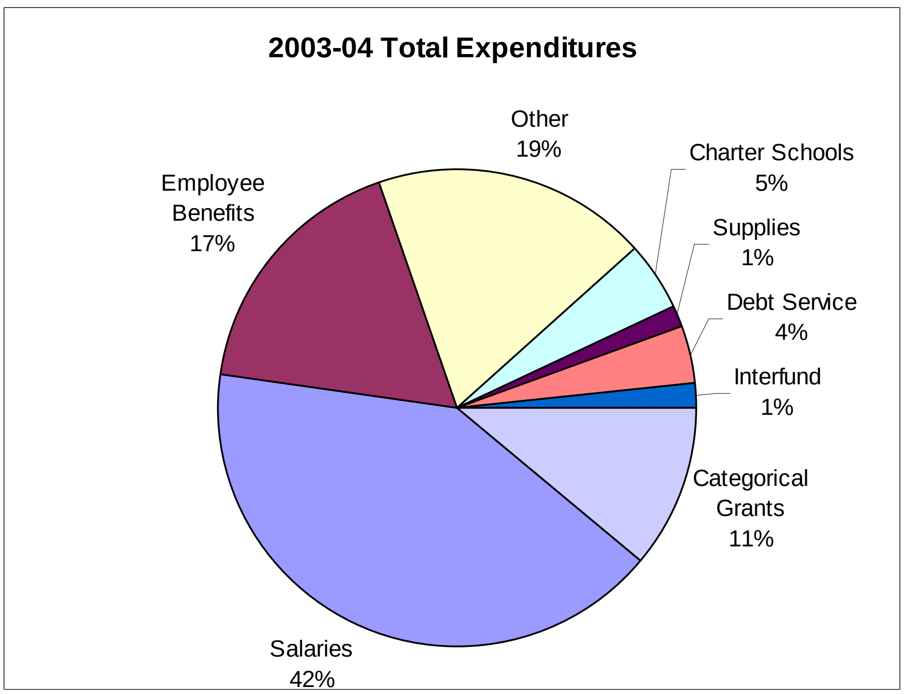
The School District also has the following additional major funds for which information was not provided in time for inclusion in this report. BFSA would like all the same information required for the general fund for: the Special Aid Fund (federal funds); School Food Service Fund; Capital Projects Fund; and Special Activities Fund. BFSA would also like to see the collective value of expenditures and revenues for these funds along with the general fund.

All funds together are likely to bring actual School district spending to approximately $600 million to BFSA's estimates. All revenues of the District must be viewed together to accurately assess the Districts allocation of its resources.

Another area BFSA will continue to target is that School District contract processes in place to ensure the revenues available to the District are carefully managed. Of particular concern is the Independent Health partial-year contract for BEST (Teacher Aide) employees. While the Authority approved the contract to ensure these employees continue to have health insurance coverage, we remain deeply concerned that the previous self-insurance contract was likely flawed from the outset and poorly– (or not at all) managed thereafter. The Districts contracting process in an area we will continue to monitor.

The District presents a balanced budget for 2003-04, with $507.5 million in appropriations, not including the above mentioned funds. The single-largest category is employee compensation costs, representing $208.9 million (42 percent) of the total School District budget. An additional $88.1 million goes to underwrite employee benefits – retirement, teacher retirement, social security, health insurance and related costs. Together, these two categories of staff-driven costs represent 59 percent of the total School District budget.





Other expenditure categories of note in the 2003-04 budget include spending on categorical grants ($57.0 million); charter Schools ($24.0 million); and debt service ($20.1 million). Transportation, utilities, tuition, and contracts – custodial, instructional and non-instructional – make up an “other” category representing $94.6 million in spending.

The District Budget Gap

The School District presents a budget that is balanced for the current year. Projected expenditures of $544.0 million were offset by $507.5 million in revenues and $37.4 million in gap closing initiatives, bringing total appropriations in line with revenues. The current-year gap was closed through “attrition and other staff reductions, program adjustments and closing of facilities” according to the District’s financial plan.

