SPECIAL REPORT

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BOSTON'S FY04 RECOMMENDED BUDGET:
Basic Services Provided, State Aid May Grow

Mayor Menino's recommended budget for fiscal 2004 totals $1.75 billion, a $72.6 million or 4.0% decrease from fiscal 2003. Submitted to City Council on April 9th, this budget represents the largest decrease since fiscal 1993. In this year's budget, 82.7% of city spending is allocated to eight departments and services. The public will notice service changes due to cutbacks in services added in recent years or delays in program delivery, but core services will remain intact. The 4.0% decrease comes after the City's budget showed growth of 33.8% from fiscal 1994 to fiscal 2003 that allowed for programs to be expanded and personnel to be added. Grants and other external funds of at least $396.3 million are anticipated, bringing the City's fiscal 2004 all-funds operating budget to $2.15 billon. The Mayor also is requesting approval for a capital budget that totals $1.20 billion over 5 years and in fiscal 2004 plans a general obligation bond issue of $65.0 million, $10.0 million less than issued in fiscal 2003.

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The fiscal 2004 budget assumes a 20.0% reduction in cherry sheet state aid to Boston, the second consecutive year this account would be cut. However, the final House budget approved on May 8th reduced Boston's general fund state aid by only $27.3 million or 5.5% from the current fiscal 2003 level. Although many steps remain before a final state budget is signed, this recent action by the House could increase Boston's state aid amount by approximately $73 million more than in the Mayor's recommended budget. Outside of the operational budget, changes to external funds may have some affect on city services in the areas of public health and education. The House budget provides some hope that the Administration may not have to enact the full package of program reductions, layoffs and use of reserves presented in the current budget. Regardless of state aid funding levels, the Administration should retain service delivery efficiencies presented in this budget, such as the elimination of two fire districts, and the assignment of police officers from administrative to patrol positions.

Fiscal 2004 General Fund Revenue Highlights

The fiscal 2004 revenue budget is $1.75 billion, a decrease of $48.4 million or 2.7% from fiscal 2003. The net property tax is $1.03 billion or 59.1% of all general fund revenues. State aid is budgeted at $396.7 million or 22.6% of revenues. All other revenues total $321.4 million and make up the remaining 18.3%. Property taxes and state aid continue to comprise the predominate share of all general fund revenues, representing $1.43 billion or 81.7% of the fiscal 2004 total. The Administration has elected to apply $30.0 million in budgetary fund balance, or free cash, to balance the fiscal 2004 budget. The last time Boston utilized free cash was in fiscal 1992. The City's other revenue sources are estimated close to their fiscal 2003 levels.

State Aid - Uncertainty regarding the final amount of Boston's state aid is the main issue on the revenue side of the City's fiscal 2004 budget. Boston's second largest revenue source has dropped as a percentage of all general fund revenues from a high of 31.9% in fiscal 1999 to a budgeted low of 22.6% in fiscal 2004, reflecting the tightening fiscal position of the state. Boston's general fund local aid, including charter school tuition and reimbursements, was cut by $43.9 million or 8.1% from fiscal 2002 to fiscal 2003. Adding the local aid cuts of $27.3 million in the House budget would bring the total state aid cut to $71.2 million or 13.2% in the two years since fiscal 2002. Governor Romney's fiscal 2004 budget proposed fundamental revisions to state aid formulas and cuts in aid of $232.0 million to help close the state's $3.0 billion revenue gap, which translated into a proposed reduction in aid to Boston of $62.7 million or 12.6%.

The Menino Administration, anticipating the Legislature would make more aggressive cuts than those in the Governor's budget, set state aid at $396.7 million for fiscal 2004, $100.8 million or 20.3% less than fiscal 2003. This approach was conservative and reasonable based on public and private commentary from legislative leaders and a memo directed to local officials from the House and Senate Ways and Means Chairs cautioning further cuts. However, the final House budget sets Boston's state aid for operations at $470.2 million, $27.3 million or 5.5% less than fiscal 2003.

