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Dear Mayor Rohde and Members of the City Council:

This is the ninth budget proposal I have prepared during my tenure as City Manager. During that time, we have never been confronted by budgetary circumstances as difficult as those we will consider this year. Decreases in multiple revenue sources combined with the increased cost of meeting our policy goal to fund the City's benefit obligations as actuarially required pose a very significant challenge. I am presenting a budget that reduces spending in nearly every department and cost center. I also am proposing less than desirable solutions to funding benefits. Nonetheless, an increase in the tax rate will still be necessary to balance the budget, although residential property taxes for a majority of homeowners will remain below the level of two years ago.

The proposed State budget eliminates and defunds the State payment in lieu of taxes (PILOT) for State owned property, the Pequot/Mohegan grant, the Municipal Revenue Sharing grant (which was enacted just last year), the Manufacturing Transition Grant (which replaced the manufacturing property PILOT created when the State exempted manufacturing property from local taxation), the State public housing PILOT and the public school transportation grant. It lowers the amount of State funding for other programs such as non-public school transportation and the PA-217 program that reimburses a portion of the cost of other services provided to non-public schools. The revenue loss for those programs if the proposed State budget is adopted totals \$3,427,834. The proposed State budget does increase some revenue sources, but does so in a manner that may not benefit the City's general fund budget. The LoCIP grant, which reimburses municipalities for eligible capital projects, would be increased by \$903,709, the amount of the Pequot/Mohegan grant that is being defunded. Unlike that grant, LoCIP funds can only be used for capital projects. That will assist the City in controlling our bonding cost over time, but reduces revenue by that amount in the operating budget. The Education Cost Sharing grant would be increased by \$2,199,332, but of that amount \$1.8 million will be paid directly to the Board of Education. As proposed, the ECS increase that the Board received directly for the current year, \$1,777,411, does appear to be included in the City's proposed ECS grant and does not appear to be subject to the Minimum Budget Requirement. If so, that revenue could be used to fund any City expenditures. My proposed budget assumes that is correct, but that is a part of the State budget proposal that will need to be closely tracked. Based on that favorable assumption, State revenues would be reduced by a net amount of

approximately \$1 million. If that proposal is changed during the State budget process, the net loss of State revenues would be nearly \$2.8 million.

Other City revenue sources also are decreasing. NRG, which has paid over \$30 million to the City under the terms of the tax agreement for the proposed power generating facility that it never completed, has given the City notice of its intent to abandon that project. It is contesting the next payment of \$1,808,756 due under the tax agreement. For that reason, I have not included that amount as revenue in the proposed budget. It should be noted that NRG, if it proceeds to abandon the project, will owe the City a payment of certain amounts that were deferred during the last four years, which it has indicated in its court pleadings it does intend to pay. Because that payment would be made in the current fiscal year, I am proposing that a portion of the amounts due be paid into the City's health fund, a proposal discussed later in this budget message.

The City's grand list for next year is lower by \$31,501,204, based on decreases in the motor vehicle and personal property grand lists and a decrease in the real estate list mostly due to the settlement of assessment appeals in the year following revaluation. Based on the current mill rate, this results in a \$1,093,092 loss of tax revenue. While much of this was anticipated, the decrease exceeds the anticipated amount by nearly \$343,000. In addition, the tax collection rate that is used to calculate the amount of current year tax revenue is based on a two year rolling average as required by our financial policies. The slight decrease in last year's tax collection rate results in a lower collection rate for the proposed budget and a revenue loss of \$62,137. The proposed budget does not yet take into account the impact of assessments that may be lowered by the Board of Assessment Appeals or the potential impact of outstanding assessment appeals.

I have not included the use of unassigned fund balance- the "rainy day" fund- in this budget. Our recent budgets did use fund balance to offset increases in retiree health funding (OPEB). For example, the current 2012-13 budget anticipates the use of \$1.2 million in reserves. Because I am recommending that OPEB funding be reduced to the level of two years ago, I am not including fund balance as revenue. Avoiding the use of fund balance is preferable for bond rating purposes. Given the fact that we will be doing multiple bond issues in the next few years for, among other purposes, the high school projects, maintaining our bond rating is critical to the City's fiscal status. We have been successful in increase our reserves in the past few years to comply with our financial policies and improve our bond rating. Now is not the time to risk that success.

