Findings and Recommendation by the Municipal Accountability Review Board Regarding a Tier IV Designation of the City of West Haven

Adopted April 14, 2022

I. Background

The City of West Haven was referred to the Municipal Accountability Review Board (MARB) in December 2017 following the City's issuance of approximately $17 million of deficit bonds. Based on Connecticut General Statutes, the issuance of deficit bonds by a municipality automatically results in its designation as a Tier III municipality and its referral to the MARB. The City had accumulated a large General Fund deficit, as well as deficits in the Allingtown Fire Fund and the Sewer Fund. The negative Fund Balances were largely the result of recurring operating deficits caused in part by unsustainable budget practices.

The MARB's authority and powers as they relate to Tier III municipalities consist of the following:

- Review and approval of 3-Year Financial Plan
- Review of monthly financial reports
- Review of certain aspects of annual budget (State Aid assumptions, property tax assumptions, mill rate assumptions)
- Review and comment on annual budget prior to local adoption
- Approval of refunding bonds and certain bonds supported by the State special capital reserve fund
- Review and comment on the issuance of all other debt obligations
- Approval of most labor contracts and some opportunity to reject arbitration awards
- Notification of non-labor contracts (over $50,000 for municipalities with population below 70,000)
- Monitoring of 3-Year Financial Plan and budget
- Ability to obtain financial information and make recommendations regarding efficiencies or productivity
- Ability to require implementation of LEAN practices

In addition to the MARB authority described above, a key feature of the Tier III designation is eligibility to request Municipal Restructuring Funds (MRF). Designated municipalities that receive MRF are subject to additional requirements, including MARB approval of the full budget and to obtain MARB approval of a 5-Year Plan (as opposed to a 3-Year Plan).

The City's first 5-Year Plan for the period FY 2019 – FY 2023 was approved by the MARB in November 2018. The plan set targets for gradually building Fund Balance to approximately $4 million by the end of FY 2023 and was based on receiving MRF over a five-year period beginning with $8 million in FY 2018 (to help close a projected deficit) and gradually phasing out payments to $0 by the final year of the Plan.

Since then, the City has revised and updated its 5-Year Plan three times. The MARB has ensured the City's adherence to the major tenets of its 5-Year Plans, enforced disciplined budget practices and realistic revenue projections, assisted the City in managing the cost of employee benefits (through labor negotiations and a transition to the State Partnership Health Plan), and helped the City stabilize its finances. Due in large part to having received a total of $16.2 million of MRF, the City has established a modest General Fund Balance (in addition to eliminating the deficits in both the Allingtown Fire Fund and Sewer Fund).

While these improvements are evident on the City's balance sheet, the MARB has noted deficiencies in the City's administrative and financial management that must be addressed in order for the City to achieve long-term fiscal sustainability. Various issues concerning to the MARB have been raised by the City's independent auditors and by outside consultants.

While the statute creating the MARB does not provide the board with the authority or powers to intervene in City operations or to compel the City to take any corrective actions, the MARB has consistently attempted to exert influence on the City to resolve internal control deficiencies and inadequate policies and procedures through its budget approval authority and the distribution of MRF.

While some measured progress in select areas has occurred, the City has not established an adequate financial management infrastructure supported by a comprehensive system of internal controls and policies and procedures.

The City's lack of urgency in addressing its financial management capacity is visible in both its reluctance to fill critical positions and its willingness to spontaneously pull staff from critical positions for reassignment. In multiple instances, the MARB has urged the City to fund key positions through the budget process or fill key vacancies in response to audit findings or consultants' recommendations only to discover positions left vacant for excessive periods, filled with internal candidates lacking relevant experience, and/or assigned to unrelated duties. [1]

The City has similarly been slow to take action in response to audit findings. The FY 2019 and FY 2020 audit findings and recommendations present the most glaring examples. The FY 2019 audit, which was finalized in March 2020, included a number of findings, including deficiencies in the City's procurement and accounts payable processes. Resolution of these findings was made a requirement for distribution of FY 2021 MRF. Anticipating that the FY 2020 audit would also likely include significant or material findings, the distribution of FY 2021 MRF was also made contingent on the City preparing corrective action plans for those findings. To date, the findings of the FY 2019 and FY 2020 audits have not been resolved and the MRF have been withheld.

