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November 7, 2014

Honorable Lou Rosamilia, Mayor
Members of the City Council
City of Troy
City Hall
Troy, NY 12180

Report Number: B5-14-23

Dear Mayor Rosamilia and Members of the City Council:

Chapter 721 of the Laws of 1994, as amended, authorized the City of Troy (City) to issue debt totaling $21,630,000 to liquidate cumulative deficits in the City's general fund for the years ending December 31, 1993, 1994 and 1995. New York State Local Finance Law Section 10.10 requires all local governments that have been authorized to issue obligations to fund operating deficits to submit to the State Comptroller each year, starting with the fiscal year during which the local government is authorized to issue obligations and for each subsequent fiscal year during which the deficit obligations are outstanding, their tentative or proposed budget for the next succeeding fiscal year.

The budget must be submitted no later than 30 days before the date scheduled for the City Council's (Council) vote on its adoption or the last date on which the budget may be finally adopted, whichever is earlier. The State Comptroller must examine the proposed budget and make recommendations for any changes that are needed to bring the proposed budget into balance. Such recommendations are made after the examination of the City's revenue and expenditure estimates.

The Council, no later than five days prior to the adoption of the budget, must review all recommendations made by the State Comptroller and may make adjustments to its proposed budget consistent with those recommendations contained in this report. All recommendations that the Council rejects must be explained in writing to our Office.

Our Office recently completed a review of the City's budget for the 2015 fiscal year. The objective of the review was to provide an independent evaluation of the proposed budget. Our review addressed the following questions related to the proposed City budget for the 2015 fiscal year:

- Are the significant revenue and expenditure projections in the City's proposed budget reasonable?

- Did the City take appropriate action to implement or resolve recommendations in our review of the proposed 2014 fiscal year budget?

To accomplish our objectives in this review, we requested your proposed budget, salary schedules, debt payment schedules and other pertinent information. We identified and examined significant estimated revenues and expenditures for reasonableness with emphasis on significant and/or unrealistic increases or decreases. We analyzed, verified, and/or corroborated trend data and estimates, where appropriate. We identified any significant new or unusually high revenue or expenditure estimates, made appropriate inquiries, and reviewed supporting documentation to determine the nature of the items and to assess whether the estimates were realistic and reasonable. We also evaluated the amount of fund balance appropriated in the proposed budget to be used as a financing source and determined if the amount of fund balance was available and sufficient for that purpose. In addition, we checked whether written recommendations from the prior year's budget review were implemented or resolved and, therefore, incorporated as part of the current year's budget.

The scope of our review does not constitute an audit under generally accepted government auditing standards. We do not offer comments or make specific recommendations on public policy decisions, such as the type and level of services under consideration to be provided.

The proposed budget package submitted for review for the fiscal year ending 2015 consisted of the following:

- Cover Letter
- 2015 Proposed Budget
- Supplementary Information

The proposed budget submitted to our Office is summarized as follows:

Figure 1: Proposed Budget

Fund	Appropriations and Provisions for Other Uses	Estimated Revenues	Appropriated Reserved Fund Balance	Real Property Taxes
General	$66,124,624	$45,787,775	$725,000	$19,611,849
Water	$12,696,267	$12,696,267	$0	$0
Sewer	$4,309,874	$4,309,874	$0	$0

The City's proposed budget, while generally reasonable, needs improvement to make it a better tool for prudently managing the City's resources. Furthermore, the general, water and sewer funds have displayed trends of weakening financial position and must be monitored to ensure the declining trends are reversed. In addition, the City's 2015 proposed budget does not appropriate enough money for contingencies to provide adequate flexibility to pay for unanticipated costs, and it provides only minimal funding for capital improvements. We found that the City's proposed real property tax levy is in compliance with the City's tax levy limit.

The following findings have been discussed with the City Comptroller and should be reviewed by the Mayor and Council. Good management practices require that City officials take prompt action concerning our recommendations, which we believe will improve the City's financial condition.