Property Tax - The fiscal 2004 gross property tax is budgeted at $1.09 billion, an increase of $50.9 million or 4.9% over fiscal 2003. Of this total, the annual 2.5% increase is $25.9 million and taxable new growth is estimated at $25.0 million. New growth is budgeted $13.5 million or 35.1% below the fiscal 2003 level because fewer new real estate projects will come online, and because this year the City completed an effort to capture greater personal property growth. Excluding the overlay for abatements, the net property tax is $1.03 billion, $39.0 million or 3.9% more than fiscal 2003. The overlay reserve is budgeted at $51.7 million, 5.0% of the net property tax, as required by law. Commercial values are expected to decline in this upcoming revaluation year, but will not affect the City's ability to increase its property tax levy by 2.5%. The City's reliance on the net property tax as a percentage of all revenues has grown from 50.3% in fiscal 1999 to 59.0% in fiscal 2004.

Where the Money Comes From
Figures in 000's

Account	Budget FY03	Budget FY04	Change	%
Gross Property Tax	$1,035,271	$1,086,153	$50,882	4.9%
Overlay Reserve	(39,818)	(51,722)	(11,903)	29.9%
Net Property Tax	$995,453	$1,034,431	$38,978	3.9%
Jet Fuel Excise	$13,600	$12,000	($1,600)	-11.8%
Chapter 121A	44,761	44,899	138	0.3%
Hotel/Motel Excise	20,000	19,000	(1,000)	-5.0%
Motor Vehicle Excise	38,006	38,255	250	0.7%
Other Tax Revenues	$116,367	$114,154	($2,213)	-1.9%
State Aid [1]	$497,494	$396,733	($100,761)	-20.3%
Parking Fines	$57,650	$59,500	$1,850	3.2%
PILOTs	20,362	23,752	3,390	16.6%
Investment Income	10,750	8,000	(2,750)	-25.6%
Non-Recurring	17,846	7,076	(10,770)	-60.3%
Certified Free Cash	0	30,000	30,000	100.0%
Medicaid Reimb.	14,000	12,000	(2,000)	-14.3%
Building Permits	15,000	12,500	(2,500)	-16.7%
Licenses/Permits	11,238	11,250	12	0.1%
Parking Meter Fees	10,000	10,000	0	0.0%
All Others	34,828	33,188	(1,640)	-4.7%
Subtotal Other	$191,674	$207,266	$15,592	8.1%
Grand Total [2]	$1,800,987	$1,752,584	($48,404)	-2.7%

[1] Does not include $6.1M in additional teacher pension reimbursement actually received during FY03.

[2] The City now shows a revenue shortfall for FY03, but expects to end FY03 balanced via spending cuts, use of reserves or both.

Fiscal 2004 General Fund Spending Highlights

The fiscal 2004 general fund expense budget of $1.75 billion is a decrease of $72.6 million or 4.0% from fiscal 2003. Departmental and county budgets, including pensions, decrease by $74.5 million or 4.6% from fiscal 2003, while fixed costs (debt service and state assessments) increased slightly by $1.9 million or 1.0% from the prior year. Various spending controls were implemented to make more resources available for departmental spending in fiscal 2004. Two separate retirement incentive programs were offered to qualified employees to reduce employee levels and the need for layoffs. Full funding of the pension system was extended three years, to 2023, creating a savings of approximately $4.8 million. The HMO health insurance system for city employees was modified by consolidating to one provider and increasing office visit co-pays to achieve a cost avoidance of $8.1 million, and steps were taken to limit debt service growth. In this year's budget, 82.7% of city spending is allocated to eight departments and services. Spending for employees (salaries, overtime and benefits) remains the single largest cost item for the City, representing 67.9% of all fiscal 2004 outlays.

Departmental Spending - While almost all departmental appropriations are reduced for fiscal 2004 and result in cutbacks to programs and personnel, the majority of cuts are absorbed by the city's three largest departments. The School, Police and Fire Departments combined represent $955.1 million or 54.5% of the city's fiscal 2004 budget, yet absorb 71.0% of all fiscal 2004 cuts. Nevertheless, these departments maintain the same proportional share of the overall budget that they did in fiscal 2003.

The Police Department will continue its efforts to re-deploy uniformed officers in the City. Officers will be transferred from administrative positions to direct service delivery or reassigned as a result of actions such as closing the cell blocks in two district stations. No police officers are expected to be laid off with 97 officers applying for the voluntary retirement program. The Department also will focus on containing overtime costs in fiscal 2004. The Fire Department plans to merge two districts into existing ones, thereby redeploying and reducing the cost of superior officer positions. Positions also will be eliminated in the Marine and Fire Alarm Units. Reductions in the School Department will curtail important supplementary services, such as art classes for students and professional development for teachers, but will preserve core academic instruction.