The unfortunate and costly consequences of failure of the City to acknowledge deficiencies and to take remedial action are documented in detail in the CohnReznick audit commissioned by the Office of Policy and Management (OPM).[2] The findings in the CohnReznick report extend beyond the use and management of Covid Relief Funds (CRF) and have implications for financial management throughout the organization. Behind the City's growing reserves, balanced budgets and operating surpluses, the City's financial management infrastructure has deteriorated.

While much has been made about the City's vastly improved balance sheet, two critical points warrant highlighting:

1. The City's reserve levels, while reaching positive territory, remain slim and are vulnerable to economic downturn or other financial shocks. As the second section of this report will demonstrate, the City's

[1] Select examples of resistance to corrective actions are provided in Attachment A

[2] CohnReznick, Summary of Fundings: City of West Haven, Connecticut Use of Coronavirus Relief Funds, 4/1/2022

finances remain precarious, especially in the absence of an underlying financial management infrastructure, and

2. The City has been on this path before. Severe fiscal distress, evidenced by a large General Fund deficit, led to the creation of a State oversight board in 1992. Shortly after restoring solvency to the City, the oversight board disbanded in 1995. After a period characterized by positive reserve levels, the City fell back into a deficit position in 2005 which continued until its designation as a Tier III municipality.[3] The MARB is determined to not repeat this cycle.

Given the findings of the CohnReznick audit and the status of the City's responses to audit findings and other areas of concern, the MARB opted to give consideration to designating the City a Tier IV municipality in accordance with the provisions of CGS Section 7-576e.

II. Findings

CGS Section7-576e(a)(2) requires that the MARB make its determination regarding a Tier IV designation on an evaluation of the following criteria:

A. The balance in the municipal reserve fund

B. The short and long-term liabilities of the municipality, including, but not limited to, the municipality's ability to meet minimum funding levels required by law, contract or court order

C. The initial budgeted revenue for the municipality for the past five fiscal years as compared to the actual revenue received by the municipality for such fiscal years

D. Budget projections for the following three fiscal years

E. The economic outlook for the municipality

F. The municipality's access to capital markets

The Board's key findings and evaluation of each of the criteria is presented below.

A - The balance in the municipal reserve fund

Findings:

- The City's General Fund Balance remains well below the 5% threshold widely considered the minimum level of responsible reserves
- Progress that has been made in stabilizing the City's reserves and eliminating the General Fund deficit has been driven by additional financial assistance through the distribution of Municipal Restructuring Funds (MRF)
- The City, based on the Recommended FY 2023 Budget, appears to have abandoned the previously approved multi-year plans for accumulating reserves
- Restatements of prior year financial statements and recent findings of policies, procedures and internal controls pose questions about the reliability of City financial statements and projections

[3] See Attachment B: City of West Haven Fund Balance Timeline and Notes Re: Special Act 92-5

- References made by City staff regarding FY 2021 invoices unrecorded as of December 2021 or later undermine confidence in the City's reported Fund Balance and ability to accurately project surpluses
- To the extent that the City generates some of its surpluses by holding key financial management positions vacant, the trade-off is short term savings at the expense of further erosion of management capacity

Evaluation:

The most recent audited financial statements are for the fiscal year ending June 30, 2020. The City's FY 2021 audit has not yet been completed despite the requirement under State law that such audits must be completed and filed with the Office of Policy and Management by no later than six months after the completion of the fiscal year.

