City of Buffalo

Department of Audit & Control

Budget Response

2018-2019 Fiscal Year
&
2019-2022 Four Year Financial Plan

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MAY 10, 2018

Charter of the City of Buffalo

§ 20-7 Comptroller's Assessment of Accuracy of Revenue and Expenditure Assessments.
[Amended 10-2-2012 by L.L. No. 1-2012, effective 10-2-2012]

"On or before the tenth day of May, the Comptroller shall submit to the council an assessment of the accuracy of the revenue and expenditure estimates of the budget and the four-year financial plan the mayor submits to the council. The comptroller shall opine on the sufficiency of the financial plan and whether it contains sufficient data to support the outcomes projected."

Introduction

Pursuant to the City Charter, and the Comptroller's role as the City's chief fiscal officer, I hereby submit this assessment of the Mayor's recommended budget for the fiscal year 2018-2019, as well as the four-year financial plan for fiscal years ending 2019-2022.

This office has very serious concerns about the proposed budget and the fiscal road ahead for the City of Buffalo. While there was progress on boosting structural revenues, it might be "too little, too late," as the city is in considerably worse financial shape than it was just a couple years ago.

In fact, those structural revenue increases serve only to keep pace with rising expenses, while doing nothing to close the budget gaps that led to $35 million in reserves being used last fiscal year, and another $30-plus million that will be needed in the current year.

And while the proposed budget for next year only relies on $4 million in reserves (from capital outlay) to balance the budget, the primary reason for that is because there are not any more reserves available for that purpose.

Instead, the budget gap is closed with revenues that are drastically overestimated, similar to what we've seen in previous years. But this time, there will be very little margin for error in the proposed budget because there are not enough reserves to bail the city out of these reckless revenue estimates. Furthermore, any savings in expenses due to vacant but budgeted positions will likely be eliminated by additional overtime expense, which was budgeted at little more than half of the actual amounts spent in recent years.

In addition to assessing the accuracy of revenue and expense estimates, this report will address the city's reserve position, the four-year financial plan, and the potential consequences of adopting the recommended budget in its current form.

Revenues

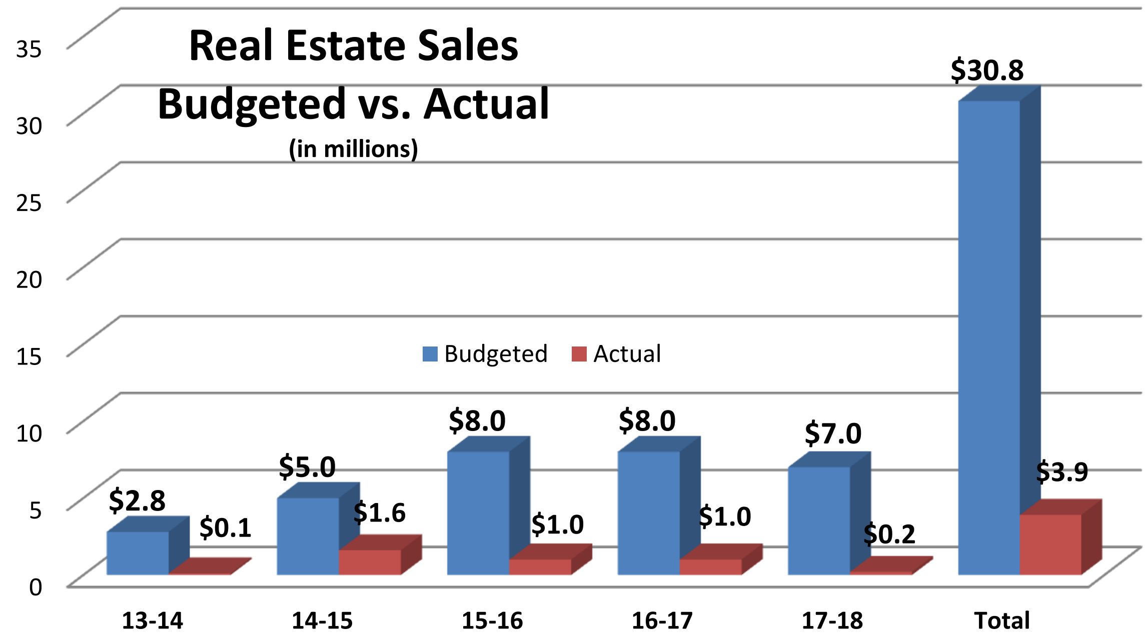
The recommended budget includes revenues of $513.5 million in 2018-2019. More than $33 million of these revenues are highly questionable, often with little assurances or information provided to corroborate the estimates.

