STRATEGIC DEFICIT REDUCTION OPTIONS

TOWN OF RAMAPO

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INTRODUCTION

A. INTRODUCTION

In the wake of the Federal criminal convictions and SEC civil settlement of charges of improper financial management and fraudulent misrepresentation in financial reporting, the Town of Ramapo, Rockland County, New York (the "Town"), continues to focus on rebuilding its fiscal operations. Although audited financial statements for the Town's 2015, 2016 and 2017 fiscal years are presently not available, the unaudited accounts reveal a materially negative fund balance in the General Fund. The Town commissioned Capital Markets Advisors, LLC – Strategic Consulting Group ("CMA") to develop this analysis (the "Analysis") to identify various options, which can be considered and utilized by Town officials in an effort to address the forecasted deficit. The strategies detailed throughout this Analysis were selected for review of their feasibility with Town officials. *Each strategy will require additional fiscal and legal analysis.*

B. WHAT IS A DEFICIT?

An operating deficit occurs when expenditures exceed income (or revenues) over a given period of time. Operating deficits can be a solitary occurrence or it can become a chronic problem, which recurs over a number of years. When operating deficits become recurring, it is an indicator that the entity's budget is not structurally sound. A budget can fall out of structural balance for several reasons. Two of the most common causes include the use of unrealistic revenue/expenditure expectations or an over dependence on one-time sources of revenue or "one shots". If recurring operating deficits become a problem, the long-term effects can hinder a municipality's ability to provide essential services to its residents. Persistent deficits also generally suggest a liquidity problem; in other words, access to cash on hand. As you may imagine, poor liquidity can potentially lead to a host of problems including the inability to pay one's expenses in full and on time, a reduction in services and a reduced credit rating.

For the Town, the (unaudited) accumulated operating deficits have resulted in a negative fund balance in the General Fund. This means (unaudited) liabilities in the General Fund exceeded its (unaudited) assets. Elected officials often refer to the fund balance as the "rainy day fund." Without a fund balance, municipalities are often unable to meet emergency cash needs that may arise from unexpected or underbudgeted expenditures.

If an operating deficit, or series of operating deficits is realized, there are a number of possible approaches that can help ameliorate or eliminate this problem. Some strategies include:

- Increasing real property taxes and exceeding the State imposed tax cap;
- Reducing expenditures by achieving economies and efficiencies, as well as right sizing the workforce;
- Increasing departmental revenues and State and Federal grants;
- Selling surplus property not required for municipal purposes;
- Issuing long-term deficit financing bonds with the approval of State legislature.

C. OVERVIEW OF DEFICIT MANAGEMENT STRATEGIES

The broad policy tools that local governments in the State of New York have most commonly employed to manage periods of severe fiscal instability have primarily involved conventional budget options such as exceeding the real property tax cap, developing other forms of revenue enhancements and expenditure reductions. Other strategies have included the sale of capital assets and the issuance of debt obligations to finance an accumulated fund deficit. It is important to note that non-recurring forms of revenue enhancements, such as the sale of property or the issuance of deficit bonds, include a certain level of future vulnerability. Although these methods may offer a temporary reprieve, they are not sustainable solutions if future fiscal operations are not brought into structural balance. Any strategy, or combination of strategies, should include the development of a structurally sound operating budget that is built upon realistic forecasts.

The Office of the New York State Comptroller ("OSC"), recommends that jurisdictions not use one-time revenues as a source of income to finance recurring expenditures.

Details relative to the most common deficit management strategies implemented by local governments in the New York are discussed in each section of this Analysis.

SECTION II
REAL PROPERTY TAXES AND REVENUE INCREASES

A. OVERVIEW

Like all public jurisdictions, in order to operate and provide adequate services to residents and other stakeholders, the Town requires secure revenue sources that grow on an annual basis to keep pace with expenditures. Annual growth of recurring revenue sources is an important factor since the Town's largest expenditures (salaries, employee benefits, debt service, equipment, acquisitions, etc.) generally tend to increase annually.