The City's General Fund Balance as of June 30, 2020 was $3,575,671 which equated to 2.07% of that year's expenditures and 2.05% of that year's revenues.[4] This level of reserves is well below the standard of 5% as a minimum.[5]

Prior to the City's referral to the MARB as a Tier III municipality, its General Fund Balance carried a deficit of -$18,138,674. Much of that deficit was eliminated through the City's issuance of deficit bonds, which was also the triggering event leading to its referral to the MARB. Increases to the City's General Fund Balance since the issuance of the deficit bonds in November 2017 are attributable directly to Municipal Restructuring Funds (MRF) distributed to the City in conjunction with its 5-Year Plans. The table below depicts the year-to-year changes in the City's General Fund Balance and the extent to which the City has relied on Municipal Restructuring Funds.

	FY 2018	**FY 2019**	**FY 2020**
Beginning Fund Balance	(18,138,674)	(1,408,027)	1,358,918
Proceeds from Deficit Bonds	17,175,796	-	-
Municipal Restructuring Funds (MRF)	8,000,000	5,000,000	3,115,000
Surplus/(Deficit): net of Deficit Bonds and MRF	(8,445,149)	(2,233,055)	(898,247)
Ending Fund Balance	(1,408,027)	1,358,918	3,575,671
Estimated Fund Balance Without MRF	(9,408,027)	(11,641,082)	(12,539,329)

As the above table makes apparent, the City's General Fund Balance would have continued to be in a deficit position had Municipal Restructuring Funds not been distributed in the three years shown.

[4] Annual Financial Report for Year Ended June 30, 2020, Statement of Revenues, Expenditures and Changes in Fund Balance

[5] CGS 7-395d identifies 5% as a key threshold for triggering referrals to the Municipal Finance Advisory Commission. CGS Sec. 7-576a – 7-576d identifies 5% as a key threshold for defining eligibility for designation at Tiers I, II, or III. The Government Finance Officers Association recommended 5% as a minimum fund balance target in the past. Currently, the GFOA recommends a minimum fund balance equal to two months of operating costs (approx. 16%).

Although the City anticipates a surplus for the fiscal year that ended June 30, 2021, audited financial statements are not expected to be finalized for several months. Even if a surplus materializes as projected by the City, it is expected to be well below the standard of a minimum 5% reserve level.

Regarding the City's level of reserves, it is also worth noting that the City was required to re-state its Fund Balance as recently as FY 2018. The General Fund Balance, originally reported at $2,181,149 as of June 30, 2018 was restated in the FY 2019 audited financial statements to be in a deficit position at ($1,408,027). The improper year-end accrual of expenditures was the cause of the inaccurate Fund Balance in the original financial statements and was included in FY 2019 audit findings as a material weakness.[6]

The discovery of FY 2018 invoices paid in FY 2019 was brought to OPM's attention by the independent auditor during an audit closing meeting late in the FY 2019 audit process. At OPM's urging, and with the City's acquiescence, the auditor expanded testing to include three additional months. That finding was repeated in the most recent completed audit (FY 2020).[7] To date, the resolution of the underlying cause has not been verified. As recently as January 2022, the City's former Finance Director reported that unpaid FY 2021 invoices were still being received and processed by the Finance Office.

FY 2018 was not the first time the City's financials needed to be restated. The City's FY 2005 General Fund Balance, originally reported at $6.8 million, was subsequently restated to be in a deficit position at ($3.6) million.

As will be discussed further in the findings for item D, the City's plan was to rely on financial assistance in the form of MRF to stabilize its Fund Balance and to bide time until previously issued pension obligation bonds were retired in FY 2022. From that point forward, the City reasoned, a significant decline in required debt service payments would allow for significant and rapid increases in General Fund Balance without any additional financial assistance from the State. The Recommended FY 2023 Budget that was recently submitted to the MARB does not direct the reduced debt service requirements to building Fund Balance. Rather, the Recommended FY 2023 Budget redirects those funds to operations resulting in minimal funding devoted to increasing fund balance. Thus, a key component of the City's plan for amassing General Fund Balance appears to have been abandoned.