The challenge posed by these revenue losses is exacerbated by increases in the cost of pension and health benefits. Pension funding is reviewed every two years to update the actuarially required contribution (ARC) necessary to fund present and accrued pension benefits. In calculating that amount, it is accepted practice to "smooth" investment gains and losses over a period of years to avoid volatile changes in required funding levels. Losses incurred in the period when stock exchange values decreased by

approximately 50% are still being absorbed into the calculation of the City's ARC. For the first time, this has resulted in the City pension fund being slightly less than fully funded (98.4%), as well as the police and fire pension funds which have historically been underfunded. The City has been contributing additional amounts to close the funding gap in those plans over a period of years. For next year, that would require \$1 million in additional funding. I am recommending that the police and fire pension fund deficits be reamortized over a period of 30 years and that the city pension fund deficit be amortized over 25 years. That reduces the additional funding necessary to meet 100% of the ARC to \$525,512. That is still a significant amount, but much less than otherwise would be required. Reamortizing does pose issues for the future that need to be closely followed, but pension contributions should stabilize or improve in the next actuarial review barring another period of very unfavorable market conditions.

The City's experience with health benefit funding has been very good in recent years. Our rate of increase in cost has been less than projected. We changed administrators and achieved savings both in administration and claims. We instituted a wellness program that has identified serious illnesses among our employees at an early stage, reducing costs for serious illnesses and improving employee health. Changes that we made to employee contributions and deductibles have resulted in additional savings. Many of our employees are now enrolled in health savings accounts, which should result in future savings. However, in the last fiscal year, claims exceeded projections, reducing the balance in the health fund by \$1.3 million. This appears to have two causes: additional utilization last year as Board of Education employees anticipated the change in plans to Health Savings Accounts and, much more significantly, an unusual number of serious illnesses and high individual claims. Based on that, our health consultant has recommended an increase in health benefit funding, minus an additional recommended reserve amount, of approximately twelve percent. That will require an increase in City health benefit funding of approximately \$492,000.

To offset those expenditure increases and the previously described losses in revenue to the extent possible, I am proposing an overall reduction in spending in the amount of \$1,694,609. This takes into account the increase in benefits. The proposed budgets for twenty-four different departments and other cost centers are equal to or less than last year. Only five budgets are higher: the fire department, in which the contractual wage increase was impossible to offset by other spending reductions, the South Meriden Volunteer Fire Department, which now includes funding for the recently approved volunteer firefighter pension plan, the Insurance budget, which includes a significant increase in police professional liability coverage premium, the Law Department, in which there is a position that was funded for only one-half a year in the current year budget, and the aviation budget, in which the expenditure increase is offset by projected revenue increases.

In order to accomplish this, departmental budgets have been reduced to the minimum amount necessary to meet current service levels. It will be very challenging for department heads to manage the proposed budgets without running deficits in the next year. The proposed budget does reduce capital equipment requests, eliminates the summer playground park program and one existing vacant position in the Planning office. Department heads were directed to submit budget requests at the current year level and absorb any contractual wage increases without increasing their overall budgets and most did. Even so, I am proposing that overall budget requests be reduced by \$5,704,913.

In addition to departmental reductions, I am also proposing that funding for workers compensation and hypertension benefits be reduced by \$699,714 from the requested amount, which will reduce the funding available for settling pending claims. As alluded to above, I am recommending the prefunding of the health benefit fund from the current year anticipated NRG payment of previously deferred amounts. If NRG proceeds to abandon their project as they have indicated they will, they will make a payment of \$2,512,500 in the current year. I am recommending that \$2 million of that amount be paid into the health fund and that next year's health benefit funding be reduced by that amount. This avoids appropriating that amount out of unassigned reserves in next year's budget, which for accounting purposes would be shown as a deficit in the audit for that year. It should be noted that although this will reduce spending in the proposed budget by that amount, it will pose an issue for the budget the year after in which that funding will have to come from a different source.

Lastly, I am recommending that funding for accrued retiree health benefits (OPEB) be reduced to the approximate level of funding in fiscal year 2012. This will enable the City to demonstrate a continued commitment and maintenance of effort to fund these obligations, but relieve the additional pressure on next year's budget that would result from again increasing the annual funding level for this purpose. The City is one of only thirty or so municipalities in Connecticut that has formed an OPEB trust and one of very few that has actually accumulated assets in that trust. This, like pension funding levels, will need to be reexamined in future years, but in a year in which the City is buffeted by the revenue and cost issues described above, the proposed level of OPEB funding is reasonable and prudent.

I am not recommending that the City choose to exempt motor vehicles from taxation, even if that option is approved by the Legislature. That would result in a loss of tax revenue in the approximate amount of \$10.8 million, which would require a 3.49 increase in the mill rate, an annual increase of \$418 for the average single family residential home.

Payments on bonded indebtedness will not increase in this budget. This is despite the fact that we conducted a bond sale this year to fund approved projects including funding for the first phase of the high school projects. We were able to structure this financing to take advantage of favorable market conditions both in that bond sale and also a refunding bond issue that resulted in a savings of \$613,913. A portion of that savings was utilized to reduce what otherwise would have been an increase in payments in the proposed budget. Our positive results also are attributable to our improved bond rating which results from strict adherence to the City's financial policies, including not authorizing new bonding more than one half of the principal amount of bonded indebtedness paid in the preceding year. I want to note again as I did last year that our present payment on bonded indebtedness is nearly \$6 million less than in FY2007.

