

Distressed Unit Appeal Board Staff Report

City of Gary, Gary Sanitary District, Gary Storm Water
Management District, Gary Public Transportation Corporation,
Gary/Chicago International Airport Authority

5/20/2009

The City of Gary (City), Gary Sanitary District (GSD), Gary Storm Water Management District (GSWMD), Gary Public Transportation Corporation (GPTC), and Gary/Chicago International Airport Authority (Airport) (“petitioners”) petitioned the Distressed Unit Appeal Board (DUAB) on December 8, 2008 for relief from the circuit breaker credits. A hearing was held by the DUAB on January 5, 2009 where the petition and proposed multi-year financial plan were presented. A site visit was conducted on January 21, 2009 by several members of the DUAB. Additional information was requested January 30 and received February 24. Additional communication and information resulted from certain events, most notably the settlement of 2008 property taxes and the 2007 shortfall appeal hearing in March. A final site visit was conducted May 6 by the DUAB staff.

Long before the imposition of the statutory property tax caps, Gary has been moving toward a fiscal capacity limit due to the acute convergence of adverse trends on the three major budget components—desired levels of spending, non-property tax funding sources (“miscellaneous revenue”), and property tax levies. Spending, until recently, has not been restrained. Gaming revenues, a major contributor to miscellaneous revenue much of which has been pledged to capital investments, is constrained by the economy and market conditions. Property taxes, levied on a weak tax base, have experienced poor collections rates. The result has been the consumption of other revenues to the point of exhausting cash balances, not paying bills, incurring internal loans for inordinate periods of time, and now drawing from the current year budget to balance the previous year. This trend started long before the current mayoral administration.

The “City Expenditures and Property Tax Levies” chart in the Appendix provides a historical perspective.

Events Prior and Subsequent to Initial Hearing

It is important to set forth the context which the petitioners submitted their petitions in December, 2008. Taxing units generally develop and adopt budgets and estimated property tax levies through the summer and fall months preceding their effective year. Those budgets, levies and property tax rates cannot be finalized until certified assessed values are received from the county. Due to delays in Lake County, the petitioners did not receive their 2008 final budget orders until November, 2008. Because of the trends noted above, the Gary City Council was required to reduce its 2008 budget due to insufficient resources after 11 months of spending as if the original budget would be approved. The 2009 budgets and DUAB petitions were developed and approved locally without this information and the time to make adjustments.

Property taxes for 2008 were not settled until March 2009. For the third year out of the last four, property tax collections were 90% or less than the amount billed. This translates to a minimum impact of \$5 million to the City general fund.

On March 26, several petitioners appealed their 2007 shortfall to the Department of Local Government Finance and two units were granted \$4,712,188 on April 9. Of this amount, \$4,207,623 was approved for the City and \$504,565 was approved for the Sanitary District.

Current Status

Due to these factors, the City has hit its fiscal capacity limit even before considering the circuit breaker caps. Annual cash flow has been dependent on a myriad of tax anticipation warrants and interfund loans and now requires drawing upon the current budget to close the prior year general fund deficit estimated at \$6 million. In addition, the City has identified outstanding obligations of over \$22 million that include a \$12.5 million loan to the Sanitary District that has been outstanding for several years and is subject to annual reporting to the U.S. Department of Justice.

Cost side reduction is the only option to address both circuit breaker caps and to restore fiscal stability. There is no revenue upside. Property tax levies have been statutorily frozen, attempts for a local option income tax have failed, and other resources have been over committed.

Upon the final settlement of 2008 property taxes, the City continued identifying budget reduction opportunities and revisited actions proposed in its original plan that were not contemplated until future years. Some of these actions have included:

- Elimination of funded vacant positions and staffing reductions
- Identifying departments for consolidation
- Contacting Lake County regarding the assumption of Health Department responsibilities (which has received a less than encouraging response from the county)
- Investigating alternative operations for the Genesis Center

While these are the types of changes that should have been considered years ago and by previous administrations, we applaud the prompt and necessary action now taken by the petitioners. If implemented and sustained, these actions can build the momentum for the further change that is needed.