Although most jurisdictions would likely prefer to avoid property tax increases, this source of funding generally constitutes the most significant form of recurring revenue. Thus, increasing real property taxes provides for a long-term fiscal benefit.

Like most municipalities, real property taxes represent the primary source of revenue for the Town. In fact, this source accounts for approximately 56.8% of total General Fund revenue included in the tentative budget for the fiscal year ending December 31, 2019. Nevertheless, there are certain constraints, which could provide an obstacle to the Town's ability to raise property taxes.

B. REAL PROPERTY TAX CONSTRAINTS AND CONSIDERATIONS

The Tax Cap. On June 24, 2011, Chapter 97 of the Laws of 2011 (the "Tax Cap") was signed by Governor Cuomo. The Tax Cap applies to the vast majority of local governments in the State, and, among other things, restricts the amount of real property taxes that may be levied to the lesser of (i) two percent (2%) or (ii) the annual increase in the consumer price index ("CPI"), over the amount of the prior year's tax levy. Exceeding the Tax Cap does not require a public referendum. A resolution to pierce the cap can be approved by a vote of 60% or more of the governing board. In fact, a town boards' willingness to raise taxes above the cap, when critically needed, is considered a credit positive by the credit rating agencies.

Of note, the Town's 2019 tentative budget operates within the parameters of the New York real property tax cap. *However, to appropriately address the (unaudited) accumulated operating deficit in the General Fund, the Town should strongly consider exceeding the Tax Cap.*

Local Burden. According to a recent report by CNBC, New York State has the highest tax burden inclusive of property taxes, income taxes and sales and use taxes, in the country. Given the State's already high property tax burden, it is important to consider the local tax base's ability to absorb any increase. In addition, if the local tax burden becomes too high, economic growth could be stalled.

This is certainly not to say real property taxes should not be increased. Instead, future increases should be carefully considered for appropriateness and strategically structured so that they do not become oppressive to the local economy.

C. ALTERNATIVE REVENUE SOURCES

In addition to analyzing its existing real property tax structure, it would be prudent for the Town to consider and actively seek out alternative sources of recurring revenues. Long-term structural balance requires that revenues match expenditures on an annual basis, which is why recurring revenue sources are vital. Although most commonly a one-time source of revenue, grants can provide immediate relief and may also offset the costs of implementing initiatives that will result in long-term savings.

In 2015 the City of Poughkeepsie submitted an application to the New York State Financial Restructuring Board (the "FRB") for a comprehensive review of its operations. The intention of the FRB is to supply resources to local governments that *have been deemed fiscally eligible*. However, even if deemed eligible, a jurisdiction must still submit an application for a comprehensive review by the FRB, which will be voted on by the 10-member board. If the application is approved, the FRB will complete a full review of a jurisdiction's operations and can make various recommendations based on the FRB's findings. As a part of this process, the FRB is authorized to offer grant funding associated with the recommendations. Grant funding can total as much as $5 million. These funds are specific to key recommendations of the FRB and are meant to offset cost associated with the FRB's recommendations. After a lengthy process, in June of 2017, a special aid package of $3 million was approved by the State and awarded to the City. The package included $1 million for economic development, $1.25 million to help resolve long-standing collective bargaining issues and $0.75 million to consolidate certain transit functions. The award was a major accomplishment for the City. In fact, the bus consolidation recently was selected by the New York State Conference of Mayors ("NYCOM") as the first-place winner of its 2018 Local Government Achievement Award.

Once audited information becomes available, CMA recommends that the Town apply for FRB services. Additional grants could also be sought by the Town. If grant awards are made, it's possible the amount of the perceived operating deficit could be reduced by the application of grant monies.

D. REAL PROPERTY TAXES AND REVENUE CONCLUSION

Revenue enhancement strategies represent one type of deficit management strategy. Most commonly there are two revenue related options: (i) exceeding the State imposed Tax Cap, or (ii) seeking out alternative sources of recurring revenues.