Spending for Employees - Overall spending for employees is budgeted at $1.19 billion for fiscal 2004, a decrease of $43.0 million or 3.5% from fiscal 2003. Employee costs represent 67.9% of the fiscal 2004 budget. Spending for salaries and overtime are budgeted to drop substantially, but an increase in employee benefits will offset some of the savings. Salaries and overtime are budgeted at $824.2 million in fiscal 2004, a decrease of $87.0 million or 9.6% from the prior year. Reflecting the dominance of the three major departments, 74.8% of the decrease in salary spending is planned for the School, Police and Fire Departments. By January 2004, the City expects to reduce 1,822 full-time equivalent positions (FTEs), 1,623 or 89.1% of which will occur in the three largest departments. The School Department expects to reduce 1,380 FTEs, followed by Fire at 147 and Police at 96. These reductions will be achieved through attrition, not filling vacant positions, retirements or layoffs.

Benefits are budgeted at $366.5 million in fiscal 2004, an increase of $44.0 million or 13.7% over fiscal 2003. Of this increase, $30.7 million or 69.7% is attributable to growth in two line items, health insurance for city employees, and school pensions. The latter is due in part to a spike in severance costs attributable to the Early Retirement program. Health insurance for city employees grew to $125.4 million in fiscal 2004, a $21.0 million or 20.1% increase from fiscal 2003. The Administration is attempting to avoid an estimated $8.1 million more in health insurance costs in fiscal 2004 by consolidating the three major providers to a one HMO provider format and by increasing office visit co-pays. However, city employee unions may challenge this initiative, claiming that such a change requires union agreement through main table negotiation.

Where the Money Goes
Figures in 000's

Department	Budget FY03	Budget FY04	Change	%
Schools	$579,636	$529,891	($49,745)	-8.6%
School Empl. Benefits	70,899	89,109	18,210	25.7%
Subtotal Schools	$650,535	$619,000	($31,535)	-4.8%
Police	220,315	207,297	(13,018)	-5.9%
Pensions	134,425	135,108	683	0.5%
Fire	135,820	128,818	(7,002)	-5.2%
Health Insurance	104,356	125,372	21,016	20.1%
Public Works/Snow	80,473	79,902	(571)	-0.7%
Public Hlth. Commission	63,897	58,582	(5,315)	-8.3%
Transportation	30,537	28,638	(1,900)	-6.2%
Library	28,008	23,857	(4,151)	-14.8%
CTR Youth/Family	19,114	17,692	(1,421)	-7.4%
ISD	14,084	12,474	(1,610)	-11.4%
Neighborhood Dev't.[1]	16,196	5,270	(10,927)	-67.5%
All Others	128,412	110,176	(18,236)	-14.2%
Subtotal	$975,639	$933,186	($42,453)	-4.4%
County	$4,837	$4,298	($539)	-11.1%
Debt Service	125,722	126,574	852	0.7%
State Assessments	68,498	69,526	1,027	1.5%
Subtotal Mandatory	$194,220	$196,100	$1,880	1.0%
Grand Total	$1,825,231	$1,752,584	($72,647)	-4.0%

[1] Large decrease in appropriation in this department reflects planned decrease in allocation for the Leading the Way program.

Other Fiscal 2004 Happenings

- Other selected items in the Mayor's budget include:
- Graffiti crews are reduced by half, and fewer animal control officers are retained. Both actions will result in delays in service call response times, and will require more selective responses.
- The City Hall Registry will close on Wednesdays, and the Public Library's main branch will close on Sundays.
- The Parks and Recreation Department is eliminating 35 positions, as well as 15 park rangers.
- The Code Enforcement Division of Inspectional Services Department (ISD) will be fully integrated into the ISD management structure, completing an initiative begun in fiscal 2003.
- The final $3 million for the City's Leading the Way housing initiative will be appropriated from the Surplus Property Disposition Fund in fiscal 2004.
- The Youth Fund's budget has been reduced by almost 50%, requiring the elimination of a significant portion of the City's summer jobs program, with priority placed on filling jobs in summer camps and community organizations.
- The Boston Center for Youth and Families is changing its organizational structure to a regional and cluster model designed to use space, personnel and resources more efficiently.
- The Transportation and Public Works Departments are scheduled to merge in fiscal 2005, consolidating overlapping services to make up the new Streets/Transportation/Sanitation Cabinet. While the new Cabinet is listed in the fiscal 2004 budget, no personnel or financial changes related to the merger will occur until fiscal 2005. Planning for the change will occur during fiscal 2004.

