ERIE COUNTY FISCAL STABILITY AUTHORITY ANALYSIS OF THE ERIE COUNTY 2017-2020 PROPOSED BUDGET BASED FINANCIAL PLAN October 31, 2016

1. ***INTRODUCTION***

This report details the analysis and comments of the Erie County Fiscal Stability Authority (ECFSA) in its review of Erie County's 2017 proposed budget and associated financial plan. The ECFSA is charged with reviewing the county's submission in light of opining on reasonableness and do-ability. Under the legislation that created the Authority, within 20 days of receiving the county's submission, the ECFSA is required to determine, in its best judgment, whether the budget and plan are in balance.

In its current version of the plan, the county is facing $6.3 million in fiscal gaps prior to any adjustments to the county's estimate. This gap is $2.5 million lower than the plan based on the 2016 adopted budget. The 2017 recommended budget property tax levy results in a $13.9 million increase in the county's tax levy, as compared to the 2016 adopted budget – a 5.93% increase. The county maintains that the levy does not exceed the property tax cap and that the tax rate per thousand of valuation decreases by $0.02. However, as a result of a property tax cap calculation error in the 2016 proposed budget, the county inadvertently exceeded the state-mandated tax cap.

2. ***MAJOR PLAN ASSUMPTIONS***

Major assumptions in the financial plan include:

- Sales tax growth of 1.25% county's for 2017 over the county's 2016 year-end forecast, then 1.75% for 2018, and 2.0% for 2019 and 2020.

- Real Estate Market Value Growth, impacting the county's property tax levy, is assumed to increase by 5.93% for 2017 and by 2.5% for 2018, 2019 and 2020.

- The county portion of the property tax levy increased by $13.89 million in 2017. Then increases by $6.20 million in 2018, $6.35 million in 2019 and $6.51 million in 2020 – a total increase of $32.95 million over the period of the plan.

- A 9.0% increase for 2017, followed by a 6.9% increase in health insurance rates for 2018, 6.6% for 2019 and 6.7% for 2020.

- Personal services expenses increase for step and longevity increments, as well as current contractual cost of living increases agreed upon through collective bargaining. For the labor agreements that expire during the period of the plan there is no allowance for potential negotiated wage increases.

- Overtime expense remains virtually flat over the entire period of the financial plan. Rising only at the rate of anticipated salary increases (1.5%) for 2018-2020. The increase for 2017 is only .073%, just under half of the anticipated rate of general salary increase.

- Capital borrowing of $37.96 million for 2017 and between $35 and $39 million for 2018, 2019 and 2020.

- The plan, as presented, shows no gap for 2017 and shortages of $0.51 million for 2018, $4.37 million for 2019 and $1.40 million for 2020.

- The budget and financial plan, to balance, assume a complicated financing arrangement, involving borrowing on behalf of the Medical Center and an ECFSA approved advance refunding totaling approximately $180 million wherein the county would reap the benefits of a credit system with ECMCC to balance tens of millions of dollars in indigent care costs.

3. ***MAJOR ADJUSTMENTS – 2016 ADOPTED BUDGET AND PLAN TO 2017 PROPOSED BUDGET AND PLAN***

Major revenue and spending revisions from the version of the plan based on the 2016 adopted budget include:

- The Property Tax levy has increased by $31.96 million for the 2017-2019 period, as compared to the 2016 adopted based plan.

- Full time salaries are reduced by $5 million for the period 2017-2019.

- Vacancy savings for the period of the plan have decreased by $2.7 million for the 2017-2019 period. An additional $1.1 million has been included in the 2020 fiscal year forecast for vacancy savings.

- The 2017 proposed county budget has an additional 28 full-time positions in the general fund, as compared to the 2016 adopted budget. Other county funds include an additional 5 full-time positions. The total position increase across funds for 2016 totals 33 full-time jobs. There are no additions planned past 2017.

- Fringe benefit costs have been increased for the 2017-2019 period by $2.7 million as compared to the 2016 adopted budget version of the plan. The greatest increase is in medical insurance costs.