B - the short and long-term liabilities of the municipality, including, but not limited to, the municipality's ability to meet minimum funding levels required by law, contract or court order

Findings:

- The City's Fire (Allingtown) Pension Plan had a funded ratio of 35% as of June 30, 2020, placing it in the lowest 10% among Connecticut municipal plans according to a Hooker & Holcombe report[8]
- The City's Police Pension Plan had a funded ratio close to 90% as a result of previously issued pension obligation bonds, however, ADEC requirements are projected to rise dramatically beginning in FY 2021

[6] Annual Financial Report for Year Ended June 30, 2019, Finding 2019-003 Year End Cash Disbursements (Material Weakness)

[7] Annual Financial Report for Year Ended June 30, 2020, Finding 2020-001 Year End Cash Disbursements (Material Weakness)

[8] Hooker & Holcombe, Municipal Pension and OPEB Report 2021, https://www.hhconsultants.com/documents/employers/brochures/2021-Municipal-Pension-and-OPEB-Report.pdf

- The City has not made progress in developing a coordinated pension investment policy or in acquiring pension investment advisory services, which will further constrain improvements in funded ratios
- The City has not yet begun to pre-fund its OPEB obligations in a meaningful way. The total OPEB liability as of June 30, 2020 was more than $337 million (including General and Allingtown Fire Funds)
- Recent findings regarding lack of adequate internal controls, policies and procedures, as well as allegations of fraud, could have a detrimental effect on both short-term and long-term liabilities – These include losses from alleged fraud that will likely be absorbed by the General Fund as well as the likelihood of having to repay disallowed Covid Relief Funds to the federal government
- The City has numerous labor contracts that are currently expired or nearing the end of their contract term – A tight labor market coupled with the modest contracts awarded in recent rounds of negotiation may create a challenging negotiating environment for the City
- Improving the funded status of the City's long-term liabilities will be a lengthy process requiring sustained effort and discipline in funding at responsible levels. However, the City has not fully established a track record of fully funding ADEC requirements

Evaluation:

Debt:

The City's long-term debt, including general obligation bonds and clean water serial notes, totaled $85.7 million as of June 30, 2020. The City issued an additional $20.545 million in general obligation bonds in September 2021 for continued financing of the high school renovation project as well as other school and City capital projects. Annual debt service requirements between FY 2019 and FY 2022 have been in the 10% to 11% range.[9]

Pension:

The City administers two separate pension plans, both of which are closed plans. The Police Pension Plan covers approximately 156 members, and the Fire (Allingtown) Pension Plan covers approximately 30 members. The status of each plan, based on the most recently completed actuarial valuation is presented in the following table.

Plan	Latest Actuarial Valuation	Actuarial Value of Assets	Total Accrued Liability	Unfunded Accrued Liability	Funded Ratio	ADEC FY 2022	ADEC 2023
Police	7/1/2020	123,710,083	138,498,201	14,788,118	89.3%	2,598,048	3,628,000
Fire (Allingtown)	7/1/2021	11,755,582	33,231,440	21,475,858	35.4%	2,488,867	2,053,411

The Police Pension Plan is relatively well-funded, due largely to pension obligation bonds issued by the City in 2002 (for which final payments will be made in FY 2022). While the plan's funded ratio is nearly 90%, the most recent valuation updated mortality tables resulting in a significant increase in the

[9] Preliminary Official Statement, 9/13/2021, p. 42

projected ADEC beginning in FY 2023 and carrying forward. The sharp rise in ADEC requirements for the Police Pension Plan will reduce the City's budgetary flexibility in FY 2023 and in subsequent years.

The Fire (Allingtown) Pension Fund has a very low funded ratio at approximately 35%. Based on projections in the latest actuarial valuation, the plan will not reach a 70% funded ratio until 2031 assuming the City makes all of the projected ADEC payments. In order for the City to accelerate progress on the funded ratio, a consistent effort to fund contributions to the plan above and beyond the ADEC will be necessary for an extended period.