Because of the severity of the current situation, the petitioners must take steps to return to a sound and solvent condition in addition to preparing to operate in the looming property tax cap environment. Property tax rates must be lowered to mitigate circuit breaker credit impact while simultaneously maintaining critical services. The success of any plan will require a focus on the future and not a debate of the past. The city must concentrate on restoring lost credibility through transparency and strict lines of accountability. Finally, there must be the courage to change long-standing, current practices and build the necessary capacity to sustain the changes.

Recommendation

The petitioners proposed a multi-year plan to address the full implementation of the property tax caps. Based on the circumstances, this is a reasonable approach. If no relief was provided, the resulting property tax levies would impact public safety. This is not to say public safety should be off limits from scrutiny but, as the most basic of services to be provided to citizens, should be reviewed deliberately and thoughtfully.

Many financial documents have been reviewed with the petitioners to develop this recommendation. The recommendation will challenge the petitioners in 2009 yet provide the opportunity to begin addressing poor decisions of the past. Additional budget cut opportunities may exist but doing so must be pursued with recognition of potential risks which are not easily quantified and will be discussed later. If this recommendation is adopted, the petitioners should be in a much better financial position at the start of 2010 than they were at the start of 2009. Budget cuts will be annualized which will further reduce the budget, past obligations will be smaller, and fiscal policy should be stronger. 2010 is a year of opportunity, but to get there, the petitioners must make and implement many hard choices in the remainder of 2009.

The following table summarizes, by unit, the requested and recommended circuit breaker credit relief for property taxes due in 2009:

<u>Unit</u>	<u>Petitioners' Requested Credit Relief</u>	<u>DUAB Staff Recommended Credit Relief</u>	<u>Difference</u>
Civil City	\$29,096,601	\$22,840,172	\$6,256,429
Sanitary District	3,907,940	0	3,907,940
Airport	639,830	259,632	380,198
Public Transportation	686,104	174,397	511,707
Storm water	422,104	227,900	194,204
Total	\$35,008,151	\$23,502,101	\$11,250,478

Note: Both scenarios include 2007 shortfall appeal

The recommended amount of circuit breaker credit relief is approximately one-third less than that requested. The difference also reflects the reduction in proposed levies for the respective units, a 15% reduction. The composition of the relief across units reflects the need to close the prior year operating deficit and the one-time shortfall appeal for the city with an offsetting impact from the other petitioning units most notably the Gary Sanitary District which recently raised user fees and imposed a garbage collection fee. The net effect without these two stabilization and corrective provisions is an aggregate levy closer to that proposed in the original petition for 2011.

Prior to adoption of P.L. 146-2008, homestead property was subject to a cap of 2% of gross assessed value. This should be preserved. The remaining credits should be allocated in the same relative concept of the statutory caps with Other Residential class cap at the midpoint between Homestead and Non-Residential. The estimated effective circuit breaker cap rates for the various scenarios are presented below:

<u>2009</u>	<u>Homestead</u>	<u>Other Residential</u>	<u>Non Residential and Personal</u>
Statutory Rates	1.50	2.50	3.50
Gary Request 1	2.93	3.93	4.93
Gary Request 2	1.50	2.50	5.67
DUAB-revised	2.00	3.27	4.55

Additional Conditions

It is vital to consider not only the amount of circuit breaker relief to be given to petitioners but also the management needs to stabilize and begin the transformation for long-term sustainability. Therefore, as a condition of relief, a fiscal monitor should be procured to further develop and oversee the financial plan. Areas within the scope of services to be considered should be:

- organizational changes
- internal control assessment
- budget integrity, compliance and transparency
- review of contracts, including unions
- planning and coordination of funds from the American Recovery and Reinvestment Act of 2009
- asset management
- personnel policy
- validation and review of outstanding obligations