A total of 645.75 positions were cut from the School District, representing the most significant step taken to bridge the budget imbalance. The largest category of staff reductions was teachers, with 370.25 positions being cut – 9 percent of the District’s teaching staff. In addition, 178.5 teacher aides, 53 clerical staff and 21 central office administrators were removed from the budget.

Initiatives to Close the District’s Gap

The District identifies in summary fashion a series of actions to bridge its widening budget gap. Bare bones expectations for both increased revenues (State aid, City aid, County sales tax and restructuring of an outstanding Municipal Bond Bank loan) and reduced expenditures (improved productivity, management of benefits and contract negotiations, closing of facilities and reduction in educational programs) are put forward. Details of each of these initiatives, including a trend analysis, actions taken to date, and/or a work plan for achievement of the initiative, must be included in the School District’s October 1 submission.

Possible increase of State aid revenues

The School District indicates that while its projections are built on a constant level of State formula aid, each 1 percent increase above the current level would yield $3.2 million in additional aid. The District points to the Campaign for Fiscal Equity lawsuit, (a New York State Court of Appeals decision will require the State to devise a new formula for distributing aid revenues to the New York City School District) as a factor which may affect the actual amount of aid allocated to the Buffalo School District. In addition, the District plan proposes a “moratorium on State-approved charter Schools and/or legislation changing the funding formula for charters.” Beyond the assumption of 1 percent increases in State aid, the School District plan does not quantify the potential impacts of these reforms vis-à-vis its budget gap.

Possible increase in City revenue

The School District indicates that while its projections are built on a constant level of City revenue through the current and out-years, it requires more local revenue to assist in bridging its budget gap. The District proposes having the Authority “review and support the proper level of local funding to public education comparable to other urban local share models in New York State.” No alternative models, nor budget implications for them, are presented in the plan.

Possible increase in County sales tax

The School District proposes having the Authority establish “fair contributions for the City Schools” through a revised County sales tax distribution formula. The District’s financial plan assumes a $9.7 million share of the additional 1-cent of County sales tax on an annual basis.

Forgiveness or extension of MBBA teacher settlement loan

As a final piece of its revenue plan, the District proposes being forgiven debt service payment requirements, or extending the term of, its outstanding Municipal Bond Bank Agency loan. The $27.415 million loan was received in 2001 to help fund the teacher settlement reached that year, ending a back pay settlement that dated to 1990. The District indicates the annual debt service on this loan totals $1.75 million. The School District’s proposal would involve either extending the term of the bonds to lower its annual cost, or having the bonds forgiven in their entirety (having the State assume payment responsibility).

BFSA Review of School District’s Program to Eliminate the Gap

The structural imbalance plaguing the District’s budget is projected to worsen in the next three fiscal years, with the gap rising to $52.1 million in 2004-05, $82.8 million in 2005-06 and $116.1 million in 2006-07.

BFSA is prepared to approve the 2003-04 budget year of the School District’s financial plan, provided that the School District provides summary cash flow information within 15 days to assure it that the week-by-week spending of the District since the beginning of the fiscal year (July 1) is consistent with the adopted budget. Any negative variances must include the superintendent’s plan to adjust spending to ensure budgetary balance.

While BFSA is prepared to accept the projections of budget balance in the current fiscal year, the Authority is troubled by the lack of care given to the preparation of a credible plan to bridge the projected out-year gaps. In fact, the Board of Education’s note on the cover of the plan indicates that educational services cannot be adequately provided under the plan. The Authority can therefore not accept this plan to eliminate the out-year gaps without further modification.

Incomplete information to assess program's implications

The BFSA Act explicitly notes that the School District, as a covered organization, is required to submit a comprehensive financial plan. The Authority is empowered to disapprove a financial plan on the following grounds:

"(If) such plan (i) is incomplete; (ii) fails to contain projections of revenues and expenditures that are based on reasonable and appropriate assumptions and methods of estimations; (iii) fails to provide that operations of the City and the covered organizations will be conducted within the cash resources available; or (iv) fails to comply with the provisions of this title or other requirements of law." (§3857)

In particular, information was not provided to BFSA by the time of this report detailing the provision of adequate reserves (as required by the Act); cash flow projections; projected revenues and expenditures depicting trends; and personnel totals/projections on an aggregate and departmental basis. These are all required to complete a proper and thorough review of the School District's financial plan.