The City's history in funding ADEC requirements has been inconsistent. Over the ten most recently audited fiscal years (FY 2011-FY 2020), the ADEC for Police Pension Plan has been fully funded in four of those years. During that same ten-year period, the ADEC for the Fire (Allingtown) Pension Plan was fully funded five times.

Other Post-Employment Benefits (OPEB):

The City and Allingtown Fire District currently provide health and life insurance benefits for eligible retirees and eligible spouses. These plans are funded on a pay-as-you-go basis, though in recent years the City has begun to budget modest amounts of advanced funding for OPEB. The unfunded liability for City OPEB as of June 30, 2020 was $308.13 million and for the Fire (Allingtown) OPEB was $29.47 million.

C - the initial budgeted revenue for the municipality for the past five fiscal years as compared to the actual revenue received by the municipality for such fiscal years

Findings:

- The five most recent audited fiscal years cover a period of transition which includes several years prior to MARB involvement in the budget process (FY 2016 – FY 2018) as well as two years in which the MARB had a role in review and approval of the budget (FY 2019 and FY 2020)
- Prior to MARB involvement, over-estimating certain revenues was a recurring theme, dating back more than five years
- Over-estimating of revenues can have the effect of artificially lowering the mill rate, but can result in operating deficits if sufficient revenues do not materialize
- Disciplined budgeting of revenues is essential to sustainable budgeting and to maintaining or growing reserves - However, the City has not fully established a track record of accurately projecting revenues

Evaluation:

The table on the following page compares revenues as originally budgeted to actual revenues for the last five fiscal years. The major variances in the actual revenues over this period can be attributed to the following:

Intergovernmental: The negative variances in Intergovernmental revenues for fiscal years 2016 and 2017 appear to be the result of over-estimating State Aid to municipalities (including Excess Cost Sharing and LoCIP). The variance in FY 2018 was the result of improperly budgeting for Special Education Excess Cost Sharing ($8.5 million). More accurate budgeting for Intergovernmental sources is reflected in the FY 2019 and FY 2020 figures developed under MARB oversight.

Charges for Services: The negative variances in FY 2016 an FY 2017 appear to be the result of over-estimating building and related permits. The negative variance in FY 2020 was a result of shortfalls in building and related permits and recreation fees due to the sudden impacts of the Covid pandemic.

Other Financing Sources: The large variance in Other Financing Sources in FY 2019 reflects the City's issuance of $17 million of deficit bonds. Positive variances in FY 2017 and FY 2019 both relate to sales of City assets.

Municipal Restructuring Funds (MRF): The City was referred to the MARB for oversight well after the FY 2018 budget was adopted. The MRF received in FY 2018 were unbudgeted revenues distributed to the City to minimize that fiscal year deficit. The negative variances in FY 2019 and FY 2020 represent the amounts of MRF withheld from the City in each of those years.