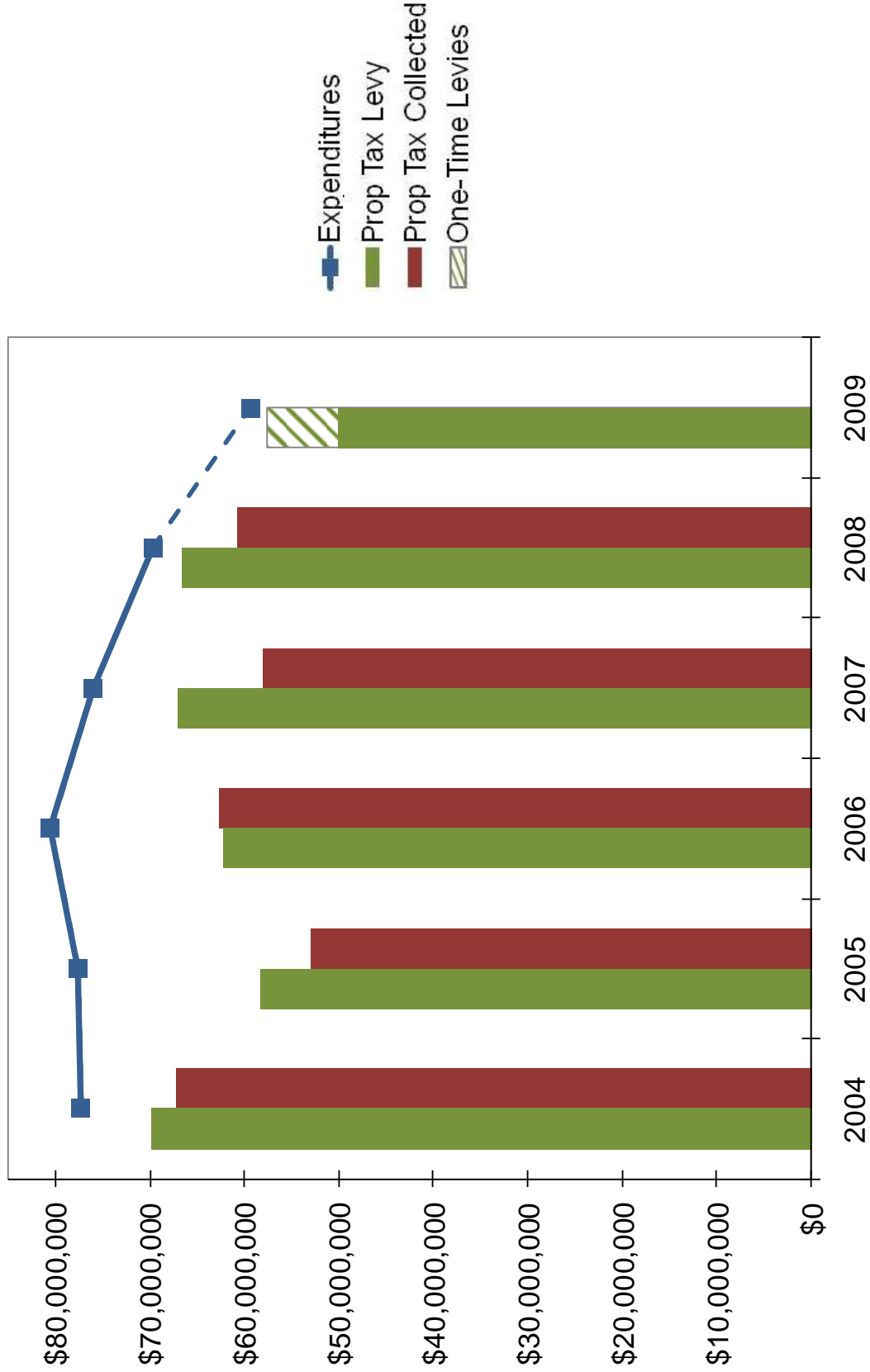
The fiscal monitor should deliver an expedited assessment within 90 days which outlines a prioritized course of action and recommendations for the petitioners’ anticipated 2010 DUAB petition. The petitioners should consult with DUAB staff in the development of a request for proposal and contract. The petitioners should pay for the fiscal monitor services. Periodic reporting to the DUAB staff should be provided in the contract. The ongoing role of the fiscal monitor, including that similar to a conservator, shall be determined upon the receipt and review of its report.

The shortfall levy for 2007 assessment errors and refunds is a one-time infusion of cash. Accordingly, these funds should be used to pay down outstanding obligations which are presented in the Appendix. The City should consult with the fiscal monitor and DUAB staff on the proper prioritization of these pay downs.