Financial Condition

The fiscal stability of each of the City's three operating funds[1] has declined over the last several years. The City has consistently relied on the appropriation of reserves to finance recurring costs in the general fund, has failed to properly fund capital costs and has failed to include an adequate contingency fund in its adopted budgets. The City did not increase sewer rates to sufficiently fund increased expenditures related to the City's participation in the Combined Sewer Overflows Long Term Control Plan[2] (Plan) which is designed to help the City meet federal Clean Water Act goals by preventing untreated effluent from entering the Hudson River. Furthermore, although the water fund realized operating surpluses over the last several years, interfund transfers to the general and capital projects funds have caused the water fund's cash and fund balance to decline significantly.

General Fund – The general fund is displaying trends of declining financial condition. From 2011 to 2013, the fund realized operating deficits totaling $5.9 million. These operating deficits were offset to some extent by transfers from the water fund. However, fund balance still declined by $3.3 million[3] from $16.2 million as of January 1, 2011 to $12.9 million as of January 31, 2014.

Figure 2: Results of Operations			
	2011	**2012**	**2013**
Revenues	$61,640,643	$62,778,140	$61,718,600
Expenditures	$63,931,114	$64,041,367	$64,085,632
Excess (Deficiency) of Revenues Over Expenditures	**($2,290,471)**	**($1,263,227)**	**($2,367,032)**
Plus: Operating Transfers In	$2,608,760	$2,154,674	$2,331,848
Less: Operating Transfers Out	$2,339,908	$911,779	$805,234
Net Results of Operations	**($2,021,619)**	**($20,332)**	**($840,418)**

Traditionally, the general fund has relied on the annual interfund transfers from the water fund to offset operating deficits. However, there are also declining trends in the water fund. As a result, the water fund's ability to make interfund transfers to the general fund may be limited in future. Additionally, in the last three years, the general fund has also made operating transfers to other funds[4] and as a result, the general fund balance has declined over the last three years which has limited the financial flexibility of the general fund.

[1] The general fund, water fund and sewer fund.

[2] The City uses combined sewer systems that collect storm water runoff, domestic sewage and industrial wastewater in the same pipe. During heavy rain and snow events, the capacity of the sewer system can be exceeded and the combined sewer overflow will be discharged directly into the river.

[3] This includes a $369,741 prior period adjustment to decrease fund equity in 2012.

[4] The capital projects fund and the community development fund

Although the City has a substantial amount of total fund balance, a significant portion of it is reserved[5] and may only be used for specific purposes. Between $8 million and $8.8 million of the City's total fund balance over the last four fiscal years was reserved for debt service associated with the bonds issued by the City to liquidate the cumulative deficit. These funds may only be used in accordance with the deficit financing legislation. Furthermore, the City established several reserves for various purposes and has used a significant portion of these reserves over the last several years to finance annual recurring costs.

Figure 3: Fund Balance and Reserves				
	January 1, 2011	**January 1, 2012**	**January 1, 2013**	**January 1, 2014**
Total Fund Balance	$16,185,260	$14,163,641	$13,773,568	$12,933,150
Reserve for Debt	$8,026,408	$8,316,476	$8,631,412	$8,771,852
Other Reserves [a]	$6,209,446	$4,365,438	$3,483,134	$2,642,955
Unreserved Fund Balance	$1,949,406	$1,481,727	$1,659,022	$1,518,343
[a] Other Reserves are comprised of the snow and ice removal reserve, insurance reserve, capital reserve, unemployment reserve and workers compensation reserve.				

In the 2011 through 2014 adopted budgets, the City appropriated significant amounts[6] of the reserves, other than the reserve for debt, to finance associated costs each year. As a result, the balances in these reserve funds has declined by $3.6 million, from a combined $6.2 million in 2011 to $2.6 million as of January 1, 2014; this represents a 58 percent decrease. The City appropriated $1.4 million from these reserves in the 2014 budget and if the City uses the entire amount appropriated in 2014, which we believe is likely, the balance will decline further to $1.2 million. The City's 2015 proposed budget also included the appropriation of $725,000 from the same reserves, which will cause the balance to decline further to $500,000. The City's use of these reserves over the last several years has limited its ability to use them in 2015 and in future years to fund associated costs. As a result, these costs must be included in the City's budget and funded with other revenue streams. Furthermore, due to the operating deficits in 2011, 2012 and 2013, the City's unreserved fund balance has also declined over the last three years from $1.9 million to $1.5 million as of January 1, 2014.