Below is a chart showing budgeted amounts compared to prior and current year actuals, as well as more responsible revenue estimates for each item:

Questionable Items included in the 2018-2019 Budget	**A 2018-2019 Proposed Budget**	**B Current FY Actual as of 4/30/2018**	**C 2016-2017 Actual**	**D Responsible Budgeting**	**E Overestimated Revenue (A-D)**
Tribal Pact Casino Revenue	$17,000,000	$0	$3,439,330	$0	$17,000,000
Sale of City Owned Real Estate	8,000,000	240,693	1,060,836	1,000,000	7,000,000
Traffic Violations Revenue	6,000,000	2,009,690	3,993,940	3,000,000	3,000,000
Entertainment Ticket Fee	2,000,000	N/A	N/A	0	2,000,000
Gifts and Donations	2,000,000	15,933	51,097	150,000	1,850,000
Parking Tags and Fines	7,900,000	5,827,008	5,784,081	6,900,000	1,000,000
Grant Reimbursement	1,414,099	90,954	0	100,000	1,314,099
Total					**$33,164,099**

Tribal Pact Casino Revenue – Prior to 2016-2017, the City had been receiving approximately $7 million per year from the Seneca Nation (via New York State) as the host community for the Buffalo Creek Casino. A dispute between the Seneca Nation and New York State has stopped those payments, with only $3.4 million received in 2016-2017, and no revenue received in the current year. Presumably, the $17 million included in the 2018-2019 recommended budget represents the revenue that wasn't received in 2016-2017 and the current year ($10 million), as well as the payments due for 2018-2019 ($7 million). With no substantial progress in resolving the dispute between the Seneca Nation and New York State, there are no assurances that payments to the City would resume in 2018-2019, nor any indication that the City would receive the back payments in that same year. Additionally, if an agreement is reached in 2018-2019, it is possible that payments to the City would be for an amount different than what it had been receiving previously. Budgeting any amount for casino revenue is overly optimistic – budgeting two and a half years' worth of revenue is extremely reckless.

Sales of City-Owned Real Estate – This is another source of revenue that is grossly overestimated, with $8 million budgeted for 2018-2019. The City has only received $4 million in revenue in the past five years ***combined***, as you can see from the graph below.



Actual revenue has been 12 percent of the $30.8 million that has been budgeted during that span. In 2016-2017, the City budgeted $8 million in real estate sales and only took in $1 million. $7 million was budgeted in the current fiscal year, and to date, the City has received $240,693. While pending sales could lead to the City receiving more revenue than it usually gets, the likelihood of the City receiving $8 million seems extremely far-fetched based on previous results. The City's ability to realize revenue from real estate sales is also hindered by the fact that the list of vacant residential properties for sale is not available to the public on the City's website.

Traffic Violations Revenue – Since the City began adjudicating its own Traffic Violations in 2015, it has regularly over budgeted this line item. For 2017-2018 the City budgeted $6.2 million for Traffic Violations revenue, yet it is only expected to receive $3 million, down from $4 million in the previous year. Despite revenue declining for this line item, the City budgeted $6 million, about twice as much as what we will receive for the current year.

Entertainment Ticket Fee – The inclusion of revenue from the newly proposed Entertainment Ticket Fee appears to be premature, as the specifics of such a program are yet to be defined. The workgroup, which will be responsible for determining the fee amounts, implementation date, and other crucial details, has not even been created at this point. To assume that revenue will start coming in for this line in 2018-2019, with no legal or logistical framework currently in place, is overly optimistic.

Gifts and Donations – This entails the creation of a "Charitable Gift Fund" which would allow citizens to contribute to this fund and use 95% of that contribution as an offset to their real property tax. This could be advantageous to those who will still itemize their deductions on their federal tax return, because this "contribution" would be treated as charitable and not subject to the State and Local Tax deduction limit within the new federal tax legislation. But this property tax "contribution" will not bring in significant revenue to the City. The increase in revenue would only be 5% of the "contribution" as the other 95% would go to offset the citizen's property tax bill. This 5% gain would most likely be offset by the administrative costs associated with administering this fund. The City also indicated that this fund would be used to aid in receiving donations from businesses and the general public, but at this point in time, there appears to be only one committed donation in an amount just over $120,000, with no other public commitments for additional donations. At this point in time, assuming $2 million for this line item appears overly optimistic, as there is little information to back up that estimate.