- Fringe benefit rates over the period of the current plan increase slightly each year from 53.16% in 2017 to 54.43% of salaries in 2019 for current county employees.

	2017	**2018**	**2019**
2016 Adopted Plan	52.78%	52.71%	53.19%
Current Plan	53.16%	53.87%	54.43%
Increase	**0.38%**	**1.16%**	**1.24%**

- County stated “gaps” are smaller in the most recent version of the plan as compared to the adopted 2016 plan. In that version, the shortages totaled approximately $8.8 million. The current plan calls for shortages of $6.3 million.

- The 2017 fiscal year assumes the use of $6,000,000 in fund balance as revenue to balance the budget. The previous version of the plan assumed no fund balance would be required to balance past 2017. The current version of the plan assumes $3 million per year for the 2018-2020 period.

4. PLAN ASSESSMENT

The stated gaps in the current financial plan are lower, as compared to the previous version that was accepted by the Erie County Fiscal Stability Authority. However, there is a significant risk item related to ECMCC that is currently unresolved. The order of magnitude of this item along with the current lack of resolution and documentation is a major concern for the ECFSA in commenting on the reasonableness and do-ability of the 2017 Erie County Budget and associated financial plan.

The following is a comparison of current and 2016 adopted plan annual gaps (in millions of $’s):

	2017	***2018***	***2019***
Current Plan Gap	***$0.00***	***$0.51***	***$ 4.37***

2016 Adopted Plan Gap	***$4.31***	***$2.52***	***$ 1.97***
Difference	***($4.31)***	***($2.01)***	***$2.40***

Baseline Estimates/Associated Risk

The major risk item is related to ECMCC costs for the county that will be discussed below, in addition to other items of concern:

1. ***Erie County Medical Center Corporation (ECMCC) IGT, DSH and UPL*** - In previous versions of the budget and plan, the county assumed that provisions of the Affordable Care Act (ACA) would significantly reduce or eliminate the county's DISH, IGT and UPL expenses related to the Medical Center. The current plan acknowledges that reaction to ACA has not resulted in the anticipated reductions and may not provide significant relief over the period of the financial plan. The October Budget Monitoring Report (BMR) indicates an expense of $27.1 million against an annual budget of $16.2 million for ECMCC care. The corresponding 2015 expense was $23 million. In 2014, actual spending was $20.7 million.

   To address this issue, the county has put forward a proposal in which it would borrow $100 million for a new ECMCC emergency room and other hospital projects, and would pay-off ECFSA bonds through a yet-to-be approved advance refunding that currently has an approximate $45 million balance. With interest, premiums and other expenses, that figure increases to $80 million. The theory is that any debt service savings, according to the county in the tens of millions of dollars, would relieve Erie County of this expense. The ECFSA has informed the county that, with its higher bond rating (including a recent ratings increase to the Fitch AAA category), it can pursue the borrowing to save interest costs

   There are a number of unresolved issues to this proposal, that fall into three categories –financial, technical and procedural.

Financial issues include:

- The extent of the county's ECMCC related liability over the period of the plan and beyond? The hospital's projections of revenues are $34.5 million greater than the county's spending expectations.

- Given that the county is responsible for any ECMCC deficits, how does this transaction impact the Medical Center's bottom line? In theory, there should be an analysis of debt service costs vs additional ER generated revenues as a subset of overall ECMCC financial projections.

- What is the order of magnitude of the proposed borrowing savings (potential credits)?

Technical issues include:

- Assuming financial questions can be resolved, how is the allocation of savings (credits) applied? Based upon total savings, present value or some other methodology?

- What is the timing of the credits? Assuming a 20 to 30 year borrowing, would the credits match the annual comparative savings over that period of time? Would that be sufficient to ameliorate the fiscal impact for the county without overburdening the Medical Center?

- If DSH, IGT and UPL are expected to significantly reduce or be eliminated over time, what would happen with potentially unused future credits?

- If credits are used faster than a realistic bond amortization schedule would call for, how does the county address this item while maintaining its and ECMCC's long-term financial health?