Furthermore, proposals made to increase revenues and reduce expenditures are not detailed in sufficient form for the Authority to consider their impact on the out-year gaps. The financial plan proposes facility closings; staff attrition; elimination of sports, music and art; and elimination of non-mandated staff to help close the imbalance, but provides no detail on which facilities or staff, what State or Federal mandates exist which could limit District actions, nor background information to justify the $16.3 million in savings projected to accrue therefrom.

Unreasonable assumption of increased revenues

The School District proposes closing out-year gaps with additional State aid, additional City property tax transfers, and an increase in County sales tax sharing. Each of these proposals runs counter to the reasonableness standard outlined by BFSA in that the School District itself is in no position to control the outcome.

Similarly, the District's plan assumes $1.8 million in additional revenue through forgiveness of the MBBA bond it received to fund the 2001 teacher back pay settlement with no indication any other party would pay debt service. BFSA will not allow any debt obligations of the City or School District to go unpaid under any circumstances. This initiative cannot be included in the plan.

The District's out-year program to eliminate the gap should limit revenue growth assumptions and focus more strategically on the management of the educational system for a declining enrollment, including changes in staffing levels.

No valuation of management actions taken to date

The School District notes that it has taken a series of management actions to date to enhance efficiency and enable it to close its budget. They do not detail those actions or their cost implications in the four-year plan. The Authority requests that ~~it~~ the School District identify what steps it has already taken to improve its operational and administrative efficiency, and provide estimates of the savings that are expected to accrue from these actions. Unless there is some reasonable expectation that management actions will provide savings or enhance service provision, the effort involved in implementing the change is without justification.

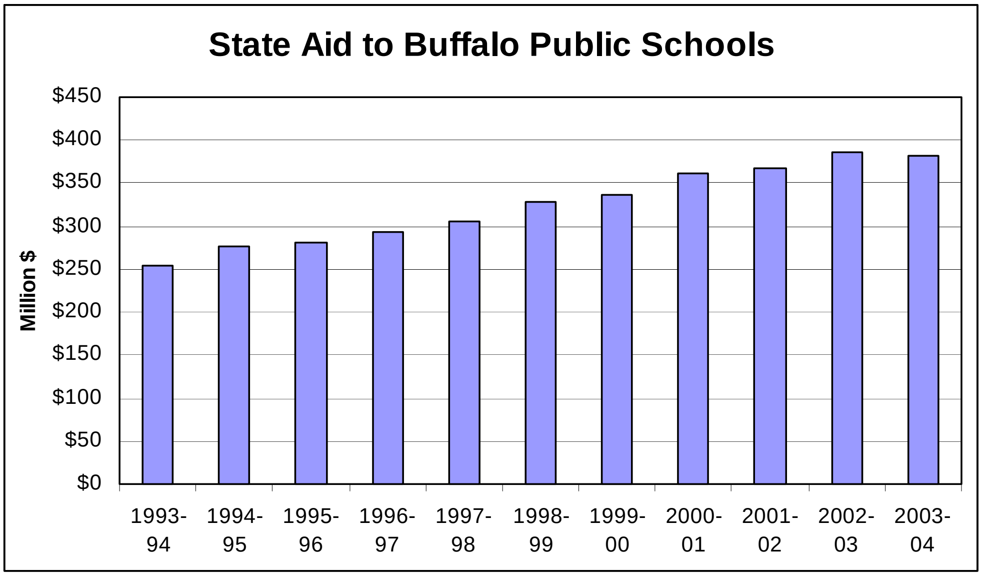
School District Employees, wages and structural budgetary balance

The School District has made significant cuts in its workforce over the last few years where funding fell short of anticipated amounts. While it is commendable that the School District acted swiftly to keep spending within available revenues, repeated reductions in staff in an ad hoc fashion is one result of failure to plan ahead. In preparing its amendment to the four-year financial plan BFSA would like the District to review its assumption that employee costs increase on an annual basis by 5 percent. This level of growth is simply unacceptable, given the financial condition of the federal and State governments, as well as the County and the City. Moreover, these salary increases are linked to employee benefits. Compensation and benefits together account for as much as 77 percent in the year-to-year growth in expenditures. Therefore, BFSA expects that no wage or salary increases will be assumed for employees where they are not currently required. In addition, BFSA would like separate information on the value of step increases in each year of the plan.