<u>Sewer Fund</u> – The fiscal stability of the sewer fund has declined over the past several years. As noted in our review of the 2014 proposed budget, the fund has displayed continuing trends of declining financial condition. Total fund balance decreased from $471,024 in 2009 to $91,619 in 2012. In 2013, the fund realized a small operating surplus, causing fund balance to increase to $126,236. Furthermore, the fund's unrestricted, unappropriated fund balance decreased from a deficit of $16,154 in 2009 to a deficit of $258,906 in 2013. During the same period, the sewer fund's assigned fund balance[7] (for which the City has an intended purpose) ranged from $810,000 to $385,000, primarily because of an encumbrance of moneys related to the City's participation in

[5] New York State General Municipal Law (GML) authorizes the establishment of various reserve funds for the purpose of financing all or part of specified future costs.
[6] The City appropriated approximately $500,000, $1.8 million, $400,000 and $1.4 million from these reserve funds in the 2011 through 2014 adopted budgets, respectively.
[7] Previously classified as reserve for encumbrances

the Plan. However, participation in the Plan without effectively developing and implementing the means to pay for it could significantly impact the sewer fund's short-term and long-term fiscal health.

As a result of our reviews of the 2012, 2013 and 2014 proposed budgets which cautioned the City against adopting budgets that do not contain provisions to adequately fund tentative Plan expenditures, City officials increased sewer rates in 2013. However, this rate increase was not sufficient to generate the $3.2 million estimate for sewer rent revenues included in the 2013 adopted budget and the City realized $2.6 million of revenues for sewer rents. This revenue shortfall was offset because the City did not expend the entire amount appropriated in the 2013 budget.

The 2014 adopted budget contained sewer fund appropriations totaling $3.5 million, of which $3.3 million was to be financed with sewer rents. Although the City increased the revenue estimate for sewer rents in the 2014 adopted budget, the City did not increase sewer rates to support the increased revenue estimate.[8] Based on total sewer rent collections as of September 30, 2014, we project the sewer fund will realize revenues of $2.8 million, creating a revenue shortfall of approximately $450,000.

Furthermore, as of September 30, 2014, the City modified the sewer fund budget, increasing appropriations to $3.9 million, in effect carrying over prior year encumbrances associated with the Plan. The City funded this increase through a $385,141 appropriation of fund balance without having a sufficient amount of fund balance available[9] to cover the appropriation. City officials indicated that they are unsure whether these encumbrances will result in obligations that will have to be paid in 2014. However, if the City expends the entire amount appropriated, even without expending any of the moneys encumbered, the sewer fund may realize an operating deficit[10] which could cause the fund to have deficit unrestricted fund balance.

Due to the sewer fund's declining financial condition, it is imperative that the City adopt a reasonable 2015 budget for the sewer fund and develop an adequate strategy to finance the short-term and long-term liabilities related to the Plan. The 2015 proposed sewer fund budget includes a $787,500 increase in the sewer rent revenue estimate[11] from the 2014 adopted budget. However, this represents an increase of more than $1.2 million from our projection of 2014 actual sewer rent revenues.[12] Although the City plans to increase sewer rates in 2015, it does not appear that the rate increase will be sufficient to generate an additional $1.2 million of revenue.[13] The City should review this estimate and make modifications as necessary.

[8] Sewer billings are calculated by applying sewer rates to water consumption.
[9] The sewer fund had $126,236 of fund balance available to appropriate in 2014.
[10] If the City expends the entire amount appropriated for the sewer fund in 2014, the sewer fund may realize a deficit of approximately $400,000.
[11] The 2015 proposed budget contains a $4 million revenue estimate for sewer rents.
[12] We project that the City will realize $2.8 million of sewer rent revenues in 2014.
[13] The City increased sewer rates by $0.74 per 1,000 gallons from 2012 to 2013 which generated an additional $600,000 of revenue. As a result, we do not believe the 2015 proposed $0.69 increase in sewer rates will be sufficient to generate the additional $1.2 million of revenue required to meet the 2015 proposed revenue estimate.