Under the proposed State budget, the Board of Education budget would receive a slight increase. The proposed funding increase for Meriden is \$1,799,163. Our understanding is that amount would be received directly by the Board as "Alliance District" funding in the same manner as the current year increase of \$1,777,411. That current year amount would be included in the ECS funding received by the City and not be restricted to use for educational purposes. It is not clear whether this part of the State budget proposal will ultimately be adopted by the Legislature and any anticipated change will need to be taken into account during the City's budget review process. The Board of Education, in addition to the Alliance funding, benefited from an increase in magnet school funding of approximately \$2.5 million in the current year budget. The Board administration has taken several measures to reduce expenditures for special education and for other purposes which have and will result in needed savings. Health benefit funding will increase by the same percentage as City funding, an increase of \$975,291. As has been the case for the past two years, the Board administration has indicated a capacity to prefund some or all of that increase out of anticipated surplus in the current year budget. The Board has acted responsibly in formulating its budget request. Given the City's very difficult budget challenges and the conservative budgeting approach traditionally taken by the Board, I am not recommending any increase in local funding for education, other than those increases in transportation and bonding costs that are paid out of the City budget line items.

Although the steps outlined above will offset much of the anticipated revenue losses and cost increases, a slight increase in the mill rate from 34.70 to 35.55 is necessary to balance the budget. This .85 of a mill increase would result in the taxes on the average single family home increasing by \$96 a year. However, 55% of residential properties- 8,213 parcels- would still be taxed less than two years ago prior to the last revaluation. Taxes on two-thirds of residential properties would either not increase or increase less than 3% over that two year period.

There will be no increase in the inner district mill rate. During the current year we conducted a request for proposals for solid waste services. The new contract will

provide the same large container curbside pickup as we presently have for recycling materials. This should improve the appearance of City streets, decrease litter, and be more convenient for our residents. The proposed contract price will offset a small increase in the solid waste disposal tipping fee.

In order to conserve retained earnings in the Water enterprise fund to offset the anticipated costs of the upgrade to the Broad Brook water treatment plant, I have proposed an increase of twenty cents in the water rate. There will be no increase in the sewer rate. The overall impact to the average family would be approximately \$24 a year. The Public Utilities Commission has approved the proposed water and sewer budgets.

The Capital Improvement Plan (CIP), including capital funding requests for the next year, is also presented in this budget proposal. The City's self-imposed bonding authorization cap for next year is \$4,243,500. The cap is the sum equal to one-half the principal payments made during the preceding year for general fund projects subject to the cap. Capital expenditures for the Board of Education and those funded by the enterprise funds are not subject to the cap. Expenditures for flood control purposes also historically have been considered separately. By City ordinance, the cap may not be exceeded except upon a two-thirds vote of the City Council. This year's requests are \$914,709 under the cap. This takes into account the proposed increase in LoCIP funding in the State budget.

The CIP proposal is based on the recommendation of the Interdepartmental Review Committee, which is composed of several Department heads and other city staff with expertise in capital project planning. The Committee reviewed the required information accompanying each individual request through a process in which each of the requesting agencies had the opportunity to present their requests to the Committee. The Committee then prioritized those requests to fit within the authorized bonding cap. The Capital Improvement Plan also sets out planned capital projects contemplated for the succeeding five year period, providing a solid basis for future financial planning.

Notable in the proposed CIP is the recommended approval of \$3,068,495 in boiler replacement and roof projects for the Board of Education. Next year, the City will pay \$2,282,962 in debt service for Board of Education projects. That amount will increase in future years to pay the cost of the high school projects and the elementary school boiler replacement and roof replacement projects. I have again recommended that a generator be installed at the library. I think the value of that has been proven in the five presidentially declared emergencies that the City has experienced in the last two years. I also have repeated the request for the repair and installation of granite curbing on the veterans' boulevard portion of Broad Street. Funding for flood control projects in the next year includes the estimated construction cost of the bypass culvert for the Amtrak railroad bridge, the next most critical component of the Harbor Brook Flood Control plan. Funding for the engineering costs for that project was approved in the last CIP.

As I stated in the beginning, this is a most challenging budget. The combination of revenue losses and benefit cost increases makes it very difficult to balance the need for essential services against the ability of our residents and businesses to pay for those services. The proposed budget does provide for those essential services while maintaining the sound fiscal status the City has achieved with minimal financial impact on our residents. As always, City staff and I stand ready to assist you as you review this proposal.

Respectfully submitted,



Lawrence J. Kendzior
City Manager