Procedural issues include:

- Approval by the NYS Comptroller's Office - Given the complex nature of the proposal, care would have to be given to any potential issues that might arise in the approval process.

- Approval/Potential Issuance by the ECFSA – According to ECFSA Bond counsel, any advance refunding of ECFSA bonds cannot unilaterally be done by the county. The county must respond to the reasonable question of how a county 30 year refinancing of ECFSA bonds that expire in 2028 can save money over a straight ECFSA refinancing without extending the end date of the securities.

- Approval by the Erie County Legislature – Any county borrowing requires a super majority of the Legislature. As of the date of the writing of this report, the Legislature has not signed-off on this borrowing/credits proposal.

2. ***Sales Tax Revenues*** – The plan assumes a 1.25% increase in 2017 sales tax revenues over 2016 county forecasted amounts. That is followed by a 1.75% increase for 2018 and 2% annual increases for 2019 and 2020. Given long term averages these growth percentages do not appear to be unreasonable. However, year-to-date sales tax trends indicate a larger budget deficit than the county is assuming for fiscal 2016.

The county has over-budgeted sales tax revenues for the last four years and as of the most recent Budget Monitoring Report, is showing a budget deficit of $1.28 million in this account. County officials have stated they expect a $2.5 million deficit in this account at year-end. The ECFSA estimates a somewhat higher negative variance, at $6.3 million for 2016, the base year for financial plan estimates.

3. ***Overtime*** – the current financial plan calls for overtime expenses to remain relatively flat, despite a current and previous budget deficits in this account and general wage increases as mandated by collective bargaining agreements

   Overtime expenses have increased slightly over the previous two fiscal years. From $15.29 million in 2014 to $15.34 million in 2015. FY 2016 is on-track for $15.5 million in overtime spending. Given recent spending trends and assuming a 1.5% general salary increase for the 2017-2020 period for the financial plan, overtime expenses for the period would run a deficit of $6.7 million for the four years total.

4. ***Vacancy Savings*** – The current plan calls for $4.4 million in savings over 4 years - $1.1 million in each of the 4 years. While annual and aggregate figures are very achievable, based upon the county's program of holding positions vacant, the increase in budgeted vacancy savings is a concern, in that it lessens the arsenal the county has to call upon in the event of a shortfall elsewhere in the budget.

5. ***Labor Agreements*** – In the Labor Relations Department Top Priorities for 2017 is to negotiate successor labor agreements with CSEA, CSEA Corrections Officers, Teamsters and PBA and to finalize outstanding issues related to negotiations with AFSCME. Potential negotiated cost of living increases are not included in the financial plan for any of these unions. The ECFSA has not been kept abreast of these negotiations so that it can opine on the financial ramifications.

6. ***Pension Expenses*** – In comparing the current financial plan to the last submission, pension expenses have gone down by almost $822,000 for the concurrent years of the forecast. Analytical review of the plan indicates these reductions appear reasonable given the new hires joining the county at Tier 6, yet hold little leeway for a surplus in this account.

7. ***Workers Compensation*** – As compared to the previous version of the financial plan, Workers Compensation expenses are anticipated to decrease from approximately $1.9 million over the 2017-2019 concurrent period of the plan. The county attributes this to solid case management and the effects of prior year lump sum settlements that reduce out-year costs.

8. ***Employee Medical***– Compared to the 2016 Adopted budget submission, employee medical expenses have increased by $5.7 million for 2017 through 2019. The county had previously indicated that health care costs would be ameliorated as a result of negotiated contract provisions.

9. ***Retiree Medical*** – As compared to the 2016 adopted budget version of the financial plan, the county has decreased its estimates for retiree medical expenses by $905,000 for the concurrent period of the plan.

10. ***Risk Retention*** – In 2015, the county incurred $3.6 million in Risk Retention expenses. Comparable 2014 and 2013 county actuals are $1.9 million and $2.2 million respectively. The 2017 departmental request is $4 million. The county has not furnished detailed schedules to support this appropriation. However, given the most recent complete year's spending, augmented by the departmental request, the current appropriation appears to be on the lower end of the range to cover expenses going forward.