Item C
Initial Budgeted Revenue vs. Actual Revenue
FY 2016 – FY 2020

	FY 2016			FY 2017			FY 2018			FY 2019			FY 2020		
Revenues	**Original Budget**	**Actual**	**Variance**	**Original Budget**	**Actual**	**Variance**	**Original Budget**	**Actual**	**Variance**	**Original Budget**	**Actual**	**Variance**	**Original Budget**	**Actual**	**Variance**
Property Taxes	$89,734,948	$90,455,343	$720,395	$93,818,902	$94,300,417	$481,515	$94,943,852	$95,880,234	$936,382	$97,580,080	$97,509,642	($70,438)	$99,786,712	$99,858,280	$71,568
Municipal Restructuring Funds (MRF)	$0	$0	$0	$0	$0	$0	$0	$8,000,000	$8,000,000	$8,000,000	$5,000,000	($3,000,000)	$4,115,000	$3,115,000	($1,000,000)
Intergovernmental	$56,715,256	$55,457,785	($1,257,471)	$57,154,480	$54,442,288	($2,712,192)	$62,008,951	$52,551,502	($9,457,449)	$52,727,631	$52,948,396	$220,765	$52,726,575	$52,626,342	($100,233)
Charges for Services	$4,807,612	$3,589,044	($1,218,568)	$4,393,620	$3,586,549	($807,071)	$3,812,561	$4,459,358	$646,797	$4,044,139	$4,458,444	$414,305	$4,181,021	$3,676,119	($504,902)
Contributions	$411,127	$413,060	$1,933	$411,127	$422,652	$11,525	$413,060	$427,290	$14,230	$422,651	$437,317	$14,666	$422,651	$444,561	$21,910
Income from Investments	$5,000	$3,946	($1,054)	$5,000	$7,199	$2,199	$5,000	$193,375	$188,375	$55,000	$381,638	$326,638	$70,000	$348,190	$278,190
Other	$200,000	$630,723	$430,723	$200,000	$198,803	($1,197)	$215,000	$138,275	($76,725)	$210,000	$220,033	$10,033	$210,000	$204,699	($5,301)
Total Revenues	$151,873,943	$150,549,901	($1,324,042)	$155,983,129	$152,957,908	($3,025,221)	$161,398,424	$161,650,034	$251,610	$163,039,501	$160,955,470	($2,084,031)	$161,511,959	$160,273,191	($1,238,768)
Other Financing Sources	$1,618,013	$1,655,231	$37,218	$1,598,013	$2,105,315	$507,302	$1,371,416	$18,678,542	$17,307,126	$1,263,700	$2,008,541	$744,841	$1,408,875	$1,296,122	($112,753)
Total Revenues & Other Financing Sources	$153,491,956	$152,205,132	($1,286,824)	$157,581,142	$155,063,223	($2,517,919)	$162,769,840	$180,328,576	$17,558,736	$164,303,201	$162,964,011	($1,339,190)	$162,920,834	$161,569,313	($1,351,521)

Sources: FY 2018-FY 2020, Annual Financial Reports, RSI-1, Schedule of General Fund Revenues and Other Financing Sources Budget and Actual - Budgetary Basis
FY 2016-FY 2017, Supplemental Schedule 1, General Fund Schedule of Revenues and Other Financing Sources - Budget and Actual

D - budget projections for the following three fiscal years

Findings:

- The City's most recent 3-year budget projections are reflected in the previously approved 5-Year Plan for FY 2022 – FY 2026
- An updated 5-Year Plan for the period FY 2023 – FY 2027 has not been submitted to the MARB yet – However, the City has submitted the Recommended FY 2023 Budget which would be the first year of an updated 5-Year Plan
- The Recommended FY 2023 Budget redirects funds that would have been set aside as Fund Balance reserves toward significantly increasing operating expenditures (by more than 10%) – This represents a major change in direction of the City's multi-year planning, as the building of reserves was one of the single most important objectives of the approved 5-Year Plans.
- This deviation from the previously approved 5-Year Plans will:
    - Impede the City's ability to accumulate Fund Balance as planned
    - Impede the City's ability to address other financial demands, including the funding of long-term liabilities
    - Limit the City's budgetary flexibility in subsequent years
- Prior reluctance on the part of the Mayor and City Council to adjust the mill rates in alignment with approved 5-Year Plans may jeopardize mill rate increases built into the current 5-Year Plan (for both the General Fund and Fire Fund)[10]

Evaluation:

Soon after its referral to the MARB as a Tier III municipality, the City was required by the board to prepare a 5-Year Financial Plan as a condition for receiving Municipal Restructuring Funds. Annual updates to the Plan have also been required as a condition of MRF payments. Since the original 5-Year Plan was approved for the period FY 2019 – FY 2023, the City has developed three updates to the Plan for the periods FY 2020 – FY 2024, FY 2021 – FY 2025, and FY 2022 – FY 2026.