State aid estimations

One of the central assumptions in the District's base revenue projections is that State aid will drop slightly from 2003-04 to 2004-05, and remain at that lower level through 2006-07. According to figures from the New York State, education aid to the City School District has risen 9 of the past 10 years. The Authority considers the slight decline for the out-years – amounting to approximately 2.8 percent – to be a reasonably cautious assumption in light of the State's own fiscal condition. In addition, the Campaign for Fiscal Equity's recent Court of Appeals victory mandating a revision in the way State aid is provided to New York City's Schools has the potential to result in a reduction in State funding for other districts.

For these reasons, the Authority believes the School District's cautious assumption to be a reasonable one at the present time. The School District should revisit this assumption upon release of the Governor's next fiscal year budget in January 2004, and provide an assessment to the Authority of the degree to which any change in State aid can reasonably be anticipated with its February 2004 quarterly update.



Recommendations to the School District: by the Office of the State Comptroller, Council of Great City Schools, and the District's Independent Auditor

Over the past several years, the School District has had outside entities review its financial systems. In 1999, under then State Comptroller H. Carl McCall (currently BFSA Director) joined with the State Education Department in auditing the School District for the period July 1, 1997 through April 30, 1999. Among the findings at that time were:

- Adequate controls had not been set by the District's senior managers; and
- The District did not have the necessary controls in place to provide reasonable assurance that complete, accurate and timely information is reported for State aid purposes: "Poor communication, inadequate oversight, outdated policies and procedures, reliance on manual processes, and fragmented and inaccurate record keeping hinder the ability of the District to manage its resources in an effective and efficient manner."

The School District also participated in a peer review process examining several aspects of its operations. The Council of Great City Schools is a coalition of 60 of the nation's largest urban School systems whose mission is to advocate for, and to assist in, the improvement of public education in the nation's major cities. Representatives of the Council have visited Buffalo's Schools on multiple occasions since 1999, and prepared research reports documenting and making recommendations to improve the District's management approach (Fall 2000) and business/finance operations (April 2003).

The Council made recommendations on leadership structure, organization, curriculum and instruction, human resources, facilities and operations, and finance in its 2000 report, and revisited the finance and business side of the operation in its 2003 report.

General themes the Council's 2000 report urged the District to attend to included: the lack of interdepartmental integration and coordination; inadequate budget expertise; poor forecasting of revenues and expenditures; budgeting processes that are more "carry forward" than strategic in nature; poor accountability over grant management; poor integration of instruction, budget and payroll decision-making; weak internal auditing processes; and weak responses to past audits of finances.

The follow-up review in 2003 revealed that finance issues were still being inadequately focused on; a continued lack of integration across the activities and operations of the finance department; the lack of a cohesive plan for recruiting financial talent to the District; a pervasive "risk avoidance" approach to decision-making; a complete lack of response to repeated structural recommendations made in external audit reports; little sense of urgency among financial managers; a non-existent or dysfunctional accounting function; and sub-optimal efforts to enhance District revenues.

In its June 30, 2002 Management Letter, the District's auditors, Deloitte & Touche, listed a member of "reportable conditions." The firm cited: the District's reconciliation process (not performed in a timely manner); budgetary appropriations (exceeded budget by $800,000 – a potential for overspending by $11 million); and the District's interim financial reporting did not perform required interim reports to the State or Board of Education.

The Authority considers it a matter of grave concern that many of the financial problems presented in the State Comptroller/State Education Department audit, the Council's 2000 and 2003 update and in the Deloitte & Touche Management persist. In particular, those that directly impinge upon the District's organizational efficiency and financial integrity mirror the inadequacies BFSA itself has encountered in attempting to obtain the basic information that should be readily at hand by any entity with the monetary and management responsibilities of this School District.