Gap and Gap Closers

On the most recent version of the plan the county is reporting a smaller gap than in the past - $6.3 million in the current submission vs. $8.8 million in the 2016 adopted plan.

The current, stated gaps are as follows:

Year	***Gap***
2018	$ 518,286
2019	$ 4,378,476
2020	$ 1,405,808
Total	***$ 6,302,570***

The county has put forward a number of potential gap closers including:

- Better than expected sales tax revenue
- Better than expected property assessment revenue
- Reductions in discretionary spending, including in personal services and deletions of positions
- Expedited retirements of employees due to union contract provisions and new contracts
- Property tax revenue
- The use of appropriated fund balance
- Participation in the Employer Contribution Stabilization Program
- State reimbursement for indigent legal defense expenses
- More favorable caseload trends in social services accounts

Potential gap closers are not quantified at this point. Amounts and usage are contingent upon the order of magnitude of fiscal issues the county may face.

5. SUMMARY/RECOMMENDATIONS

The overriding issue for Erie County at this point is related to ECMCC - DSH, IGT and UPL payments. There is a documented disconnect between ECMCC's expectations of county payments and the county's budget and financial plan. The order of magnitude of the issue and the uncertainty of a potential resolution is so great that the ECFSA, in accordance with its enabling legislation, cannot opine with certainty at this time that the county budget and financial plan are in balance, are reasonable and achievable.

In addition to the ECMCC issue there are a number of risk items that, if not addressed sooner rather than later, could exacerbate future shortfalls and stall the county's fiscal recovery.

The ECFSA, in this report cites specific issues the county faces and needs to appropriately address, including:

Erie County Medical Center Corporation

- Over the period of the financial plan, Erie County has budgeted $107,187,842 in ECMCC related DSH, IGT and UPL related expenses. For the same period, ECMCC has projected $283,409,000 in DSH, IGT and UPL revenues. Erie County's share of those ECMCC revenues is 50% - $141,704,500. Leaving a $34,516,658 shortfall in anticipated county appropriations. The county is looking toward a yet-to-be-realized borrowing/credits proposal (covered earlier in this report), worth in the "tens of millions of dollars" to fill the gap.

Recommendation - Given the order of magnitude of the problem and the immediacy of financial ramifications, a resolution is required by the completion of the 2017 budget adoption process. There appears not to be a sufficient appetite among the necessary number of county lawmakers for the initial borrowing proposal to be implemented. The ECFSA urges county leaders to address this issue in a cooperative, non-partisan way to provide reasonable assurance of the county's and the hospital's long-term fiscal health.

Property Tax Revenues/Cap

- The property Tax Levy, at $248 million in the 2017 proposed budget encompasses 17% of all general fund revenues. Erie County, like all municipalities in New York State is constrained by the State imposed tax cap. For 2017, the county's cap work sheet indicates it is only $124,362 under that cap. It was reported that last year's proposed budget levy inadvertently exceeded the cap.

Recommendation - Given the nuances of calculating the cap, it is recommended that the county carefully calculate its cap on a consistent basis over the period of the plan to provide reasonable assurance of compliance with its tenets.

Sales Tax Revenues

- Sales tax is the largest single revenue source for Erie County, encompassing 30% of general fund revenues in 2017. Since 2009, when sales tax revenues decreased as compared to the prior year, the county has benefitted from regular increases in this revenue source. Outside of regularly reauthorizing the legislation to maintain this revenue, there is little the county can do to impact its growth. According the most recent BMR the county has a $1.28 million budget deficit in this account. Assuming sales tax revenues maintain their current trajectory in 2016, the county would suffer a $6.3 million deficit in this account for the current year (the base year), thereby lowering future estimates. Assuming current rates of increase hold constant, sales tax receipts would fall short of plan expectations by approximately $16.7 million.

- ***Recommendation*** - Given the volatility of this revenue source, and prior overestimations, the ECFSA urges the county to closely monitor receipts and make strategic decisions to maintain a balanced budget in the event that this major item does not meet expectations.