As noted in the discussion under item A, a key component of the 5-Year Plan has been a planned escalation in projected surpluses beginning in FY 2023 coinciding with the retirement of previously issued pension obligation bonds. Each version of the 5-Year Plan has projected an increase of at least $4.0 million to General Fund Balance in FY 2023 (driven largely by the retirement of pension obligation bonds by the end of FY 2022).

A proposed updated Plan for the period commencing July 1, 2023 has not yet been submitted to the MARB. However, the City's Recommended FY 2023 Budget, which would constitute the first year of the updated Plan, was submitted for MARB review on March 18, 2022. The Recommended FY 2023 Budget proposes no significant addition to Fund Balance. Based on the budget as proposed, the funds which previously would have been directed to increasing Fund Balance appear to be spread across

[10] For example the FY 2020 recommended budget which deviated significantly from the approved 5-Year Plan.

departmental operating expenses. The table below illustrates the deviation from the most recently updated 5-Year Plan with regard to bolstering Fund Balance.

	Based on 5-Year Plan FY22-FY26				Recommended FY23 Budget			
General Fund	FY 2022	FY 2023	$ Change	% Change	FY 2022	FY 2023	$ Change	% Change
Total Revenues	$165,542,701	$165,259,603	($283,098)	-0.2%	$165,542,699	$168,339,209	$2,796,510	1.7%
Expenditures								
City Operations	$56,193,334	$57,820,392	$1,627,058	2.9%	$56,193,332	$62,183,593	$5,990,261	10.7%
Board of Education	$89,960,421	$90,320,262	$359,841	0.4%	$89,960,421	$89,960,421	$0	0.0%
Debt Service	$17,900,579	$12,432,968	($5,467,611)	-30.5%	$17,900,579	$14,628,695	($3,271,884)	-18.3%
Contingency/Other Expenses	$1,188,367	$737,442	($450,925)	-37.9%	$1,188,367	$1,416,500	$228,133	19.2%
Total Expenditures	$165,242,701	$161,311,064	($3,931,637)	-2.4%	$165,242,699	$168,189,209	$2,946,510	1.8%
Projected Surplus/(Deficit)	$300,000	$3,948,539	$3,648,539	1216.2%	$300,000	$150,000	($150,000)	-50.0%

As can be seen in the table, the proposed FY 2023 Budget does not use the decline in debt service requirements to maximize surplus which would add to Fund Balance. Rather, the reduction in debt service is more than offset by increased spending on City Operations, which rises by more than 10%. This deviation from the 5-Year Plan has obvious implications for subsequent fiscal years. By building the debt service windfall into recurring expenses (City Operations) in what will be the baseline year of the 5-Year Plan, the City limits its flexibility in future years and constrains its ability to build Fund Balance beyond FY 2023.

Other aspects of the City's multi-year plan are also undermined by the Recommended FY 2023 Budget:

- Flexibility: As noted above, significant increases in recurring expenses limits flexibility. Planned contributions to Fund Balance can be modified as needed when circumstances change unexpectedly. Sudden adjustments to operating expenses are far more difficult and can be detrimental to public services.
- Capital Investments: A portion of the budgetary capacity that was created by the retirement of pension obligation bonds would have allowed for some additional borrowing to support the City's capital improvement plan. By absorbing that capacity into operating expenses, less is available for capital investments.
- OPEB Funding: The 5-Year Plan projected gradual increases in OPEB funding. Opportunities to make significant strides in this area will be hindered by the increase in baseline operating expenses.
- Police Pension Funding: The 5-Year Plan was based on long-term projected ADEC requirements included in the July 1, 2018 valuation. Preliminary projections from a July 1, 2020 valuation indicate significantly higher funding requirements beginning in FY 2023. The FY 2023 Recommended Budget includes $3.6 million as the contribution to the Police Pension fund. This exceeds the FY 2023 amount projected in the current 5-Year Plan by more than $1 million.