Grant Funds

In addition to the general fund, $396.3 million in grant funds is expected to be received in fiscal 2004. Three departments - Schools, Neighborhood Development and Suffolk County Sheriff - are expected to receive a combined $320 million or 80.8% of total grants available. Grant fund estimates have increased by $9.6 million or 2.5% from fiscal 2003.

Capital Budget

Boston's fiscal 2004 five-year (FY2004-2008) recommended capital budget totals $1.20 billion, a 13.8% reduction from last year's five-year plan. This budget reflects the Administration's efforts to balance the provision of basic capital needs with further control over capital spending. The City's general obligation borrowing in fiscal 2004 will total $65.0 million, $10.0 million less than authorized in fiscal 2003 and $35.0 million less than sold in fiscal 2002. New commitments in fiscal 2004 total $48.5 million, by far the smallest annual commitment over the past seven years. From all sources, the City budgeted capital spending of $109.4 million in fiscal 2004.

FY04 Capital Budget
Figures in 000s

Department	Amount	% of Total
School	$41,758*	38.2%
Library	19,385	17.7%
Public Works	17,763	16.2%
Public Health	6,930	6.3%
Parks	6,145	5.6%
Fire	5,385	4.9%
Other	12,030	11.0%
Total	$109,396	100.0%

* Includes new schools of $15.5 million

Debt service for the principal and interest of long and short-term borrowing is budgeted at $126.6 million in fiscal 2004, an increase of $852,205 or 0.7%. The small increase is due to the reduction in the amount to be borrowed and the benefit of four refinancing issues in 2002 and 2003 that produced a total present value savings of $17.3 million on future debt service costs, starting with $4.5 million in fiscal 2004. Even so, next year's debt service costs will represent 7.2% of operational spending and exceed one of the City's major debt standards.

CONCLUSION AND RECOMMENDATIONS

The Administration presented a budget that, while containing difficult layoffs and program cuts, provides core service delivery. Even as positive efforts have been made to control spending and make service delivery more efficient, more can be done. The following Bureau recommendations build on those efforts.

1. Implement Service Efficiencies: The departmental service efficiencies recommended in the fiscal 2004 budget should be implemented regardless of final state aid support. Some of the efficiencies planned include the elimination of two fire districts, consolidating positions in the Fire Department's Marine and Fire Alarm units, the competitive bidding of custodial services in one-custodian schools, the reassignment and redeployment of police officers and the modernization of the Election Department. Steps not in this budget should be taken such as implementing more of the 149 recommendations already identified in the O'Toole Commission and MMA Consulting Group reports on Fire Department operations. The closing of one or more fire stations should be put on the table for consideration. Bi-monthly pay periods should also be instituted.

2. Build on Competitive Service Delivery: The plan to competitively bid for custodial services in smaller, single custodian schools, with an offer to the BPS custodians to compete, is a positive step toward using competition in service delivery, but the Administration could do more. Services that lend themselves to competition should be identified and bids sent to legitimate sources, both city employees and private companies, with the lowest bidder selected. Other areas that should be considered are public works functions such as the operation and maintenance of the City's three drawbridges.

3. Restore Selected Accounts: The City should consider what fiscal 2004 accounts it might restore if more state aid than expected is approved in the final state budget. Planned savings at risk such as the School Department's budget freeze to contractually scheduled step and lane pay increases and increased class size should be primary considerations for restoration. An inability to reach agreement on these issues with the Boston Teachers Union would add approximately $16 million to the City's spending liabilities in fiscal 2004. Retaining this year's class size limits would restore approximately 129 teachers to the classroom. The City should restore as much of the $30 million in proposed free cash as possible to retain healthy reserves for future use and a strong credit rating. More reserves could be needed if the Governor uses his veto power to cut state aid further believing that the Legislature had approved a fiscal 2004 budget that was out of balance. Reserves that will be used are non-recurring and should be applied to one-time expenses where feasible. These reserves should not be used for salaries and benefits in new collective bargaining agreements, which would be recurring expenses.

4. Relax Overlay Requirement: Boston's improved assessing practices in recent years justify the relaxation of the legal requirement (Chapter 717 of the Acts of 1957) that the City's overlay reserve for abatements be no less than 5% of the net property tax levy. However, Boston should continue to maintain a prudent discipline in establishing reserves for abatements and the current overlay reserve requirement of 5%-6% of the net levy should be amended to 3%-5%.