Parking Tag and Fines – The City plans to roll out an amnesty program for parking tickets and quality of life fines. The establishment of this program should bring in revenues, but the waiving of interest and penalties will need to be considered as a partial offset to this gain. Relying on a $2 million revenue expectation to help balance the budget, when we have no history administering such a program, is concerning.

Grant Reimbursement – The City plans to increase revenues with the addition of two grant writing positions, which are supposed to generate approximately $1.4 million in grant revenue. Like the Entertainment Ticket Fee, many steps must take place in order to realize this revenue – the hiring of candidates, and the identification, application, and awarding of grants, as well as the fact that many grants require that the funds be spent first before reimbursement is received. It is highly likely that any grant gain will not be realized for some time. Therefore, the reliance on this revenue item is also overly optimistic.

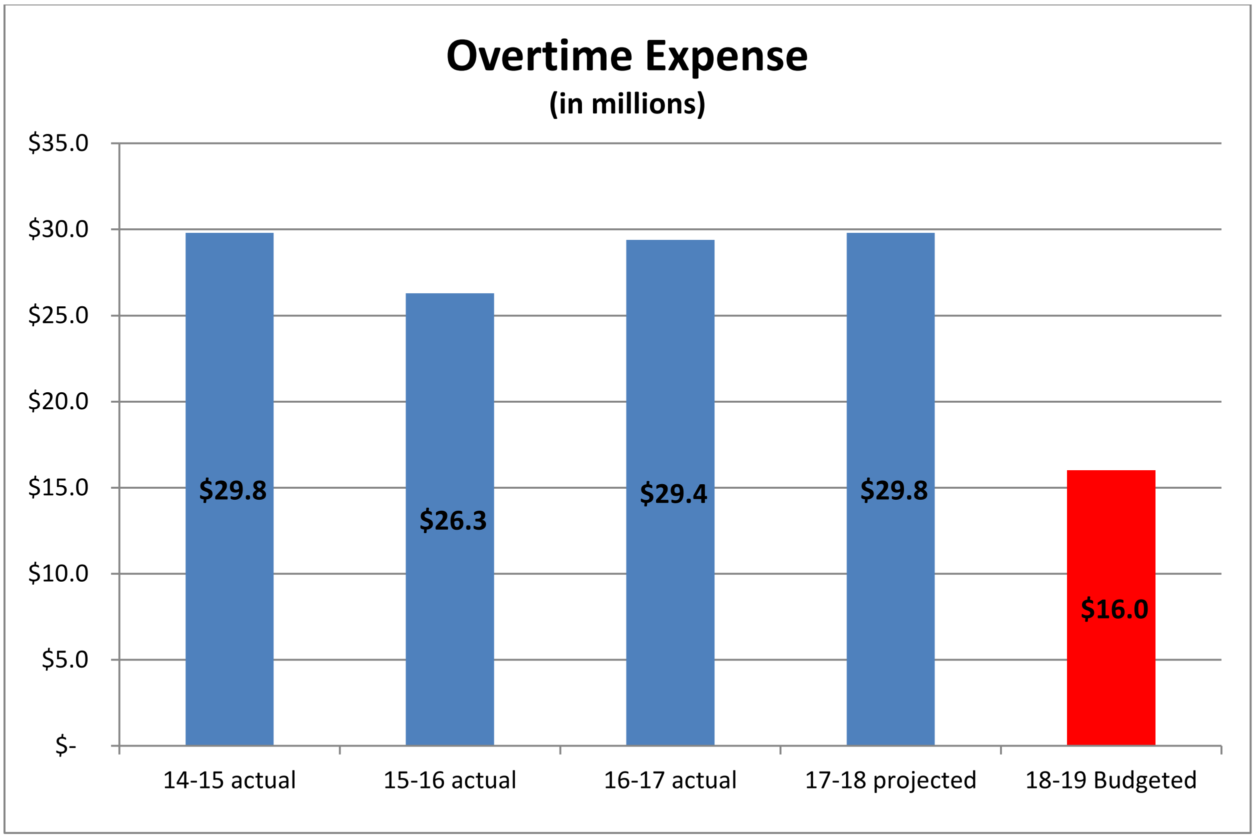
Rate Increases – There are several revenue items budgeted for rate increases, such as building permits and home inspection licenses, that are expected to bring in over $1 million of additional revenue. These rate increases appear to go into effect July 1, 2018 and require prior Common Council approval. The City should ensure that the approval process is accomplished timely to guarantee full receipt of these budgeted increases.