According to Town officials, the Town successfully licenses its golf course which resulted in a reduction of expenditures of approximately $800,000 (unaudited), plus an increase in departmental revenues of $300,000 (unaudited), for a combined improvement of approximately $1.1 million in the Town's financial position. Given the success of the golf course, *CMA recommends that the Town seek additional revenue enhancement opportunities at the departmental level wherever possible.*

Most commonly, the revenue enhancing strategy is accompanied by some level of expenditure reductions.

SECTION III
EXPENDITURE REDUCTIONS

A. OVERVIEW

Expenditure reductions may help to mitigate property tax increases and contribute to achieving fiscal stability. We note that approximately 54% of total expenditures tentatively budgeted for 2019 are comprised of salary and benefits. Some of the more common reduction strategies include hiring freezes, employee layoffs (if and when allowable), the delay of capital projects, service cuts, modification of health or fringe benefits and across-the-board departmental cuts. Cost reduction strategies should first consider which expenditures are discretionary and which are mandated. At the option of the Town, discretionary expenditure items may be considered for elimination. However, in all cases the objective would be to identify expenditure reductions without impacting critical service levels.

B. SHARED SERVICE OPPORTUNITIES

To mitigate losses, many jurisdictions have started to explore ways to eliminate duplicative services through the use of shared service agreements. In fact, New York State has been proactive in offering support for such initiatives. Shared services and efficiency opportunities may be present with both internally and with other local governments. These opportunities can reduce redundancies and subsequently decrease costs. Common areas considered for efficiencies include, administrative functions, human capital management, general operations, technology, public safety services, public works, recreation and infrastructure.

There are numerous State laws authorizing collaboration between jurisdictions. In fact, General Municipal Law Article 5-G provides wide-ranging authority for entities to investigate such activities. The types of joint projects that have been investigated are well documented by the State through its Local Government Services Division. The Division includes case studies of previous projects, information on applicable State funding to offset costs and various other resources. In addition to the Local Government Services Division, the Office of the State Comptroller and the New York State Attorney General's Office are usually able to provide technical and legal assistance in connection with the investigation of shared services.

Given the complex collective bargaining agreements and unique tax laws surrounding the Town, it may want to take advantage of State resources when considering functions for shared services.

We note that the Town participated in the county level shared services meetings over the past two years with limited results.

C. EFFICIENCIES

While costs may be reduced through shared services with other local governments, there may also be internal opportunities to reduce redundancies and subsequently costs.

For instance, Town officials have indicated that certain technologies may be outdated. As such, it may be possible to streamline current operations through the use of improved technology. According to Gartner, Inc., a research and advisory firm specializing in IT services, projects optimizing technology can effectively reduce certain costs by up to 50%. Furthermore, Forrester, Inc., another IT research and advisory firm, suggests that technology can be utilized to automate redundant workflow tasks. Automation is projected to reduce the time spent on those tasks by upwards of 60%, with an additional 20% reduction in the time taken to manage and support those tasks.

D. EXPENDITURE CONCLUSION

Revenue enhancement strategies, expenditure controls and reductions, represent another type of deficit management strategy. Most commonly expenditure reductions are paired with revenue enhancement strategies.

SECTION IV
DEFICIT FINANCING

A. OVERVIEW

Deficit financing is a technique in which a municipal government issues debt in order to finance accumulated financial shortfalls. Bond anticipation notes may be issued initially but they are generally converted to long-term serial bonds within a couple of years. Although a somewhat uncommon practice amongst New York State municipal jurisdictions, the use of deficit financing has become much more common in recent years. In fact, between 2004 and June 2014, the State Legislature passed 25 special acts authorizing, or amending authorizations for deficit financings. Most recently Rockland County, the cities of Long Beach, Yonkers and Glen Cove and the town of East Hampton were approved for such financings. Each of these jurisdictions is a CMA client.