Furthermore, the City's 2015 proposed budget includes appropriations totaling $1.8 million for costs associated with the Plan which is $700,000 more than the total Plan costs for 2015 outlined in the Plan Implementation Schedule (Schedule).[14] According to the Schedule, the Plan will have a $33.1 million cost to the City over the next 13 years. To ensure fiscal stability in the sewer fund, the City must develop a long-term plan to fund these costs.

Water Fund – The City has historically budgeted for and transferred moneys from the water fund to the general fund. Over the past several years, the amount of this annual transfer has increased from $1.5 million to nearly $2.5 million in 2014. In addition, the City has increasingly relied on the appropriation of fund balance to fund capital costs in the water fund. In 2013 the adopted budget appropriated $2 million of fund balance for capital costs. During 2013, the City amended the adopted budget to appropriate an additional $4.4 million of fund balance to fund capital costs and transferred a total of $6.4 million to the capital projects fund. Although the water fund realized a $1.5 million operating surplus in 2013, the $6.4 million of interfund transfers caused fund balance to decline by $4.9 million, from $9.2 million as of December 31, 2012 to $4.3 million as of December 31, 2013.

In 2014 the City modified the water fund budget and transferred $1.6 million to the capital fund to fund capital costs. During the past three fiscal years, the fund has realized significant operating surpluses ($2.2 million in 2011, $2 million in 2012 and $1.5 million in 2013). However these annual operating surpluses have been decreasing and have also been offset by the annual $2 million transfers to the general fund. If the fund realizes similar results of operations in 2014, the $2.5 million planned transfer to the general fund along with the $1.6 million transfer to the capital fund will result in a decrease to the water fund balance.

The water fund's cash balance has steadily declined over the last several years and was $2.2 million as of December 31, 2012. Although the City reported a $4.3 million cash balance at the end of 2013, the fund also reported a net interfund loan payable of $2.5 million. Had the City repaid this interfund loan from to the water fund, it would have had a cash balance of $1.8 million. Furthermore, based on the projection that water fund balance will significantly decrease in 2014, it is possible that the fund will end 2014 in a deficit cash position.

In the 2015 proposed budget the City's budgeted water fund transfer to the general fund is $2 million, a decrease from the $2.5 million that was included in the 2014 adopted budget. While we commend the City for reducing this interfund transfer to a more reasonable level, due to the likely fiscal decline in the water fund during 2014, we encourage the City to develop a plan to mitigate any potential future declines in the water fund.

Contingency Account

Local governments use contingency accounts to provide funding for unexpected events. Although the City Charter does not specifically address budgeting for contingencies, New York State statutes for certain other classes of local government set the maximum for such accounts at 10 percent of the general fund budget (excluding appropriations for debt service and judgments), which can

[14] The City plans to expend $700,000 less than the amount in the Plan in 2014 and is planning on spending that in 2015, resulting in a 2015 appropriation that is $700,000 more than what is called for in the Plan.

serve as a general guideline for the City. The City's proposed general fund budget includes a $650,000 contingency appropriation, an increase of approximately $70,000 from the 2014 adopted budget. However this amount still only represents less than 1 percent of total anticipated general fund expenditures. This amount provides the City with a limited amount of flexibility in the event of unforeseen circumstances that may require additional funds.

According to City officials, five of the City's six collective bargaining agreements are expired and the remaining agreement will expire on December 31, 2014. The 2015 budget does not contain provisions for any potential increased costs associated with settling the collective bargaining agreements. By underfunding the contingency appropriation, the City's ability to pay any liabilities which may arise from contract negotiations in 2015 will be limited.

Given the uncertainty that can result from contract negotiations, the volatility of certain City revenues and expenditures and current economic conditions, we do not believe that the proposed contingency appropriation provides a sufficient safeguard against unforeseen events. Over the past several years, the City has consistently budgeted minimal amounts for contingencies. In previous budget review letters we have commented on this practice and the City has not taken corrective action on our recommendations.