Appendices

City Expenditures and Property Taxes

Property Tax Supported Funds



Summary of Outstanding Obligations

<u>Obligation</u>	<u>Amount</u>
2008 Medical Claims	\$958,602
2008 Utility Bills	650,000
Interfund Loans-TIF	4,000,000
Judgments	1,000,000
RDA	3,100,000
Due GSD-2005 Loan*	12,497,127
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	\$22,205,729

*Repayment of this obligation is included as part
of an extensive consent decree.

Other Observations and Areas Requiring Attention

While the petitioning units proposed a multi-year plan, the circuit breaker relief recommended is for 2009 only. The petitioning units will need to return to the DUAB for consideration of relief for future years. While cuts must be made, this year should be viewed as one of stabilization and a sound positioning to 2010. The petitioners face daunting challenges and can no longer afford to be reactive. There are initiatives, with the input and assistance of the fiscal monitor and others, which must be planned and started in order to succeed in 2010 and beyond. Some of these areas are discussed in this section of the Appendix.

Budget Control and Transparency

- Although efforts have started in earnest to cut excess budget items, there appear to be opportunities to strengthen budget control and establish funding priorities that could lead to further cuts.
 - Numerous examples exist of some line items being nearly exhausted only a third of the way in to the year while others have not been spent at all. Examples are Utilities that has only \$100,000 remaining out of \$1.3 million budget and Other Compensation, General Fund Debt Service and Overtime (discussed further below) that have hardly been drawn to date that are being used to fund the 2008 operating deficit or will be used for overages such as Utilities.
 - A line item exists in the budget for gasoline, but to this date, not a dollar has been spent. While the City believes the charges have been accumulating in the Motor Vehicle Highway fund, without proper monitoring there is little ability to control spending.
 - There were \$2.1 million in open purchase orders at the end of April. It is unclear whether these were valid encumbrances or whether they were departmental placeholders for future spending. Greater control could be exerted in this regard.
- Continue to reduce the number of city departments and cut administrative costs where possible and right-size the departments for the required level of service.
 - The council budget appears to be three times the council budgets for South Bend and Evansville
 - Undertake a specific review of public safety using data to determine proper staffing and capital investment requirements and make appropriate adjustments
- A specific plan to address the payment of the \$22 million in deferred obligations should be developed. The debt service demands of gaming revenue begin to expire in 2010 and its use should be incorporated in the analysis.
- Risks to monitor and plan for mitigation
 - Lake County is currently appealing to the Supreme Court the assessment of USX . If unsuccessful, Gary would be responsible for \$7 million of the refund.
 - As noted above, Public Safety overtime has hardly been used. This was surprising due to the recent departures from the force. It seems overtime is currently foregone in exchange for compensatory time. Up to a quarter of a year's wages can be accumulated and claimed upon separation of service. At a minimum, this contingent liability should be tracked and reserved. An alternative would be to address in union negotiations.
 - If poor property tax collections persist, the budget will have to be managed more stringently for such occurrences.

Relationships with Other Units

A property tax cap environment is one of interdependency among the units within the taxing district.

- Major strides have been made by Gary to remove or reduce reliance on property tax by GSD, GPTC, and Airport. While tougher to make, the continuation of these efforts is critical
- The non-petitioning units (school, library, township) that have the same general geographic footprint must be engaged to both “steer” and “row” in this process.
- Gary has initiated conversations with Lake County concerning health department operations and received a less than cooperative response. This, along with the other opportunities identified in the original plan, should receive continued planning.
- Transportation services are important to the community. GPTC and City are encouraged to continue their involvement in the regional planning of those services.
- The City and Airport should research all alternatives, including public-private partnerships, to maximize the value of the Gary/Chicago International Airport.

Tax Base Revitalization

The decades-old, highly-industrialized and concentrated tax base that was supplemented by once-vibrant riverboat gaming in the mid 1990’s that permitted a more causal fiscal stewardship no longer exists.

- Gary has a weak tax base, which will hinder its ability to moderate property tax rates even with the necessary budget cuts.
 - While population has declined 46 percent from its high in the 1960’s and is now at levels comparable to the 1930 census, its assessed value per capita, approximately \$23,000, is one of the lowest for municipalities in the State.
- Gary conducts a land banking operation but its strategy is not clear.
 - The city controls 15% of all parcels.
 - The city petitioned DLGF to forgive \$1.8 million in property taxes due on abandoned properties in 2008 alone.