Prior to the issuance of deficit financing, a municipality must first obtain authorization from both its governing board and subsequently from New York State. The State's approval entails the enactment of special legislation that is specifically tailored to the jurisdiction. In addition, before long-term bonds can be issued, the State, through its Comptroller's ("OSC") office, reviews the entity's finances in order to certify the actual size of the deficit. The entity will be permitted to bond only the amount of the deficit certified by the State.

B. STATE AUTHORIZATION AND REQUIRED ACTIONS

Over the past several years the State's response to local governments in fiscal distress has been largely ad hoc. If approached by a fiscally distressed jurisdiction, the State Legislature *may* elect to take action.

Techniques utilized by the State Legislature to assist distressed jurisdictions in the past have included the award of emergency, one-time aid, permitting an entity to issue debt to finance a deficit, and, in extreme cases, appoint a control board with extraordinary powers. This latter measure has been taken in the cities of Buffalo and Yonkers and the counties of Erie and Nassau County; all CMA clients. It is also possible that the State could elect to take no action. When the State Legislature does authorize a municipal jurisdiction to issue debt to pay for an accumulated deficit, Local Finance Law § 10.10 requires oversight of the entity's finances by the State Comptroller for as long as the deficit bonds are outstanding.

As it relates to deficit financing, the State has generally imposed the following requirements:

- Quarterly budget reporting
- Development and maintenance of a multi-year plan
- Prior review and approval of all subsequent debt issuance
- Oversight of the annual budget and multi-year plan by the OSC. OSC will review the proposed budget for reasonableness and will make recommendations as it sees fit. These recommendations should be incorporated by the entity prior to the adoption of the budget.

Although the above bullet points represent typical State requirements in connection with deficit financing, since the State's response has been so ad hoc, additional conditions, such as imposing a fiscal control board, could certainly be imposed. The State determines these requirements on a case-by-case basis.

In conclusion, State requirements associated with deficit financing can, to some extent, limit a jurisdiction's ability to self-govern certain financial matters. The restrictions are largely dependent on what is included in the special legislation adopted by the State in connection with the authorization of the deficit financing debt. Although no longer as common, the appointment of a fiscal control board would present the greatest impact on the Town. *As noted above, any requirements imposed by the State remain in place through the term of the deficit financing bonds.*

C. PAYMENT TERM OF DEFICIT FINANCING

In general, the State permits a term of 10 years for the repayment of deficit financing. This period begins with the first issuance of debt, regardless of the debt instrument that is used whether it is bond anticipation notes or serial bonds. If an entity is able to demonstrate that paying the debt over 10 years is too burdensome, the State can authorize a longer term. For example, the legislation that was passed for the City of Newburgh included a payment term of 15 years. After the State authorizes a deficit financing, OSC will review the entity's financial records in order to certify the actual amount of the deficit. The par amount of the bonds or notes issued may not exceed the amount that has been certified by OSC.

If a jurisdiction issues deficit bonds and subsequently generates annual operating surpluses, it may be required to call and redeem a portion of its outstanding deficit bonds or purchase tax exempt debt with a portion of the surplus revenues.

D. IMPACT OF A DEFICIT FINANCING - PROS AND CONS

Prior to requesting special deficit legislation, there are various pros and cons that should be carefully considered by the requesting jurisdiction. Below is a summary of these considerations:

- *Pros:*
    - The immediate infusion of funds would assist in alleviating short-term cash flow concerns.

- Reducing short-term cash flow concerns would be positive from an investor's perspective and consequently the credit rating agencies' perspective.
- Implementation of State requirements associated with special deficit legislation, particularly as it relates to budget recommendations, is usually mandatory. This may lessen the impact of decisions that are politically difficult or unpopular.