Capital Expenditures

In past years, we have reported, and City officials have acknowledged, that the City's budget provides minimal funding for capital expenditures. This continues to be the case with the City's 2015 proposed general fund budget. Furthermore, we have also noted in past years that the City has depleted the balance in its capital reserve. In 2014, the depletion of the capital reserve caused, in part, the City to shift its method of funding capital expenditures from using traditional budget appropriations to issuing debt.

The 2015 general fund capital plan calls for approximately $420,000 in capital-related expenditures, but also calls for the issuance of debt for department of public works, recreation department and fire department capital costs.[15] The proposed budget contains an appropriation of only $122,219 in the general fund for equipment and capital improvements and includes a $725,000 interfund transfer to the capital projects fund.

In our 2012, 2013 and 2014 budget reviews, we noted the balance in the capital reserve decreased from $6.5 million in 2006 to $2.1 million in 2012. The reserve has decreased further to $1.6 million in 2013. The City's 2014 adopted budget contained provisions to use $725,000 from the capital reserve and transfer it to the capital projects fund to pay for capital improvements in 2014. Based on this information, the capital reserve will finish 2014 with a balance of approximately $900,000. The 2015 proposed budget contains provisions to use an additional $725,000 of this balance to fund capital purchases. If the City uses the entire amount included in the budget, the reserve will have a balance of only about $175,000 at the end of 2015 for future capital plans.

Similarly, in the water fund, the City's capital plan provides for $1.7 million of capital expenditures in 2015; however, the 2015 proposed water fund budget contains capital appropriations totaling

[15] The 2015 capital plan does not quantify these costs.

$127,250. Traditionally, the City does not include sufficient appropriations in water fund budgets to fully fund the water fund capital plans. Instead, the City later amends the budgets to appropriate fund balance during the year to fund the capital plan. In 2013, the City modified the budget and appropriated $4.4 million of fund balance in the water fund to finance capital costs and transferred the $4.4 million to the capital projects fund. The appropriation of, and ultimate use of fund balance, will limit the financial flexibility of the water fund in the future. Furthermore, it appears that in 2015, the water fund will not have sufficient resources available to appropriate fund balance during the year to finance capital costs.

Although the City has established a multiyear capital plan, given that the City is rapidly drawing down its general fund capital reserve and water fund unrestricted fund balance, we encourage City officials to identify reliable funding sources for capital expenditures and to include these funding sources in their operating budgets.

In previous budget review letters, we have expressed concern that the City was not including funding for capital expenditures in its adopted budget and was deferring capital costs. We continue to be concerned that the City is deferring certain capital expenditures that it may be forced to incur in the future, possibly at a higher cost, at a time when the City is inadequately prepared to fund such costs because the capital reserve has been depleted.

Retirement Appropriations

Historically the City has accounted for retirement expenditures utilizing the cash basis of accounting by recording the entire amount paid each fiscal year as an expenditure in that year. However, the City's retirement bill, which the City has traditionally paid in December each year, is for the period covering April of the current year through March of the ensuing year.[16] As a result, the City's payments have covered three quarters (9 months) of the current years' obligations and one quarter (3 months) of the next years' obligations. In 2015, the City does not plan on making its payment in December, but will instead make its payment in February 2016.[17] In addition, the City is planning to modify its method of accounting for this expenditure to record only the three quarters of the cost which is attributable to the period of April through December of 2015 in the 2015 fiscal year.[18] The remaining three months[19] will be recorded as an expenditure in 2016.

This change in the method of accounting for retirement expenditures will result in the City recognizing only three quarters of their traditional retirement costs in 2015. As a result, the 2015 proposed budget includes only three quarters, or $5.7 million, of their estimated retirement costs and excludes the $1.9 million cost associated with the period January through March of 2016. However, in 2016 and future years, the City will be required to recognize 100 percent of their

[16] Annual retirement payments are due in February; however, the City has elected to pay in the preceding December to take advantage of a discount in its bill.
[17] By making the payment in February 2016, the City will only need to budget for three quarters of the bill in the 2015 budget.
[18] This will result in the City recognizing an expenditure in 2015 for three quarters of the retirement obligation and offsetting the expenditure with a liability that will be paid in the 2016 year.
[19] January through March 2016

retirement costs each year.[20] As a result, the 2016 budget must contain provisions for a significant increase[21] in retirement appropriations. City officials should begin developing a plan to fund this increase in 2016 appropriations.