Overtime

- The county has consistently exceeded its overtime allocation. In 2014 and 2015 respectively, the county spent $15.29 million and $15.34 million. For 2016, the county is on track to spend $15.5 million by year-end against a budget of $13.9 million. That shortfall is anticipated to continue, exacerbated by annual salary level increases, resulting in a $6.7 million shortfall over the period of the plan.

- ***Recommendation*** - The ECFSA urges the county to continue to closely monitor overtime to provide reasonable assurance that overtime will be reduced to expected levels of approximately $14 million per year, while not compromising compliance. If anticipated material overtime reductions do not emerge in a reasonable period of time the county is urged to take appropriate actions, which may include overtime appropriations that more closely match actual expenses.

Expired/Expiring Labor Agreements

- Despite the Department of Labor Relations goals of settling significant contracts in 2017, the county has not specifically budgeted funds for any potential net settlement costs.

- ***Recommendation*** – the ECFSA urges the county to prepare for potential negotiations with an eye toward further benefit and/or work rule changes that will foster a stable county labor force, while not overburdening county taxpayers.

Vacancy Control

- The use of vacancy savings to help balance the budget and plan reduces the order of magnitude of turnover/vacancy savings as a potential gap closer.

- ***Recommendation*** - the ECFSA urges the county to maintain its vacancy control program, while keeping budgeted vacancy savings at minimal levels. In 2016 the county has maintained a program in which between 5-7% of its full time general fund positions remain vacant. Continuation of that program with like vacancy percentages is necessary to balance the plan through 2020.

Pension

- County pension rates and associated expenses are going down, with rates and costs lower in the current version of the plan as compared to the previous plan.

- ***Recommendation –*** The ECFSA recommends that the county closely monitor this account and maintain vacancy and other related savings that will mitigate its exposure in this account, given the reductions in the plan expenditures.

Workers Compensation

- There are expected decreases in anticipated Workers Compensation expenses as compared to the previous version of the financial plan. The county has indicated, in the past, that there are initiatives that are assumed to reduce this expense line.

- ***Recommendation*** – The ECFSA recommends that the county closely monitor initiatives to reduce this expense line to determine whether the undertaken initiatives are having or will have the originally intended expense reduction impact.

Medical Expenses

- Compared to the Adopted 2016 Budget submission, employee medical expenses have increased in this version of the financial plan. The county has indicated that the higher costs are the result of trends received from its healthcare subsidiary – Labor Management Healthcare Fund and its consultant. According to the county, there is a blended increased cost of 9%. However, LMHF published rates for 2017 show an increase of 15%.

- ***Recommendation*** - The ECFSA urges the county to closely monitor the implementation of contract provisions and other initiatives to provide reasonable assurance that the order of magnitude of anticipated savings mitigates general health care cost increases.

Staffing

- For the 2017 proposed budget, the county is assuming the addition of 33 positions across all funds, as compared to the 2016 adopted budget. The county is not planning further additions or deletions past 2017.

- ***Recommendation* -** The ECFSA urges the county to continue to use technology and management initiatives to "do more with less" and to maintain the management discipline of looking for and implementing efficiencies within functions and departments to further streamline county government.

Fund Balance

- In the most recent version of the plan, the county is extending its use of budgeted fund balance. If not replenished, the potential use of $15 million lowers the county's reserves and indicates an imbalance between recurring revenues and expenses.

- ***Recommendation*** - the ECFSA looks to the county to closely monitor expenses and revenues and to review service models to determine the best and most cost-effective ways of providing both mandated and non-mandated services to those impacted by Erie County Government, while maintaining the county's reserves and to tap fund balance as a last resort.

In closing, we want to reiterate that there are significant uncertainties in the county's current budget and financial plan that will require positive action by county leaders prior to the completion of the 2017 budget adoption process. The ECFSA urges county officials to work jointly toward addressing the matters at hand to provide reasonable assurance that the county's fiscal health will continue to improve.