Allegations of fraud and the apparent mismanagement of Covid Relieve Funds may also have an impact on the revenue portion of the City's 5-Year Plan. Even with the relatively modest spending increases envisioned in previously approved Plans, mill rate increases were built into most years for both the General Fund and Fire Fund. With the baseline elevated considerably in the FY 2023 budget, more sizeable mill rate increases may be required in subsequent years.

E - The economic outlook for the municipality

Findings:

- In the short-term, the City will face inflationary pressures, including rising energy costs as well as potential impact on labor costs (which are not reflected in the City's most recently approved 5-Year Plan
- The City's wealth and tax base indicators lag behind the region and the state

Evaluation:

The following table provides select economic indicators for the City of West Haven and the State.

Metric	City	Statewide	Source
2020 Per Capita Income	$30,103	$45,668	U.S. Census
2020 Median Household Income	$64,255	$79,855	U.S. Census
2020 Median Home Value	$196,800	$279,700	U.S. Census
2021 Unemployment Rate	6.7%	6.3%	CT Dept. of Labor
2020 Equalized Mill Rate (preliminary)	22.49	19.90	OPM Data
Net Assessed Value per Capita (2019)	49,853	108,114	OPM Data/Dept. Public Health

The credit analysis issued by Standard & Poor's in conjunction with the City's September 2021 bond issue described the West Haven economy as adequate, noting some positive factors such as planned development projects and the City's position in the greater New Haven market, while also citing residents' relatively low purchasing power and a higher than average unemployment rate.

Since the release of the Standard & Poor's analysis, inflation has accelerated sharply and will potentially have a negative impact on the City's economic outlook.[11]

F - the municipality's access to capital markets

Findings:

While the City's fiscal condition may not restrict its access to capital markets, conditions described in the CohnReznick report and prior year audit findings, the potential for a restatement of financials and delays in completing financial statements are all factors that could affect the cost of borrowing for the City.

Evaluation:

In addition to fiscal conditions (such as level of reserves), debt and long-term liabilities, and economic conditions, agencies that rate municipal credit take financial management and administration into consideration. Factors that could negatively affect the scoring related to municipal financial management by rating agencies include:

[11] U.S. Bureau of Labor Statistics data shows the year-over-year rate of inflation as of September 2021 at 5.4%. As of February 2022, the year-over-year rate is 7.9%. https://www.bls.gov/cpi/tables/supplemental-files/home.htm

- Financial planning and budget management that is unusually weak in ways not reflected in the recent financial trend, existing cash reserve and fund balance[12]
- Absence of independently verifiable financial information
- Management teams that lack the relevant skills to adequately plan, monitor, and manage the government's finances[13]
- Restated financial statements[13]

III. Recommendation

The MARB notes that historically, there have been systemic deficiencies that have prevented the City from achieving long-term financial stability. While the City's balance sheet has recovered from a deficit position to a positive reserve level, ensuring that these improvements are sustained requires systemic and cultural changes to the way the City manages its financial operations. The City's record demonstrates that implementing systemic change will require a greater degree of intervention by the State.

Therefore, based on the findings for items A – F described above, the MARB recommends that the City of West Haven be designated a Tier IV municipality.[14]

The MARB recognizes that a Tier IV designation will not guarantee that systemic and cultural change is achieved. There are limits to the additional authority provided by a Tier IV designation. However, Tier IV does provide the MARB with additional oversight tools, notably the ability to hire a Financial Manager. With good faith cooperation from the City's leadership, Tier IV oversight can help the City implement the cultural changes and financial infrastructure development that previous oversight boards have been unable to enforce.

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[12] Moody's: U.S. Public Finance, General Obligation Bonds Issued by U.S. Local Governments, October 2009

[13] Standard & Poor's Ratings Direct: U.S. Local Governments General Obligation Ratings: Methodology And Assumptions, 9/12/2013

[14] See Attachment C: Procedures for Designation of Tier III Municipality to Tier IV