Tax Cap Compliance

The State Legislature enacted Chapter 97 of the Laws of 2011 that established a tax levy limit on all local governments, which was effective beginning in the 2012 fiscal year. The law precludes local governments from adopting a budget requiring a tax levy that exceeds the prior year tax levy by more than 2 percent or the rate of inflation, whichever is less, unless the governing board adopts a local law to override the tax levy limit.

The City's proposed budget complies with the tax levy limit because it includes a tax levy of $20,371,805,[22] which increases the 2014 tax levy by 2.9 percent[23] over the 2014 tax levy of $19,805,669.[24] In adopting the 2015 budget, the City Council should be mindful of the legal requirement to maintain the tax levy increase to no more than the tax levy limit, as permitted by law, unless it adopts a local law to override the cap.

2014 Adopted Budget

The Council, no later than five days prior to the adoption of the budget, must review all recommendations made by the State Comptroller and may make adjustments to its preliminary budget consistent with those recommendations contained in this report. All recommendations that the Council rejects must be explained in writing to our Office. The Council adopted the City's 2014 budget on November 14, 2013, four days before our office commented on the City's 2014 proposed budget.[25] As a result, City officials did not consider our findings and recommendations prior to adopting the 2014 budget.

As noted earlier, the City Council has the responsibility to initiate corrective action to address the recommendations in this report. The Council must explain in writing to our office any recommendations that it has rejected. In addition, pursuant to Section 35 of General Municipal Law, the Council should prepare a plan of action that addresses the recommendations in this report and forward the plan to our office within 90 days. We encourage the Council to make this plan

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[20] The expenditures recognized in each year beginning in 2016 will be for the period January through December of each year.

[21] If retirement costs remain at 2015 levels, the 2016 budget must include a $1.9 million increase in retirement appropriations, an amount which represents approximately 10 percent of the 2015 proposed tax levy.

[22] This amount includes the City's proposed budget tax levy as well a projected tax levy for the Troy Business Improvement District and projected omitted taxes.

[23] Although the tax levy increased by 2.9 percent, it remains under the City's tax levy limit because the City had a carryover balance from the 2014 tax levy limit calculation.

[24] This amount includes the City's actual 2014 tax levy, the Troy Business Improvement District tax levy and total omitted taxes.

[25] Our 2014 budget letter was issued on November 18, 2013. While the City provided the proposed budget to us on October 7, 2013, we were not provided with all documents until November 12, 2013. The City's failure to provide us with requested budget documents in a timely manner precluded us from completing our review and providing the budget letter prior to the Council adopting the budget.

available for public review in the City Clerk's office. For guidance in preparing your plan of action and filing this report, please refer to the attached documents.

We request that you provide us with a copy of the adopted budget.

We hope that this information is useful as you adopt the upcoming budget for the City. If you have any questions on the scope of our work, please feel free to contact Jeffrey Leonard, Chief Examiner in the Glens Falls Regional Office, at (518) 793-0057.

Very truly yours,

Gabriel F. Deyo

cc: Joseph Mazzariello, Acting City Comptroller
Cheryl Christiansen, Clerk
Hon. John A. DeFrancisco, Chair, Senate Finance Committee
Hon. Herman D. Farrell, Jr., Chair, Assembly Ways and Means Committee
Hon. Steven F. McLaughlin, State Assembly
Hon. John T. McDonald III, State Assembly
Hon. Neil D. Breslin, State Senate
Hon. Kathleen A. Marchione, State Senate
Mr. Robert L. Megna, Director, Division of the Budget
Troy Supervisory Board Members
Andrew A. SanFilippo, Executive Deputy Comptroller
Jeffrey Leonard, Regional Chief Examiner