The Authority will initiate an independent review of these practices as it engages in an ongoing effort to obtain all the documentation and summary detail necessary to better develop, manage and assess the School District financial plan. BFSA will take whatever action within its powers and that it deems necessary to ensure organizational and procedural changes are made to the extent the District is unwilling or unable to implement them on its own.

Finally, the District is required by the BFSA Act to submit monthly cash flows and quarterly financial reports to the Authority. The Authority will require that processes and mechanisms for meeting this request be put in place immediately.

BUFFALO URBAN RENEWAL AGENCY FINANCIAL PLAN

BURA's Budget Gap

BURA estimates its current-year deficit to be $2.35 million. The Agency has run annual deficits for at least the past two years: $1.77 million two years ago, and $1.76 last year. Surprisingly, BURA is unable to conclude whether deficits preceded the past three fiscal years. Currently, the Agency attributes the deficits to overstatement of program income.

Initiatives to Close BURA's Gap

BURA notes that in order to eliminate its structural budget deficiency, it will need to reduce staff and program costs. With combined past-year deficits totaling at least $3.5 million, and a current-year shortfall of $2.35 million, BURA proposes using program reductions exclusively to eliminate the current-year gap. Doing so would reduce actual program activity costs by more than 28 percent.

BFSA Review of BURA's Program to Eliminate the Gap

The Authority considers the financial plan as submitted by the Buffalo Urban Renewal Agency to be incomplete. The organization has not provided information on current or projected staffing; actions related to employee costs; the provision of adequate reserves in the current and out-years; or a comprehensive financial plan to eliminate the gap built on reasonable assumptions.

BURA's financial plan to eliminate its projected deficit – which by its own estimate approximates 28.5 percent of the current Community Development Block Grant Budget (CDBG) – appears to rely on assumptions even the Agency itself considers uncertain. Using CDBG funds to close the current gap would result in a reduction of actual program activities. BURA's plan notes that "there is no guarantee that HUD will allow such a significant reduction in program funding. Under such a plan we would reduce program costs to a level that is actually less than the salary and related administrative costs we are proposing to run our programs. It will be a difficult plan to sell."

Based on incomplete information and BURA's own concern over the reasonableness of its program assumptions, the Authority cannot approve the BURA plan.

BUFFALO MUNICIPAL HOUSING AUTHORITY FINANCIAL PLAN

BMHA's Budget Gap

BMHA indicates that it operated at a $1.5 million deficit for the 2002-03 fiscal year. The Authority projects running deficits through 2006-07, although it estimates the annual gap to lessen over time – from $1.4 million in the current year, to $152,000 in 2006-07. By 2007-08, it projects a $48,000 operating budget surplus.

Initiatives to Close BMHA's Gap

BMHA proposes to close its gap, first, through increased revenues. The Housing Authority projects dwelling rents to rise by 1.5 percent each of the next four years; non-dwelling rental income to increase 3 percent each year through lease renegotiations; and HUD subsidy eligibility funding to increase by 3 percent annually along with a funding level of 95 percent (the current level is 93 percent).

BMHA anticipates closing the gap through reduced costs, as well. Tenant Services Materials and contract costs are projected to decrease and stabilize at a level approximately 5 percent lower, yielding a savings of $125,000 annually beyond 2003-04. Downsizing in staff will also permit reductions in protective services costs.

BFSA Review of BMHA's Program to Eliminate the Gap

The Authority considers the financial plan as submitted by the Buffalo Municipal Housing Authority to be incomplete. The organization has not provided complete information on current or projected staffing; actions related to employee costs; the provision of adequate reserves in the current and out-years; or a comprehensive financial plan to eliminate the gap built on reasonable assumptions. While BMHA indicates the status of a series of key operating accounts for fiscal year 2002-03, it does not provide information on what measures were taken to reduce expenditures or what factors contributed to increased costs.

Regarding expenditure and revenue projections for the BMHA through 2008, no justification or historical trends have been provided to convince the Authority of the reasonableness of assumptions that specific revenues will increase and/or specific expenditures will decrease beyond the base year. By BMHA's own admission, rental incomes have declined over recent years. For example, BMHA has provided insufficient background information to confirm that expenditures will decrease beyond the base year in categories like protective services, maintenance, general expenses and tenant service contracts.