Expenses

The recommended budget includes $513.6 million in expenses for 2018-2019, an increase of 2.8 percent over the 2017-2018 adopted budget.

Personal Services – This labor-driven line item represents $200.9 million of expenses, and includes items such as salary, overtime, duty disability pay, and longevity payments. While budgeted positions account for $205.3 million worth of expense, savings from "attrition" reduces this amount by $4.4 million. "Attrition" accounts for anticipated retirements and the expectation that those positions will go either unfilled or be filled by an employee earning lower wages.

While attrition is accounted for in the recommended budget, vacant positions are not, which could lead to savings on expenses. However, those savings could be wiped out by additional overtime costs, which are budgeted at $16 million, despite recent trends indicating an expense of nearly twice that amount.



While the City has hired hundreds of employees in recent years, any overtime savings from the recent hires has been mitigated by corresponding retirements.

Judgments and Claims – This expense is regularly underestimated, and with $2 million budgeted in the 2018-2019 recommended budget, is most likely underestimated once again. The average annual expenditure for Judgments and Claims has been approximately $4 million over the past six years, and exceeded $8 million just last year.

2014-2015 Actual	**2015-2016 Actual**	**2016-2017 Actual**	**2017-2018 as of 4/30/2018**	**2017-2018 Budgeted**	**2018-2019 Recommended Budget**
$2,900,927	$3,624,789	$8,113,841	$3,949,205	$2,000,000	$2,000,000

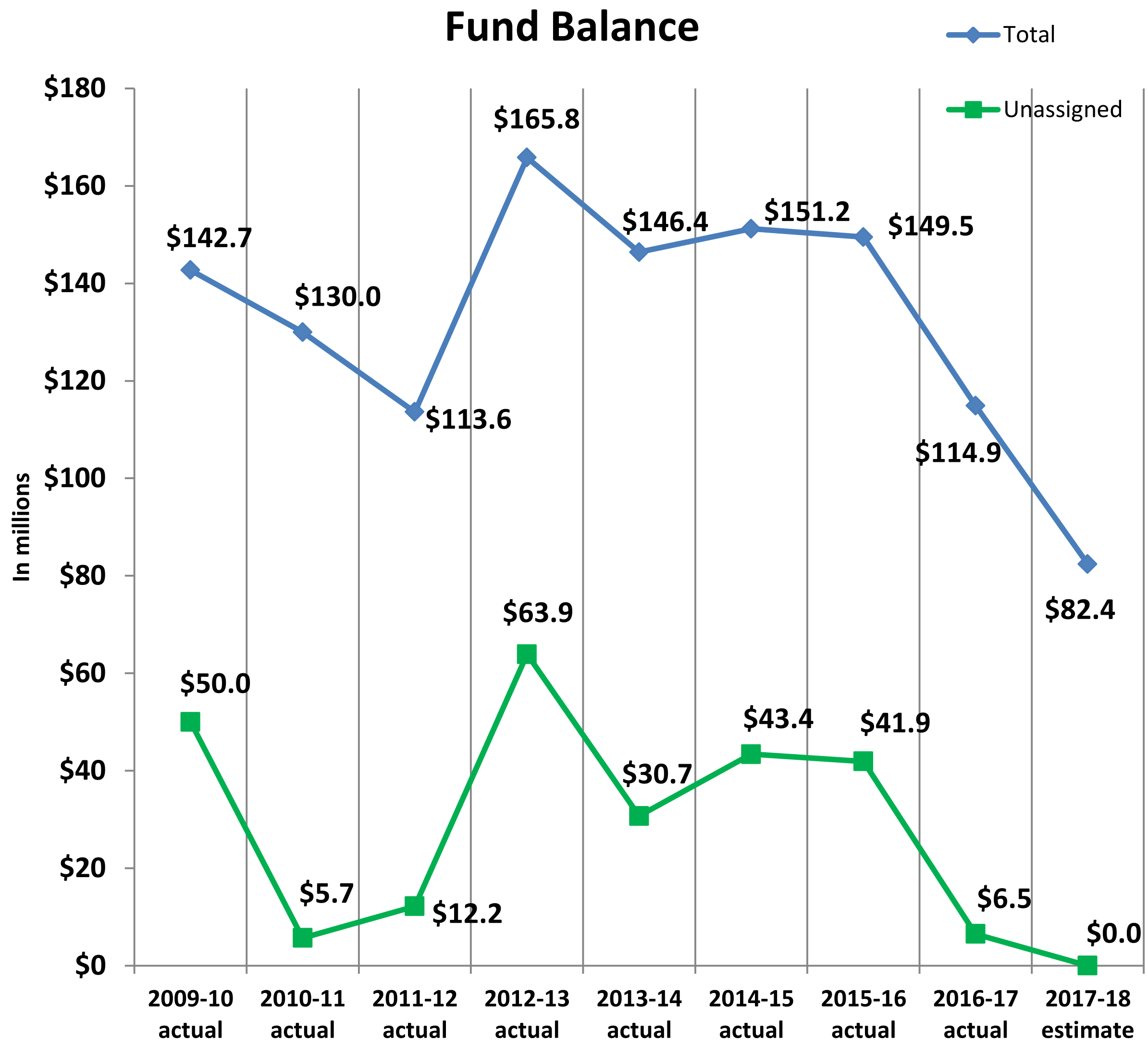
Since the City is self-insured, this is an expense that can result in significant exposure based on claims made against the City. Due to the projected poor financial performance on the 2017-2018 year, the City is expected to completely deplete its unassigned fund balance. Without an amount within the unassigned fund balance, the City will be unable to set aside any additional funds for potential exposure within the assigned fund balance, and in fact will need to eliminate the $13 million that is currently designated in assigned fund balance for Judgments and Claims. Therefore, it is likely that the current budgeted amount of $2 million is understated, likely by millions of dollars.