- *Cons:*
  - Special deficit legislation will result in, at least to some extent, State oversight of certain financial matters, until the financing is paid in full.
  - As with bond financing, there will be legal costs and issuance costs associated with a deficit financing.
  - Depending on the State's legislation, a payment period of either 10 or more years is likely to be authorized. Principal payments sufficient to pay back the amount borrowed will be required annually over this period, in addition to semi-annual interest payments. The combination of these payments will increase the jurisdiction's current debt burden.

Special Note: Increase To Property Taxes. As noted above, oversight of the annual budget by the OSC will be a requirement if the Town is successful in securing State approval to issue deficit financing debt. During the application process, OSC will analyze the proposed budget and make recommendations as it sees fit. The intention is to ensure that the requesting jurisdiction's budget is structurally balanced. It is possible that an increase to the property tax levy could be a recommendation. However, given the State imposed 2% tax cap, this is an action that OSC would not take lightly.

CMA is aware of five entities that have recently issued deficit obligations, the Town of East Hampton, cities of Glen Cove, Newburgh and Yonkers and Rockland County. The case of Yonkers is not comparable for the purposes of this memo. As one of the "Big Five," the school district in Yonkers is comingled with the city. The issues surrounding the recent Yonkers issuance were the result of decisions made by the school district. However, in the cases of East Hampton, Glen Cove, Newburgh and Rockland County, property taxes were raised significantly prior to the jurisdictions' request to the State. As such, the post issuance budget recommendations for these entities did not include increases to real property taxes.

Rockland County used deficit financing as a strategy in its financial turnaround. The proceeds of the deficit obligations assisted Rockland County in its ability to promptly stabilize its fiscal conditions.

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SECTION V
ASSET SALES

A. OVERVIEW

The sale of surplus government assets can effectively provide a one-time infusion of monies, which can counterbalance the effects of an accumulated deficit. Nevertheless, the process may be lengthy, unpopular with residents and could result in additional financial risk if improperly handled.

According to OSC, using non-recurring, one-shot revenues to support recurring expenditures may appear to offer a solution to an imbalanced budget; however, the strategy is a short-term solution and only temporarily defers the need to address structural budget imbalances. Localities may also wish to track non-recurring expenditures to determine if they are using one-time windfalls to fund one-time capital expenses, ongoing operating expenses or establish reserves. If a jurisdiction is funding an increasing portion of its budget with such revenues, it may be using "one-shots" to address a structural imbalance between recurring revenue and recurring expenses. A locality's plan should aim to address this situation with long-term revenue or expenditure adjustments. The use of one-shots is frowned upon by the credit rating agencies.

B. CURRENT ASSETS

Town officials have indicated there are presently several Town-owned properties, which could be considered for future sales. As noted throughout this analysis, the best approach to contending with a proposed deficit is usually a combination of various strategies. As such, it may be a prudent exercise for the Town to determine which properties are appropriate for sale. Nevertheless, since a sale would represent a one-time source of funds and a certain level of risk, it should not be considered as the sole means to balance the budget. The fund should purely represent a method to reduce the accumulated deficit.

SECTION VI
CONCLUSION

Failure to satisfactorily address the forecasted General Fund deficit may have a materially adverse impact on the Town. Despite the challenges that may be ahead, the development of this memorandum alone denotes that steps are being taken toward corrective measures. Success will be largely contingent upon a coordinated effort, collaboration between various interested parties and a combination of the strategies previously discussed. A sustainable, balanced budget in the near-term can be an achievable goal with the proper planning and implementation of a well-developed recovery strategy.

We recommend that the Town consider the following course of immediate action(s):

- Identify surplus property that can be legally sold and is not required for Town purposes to be offered for sale; if successful, asset sales may bring some level of immediate relief as other initiatives are being pursued;
- Continue the internal cost reduction and revenue enhancing measures already underway including the outside expert study of the baseball stadium;
- Identify additional cost reductions and revenue enhancing measures;

- Once the independent audit of the Town's financials statements is brought up to date, CMA recommends that the Town evaluate the opportunity to seek assistance from the NYS Financial Restructuring Board, or other grant related programs;
- Contemplate deficit financing.

END