Fund Balance

The City's reserves, known as Fund Balance, acts as a savings account for the City. Unfortunately, in recent years it has instead been used to shore up budgets that are not structurally balanced. $85 million in reserves have been squandered in the past seven years, and with approximately $35 million needed for the current fiscal year, the amount of reserves used to close budget gaps will be about $120 million.

Most of the City's Fund Balance is set aside for specific purposes. The only category of Fund Balance that can be used to fill budget gaps is Unassigned Fund Balance, which was $41.9 million just two years ago. Today, Unassigned Fund Balance sits at $6.5 million, and by the end of the current fiscal year, it will either be $0 or a negative amount.

The depletion of the City's Fund Balance (and the cause of that depletion – structurally imbalanced budgets) has led both Moody's and Standard & Poor's to revise the City's bond ratings from "Positive Outlook" to "Stable Outlook." Such actions are precursors to rating downgrades from those rating agencies, as well as Fitch Ratings, the third of the "Big Three" rating agencies. Downgrades lead to increased interest costs for capital borrowing.



In addition to potential bond rating downgrades, the depletion of the City's reserves will undoubtedly lead to serious cash flow problems in 2018-2019. As a result, the City will have to rely on short-term borrowing just to pay its bills. Such borrowing, in the form of a Revenue Anticipation Note (RAN), will be needed by December 2018, and the amount needed could exceed $100 million. Interest costs for a RAN of that amount will be more than $1 million, an expense the city would not have to incur if it hadn't squandered its reserves. Judgment and claims in excess of what is anticipated could lead to the need for additional short term borrowing.

To put that into perspective, between 2013-2016, the City was so cash-rich that it loaned other municipalities $85 million to help them with their cash flow issues, yielding nearly $330,000 in interest income. Now the City is on the other side of that equation – so cash-poor that it will need to be the one doing the borrowing and paying interest.

Four-year Financial Plan

The four-year financial plan inexplicably keeps expenses flat in the out years, despite a clear trend of growing expenditures. The four-year plan does not contain sufficient data to support the outcomes projected. Also absent from the plan is an effort to gradually replenish the City's Fund Balance, as the lack of available reserves is a problem that needs to be addressed immediately and consistently.

Conclusion

While the 2018-2019 recommended budget may be balanced on paper, in actuality, it is based on fuzzy math and wishful thinking. Adopting such a budget in its current form will set the City up for failure. Without the adjustment of revenues to more realistic amounts, and/or the cutting of expenses, the City will have an extremely difficult time meeting the projections included in the recommended budget.

While Budget Responses from this office in previous years had issued similar warnings, the consequences for coming up short on revenues in 2018-2019 – potentially by more than $30 million – are especially dire. Aside from the potential bond rating downgrades and cash flow problems addressed in the previous section, an operating deficit of more than one percent (approximately $5 million) could lead the Buffalo Fiscal Stability Authority to change from an advisory status to a control period. In addition to taking control of the City out of the hands of the officials that were elected to govern, the return of the "hard control board" would send a terrible message to the City's investors, creditors, rating agencies, and most importantly, its citizens.