Options To Restore Youth Alcohol and Drug Treatment Beds

Reminder of Uncertainties in FY 03-04 Approved Budget

Employ. Ben. Cost Sharing	$ 500,000	
PERS Reform/Litigation	?	Rate orders not issued til end of June; asset smoothing removed?
State Budget	?	Not yet settled; is up going to be up or down; rev. sharing ok?
Transfer from Benefit Fund	500,000	One-time transfer; gone in 04-05.
Interfund Loans for Sher. Off	481,257	Parks also doing loan.
Future projected deficits		

Recap Pathways' FY 02-03 Program (Annual Costs): (see Linda Wagner's 6-13-03 Memo, Attachment #1)

Current Prog. Cost/Year	$899,360	3 Year cost = $2,600,000
No. of Beds	14	Male only
Cost per Bed (fully loaded)	64,240	
Avg Daily Rate	176.00	County owns, provides and maintains facility.
OYA Appr'd Rate	132.48	
County Difference	43.52	
Avg. No. Youth Served/Year	36	Up from 28 youth and avg cost of $32,120 per year.
Avg Length of Stay	2.6 mo.	Previously six months
Avg Cost/Youth/Year	24,982	

In consultation with Youth Services we have learned:

Pathways' cost is 10 percent of the DYS budget and serves 1 percent of all offenders.

Pathways' reduction results in 18 high-risk offenders not receiving service while a reduction in other services for high-risk offenders impacts between 50 - 300 juveniles.

System Assessment recommended maintaining a continuum of care.

$250,000 cut to Pathways maintained seven A&D beds and did not create gap in care continuum.

The Following Options were Examined:

Lapse Funding (One-Time; see attached)

General Expense	(1,691,514)	Projections are to end year with new revenue down about $1.0 million
Other Depts-Amt above 2%	1,000,000	Depts typically just meet 2% lapse requirement and use balance
	(691,514)	Note: FY02-03 Actual Beginning Balance was $600K less than anticipated.

Contingency Funds

Board of Comm FY02-03	13,000	Remaining balance in BCC contingency account for FY02-03
Board of Comm FY03-04	25,000	Total amount in budget for FY03-04

Redirect Revenues (see attached)

Transient Room Tax-	
Special Projects	Projected to be flat; expect first $50K payment on Fair loan
Video Lottery	Extra $100K this year; maybe $60K next year; does it meet criteria?
Car Rental Tax	Could redirect from Parks - would cause reduction in Parks' services.

New/Additional Revenues

Robert Wood Johnson Foundation Grant for Alc. & Drug Treament just announced.

Pro Could possibly be used for Pathways.

Con Would begin reliance on soft money.

Other Youth Services Reduction Options (see Linda Wagner's 6-13-03 Memo)

1. Reduce Pathways Daily Rate to OYA Rate	Pro Full BRS funds still leveraged since based upon OYA rate.
	Pro Maintains all 14 beds.
	Con Some services will be reduced.

Options To Restore Youth Alcohol and Drug Treatment Beds

2. Close Half of Existing Detention Pod	Pro	Would allow restoration of seven Pathways beds to serve 18 youth.
	Con	500 fewer admissions in detention.

Other Youth Services Reduction Options - continued

3. Close Pathways Completely	Pro	Use other treament options
	Con	Other options limited - means more time on waiting lists.
4. Lay Off Additional Prob. Staff	Pro	Would allow restoration of seven Pathways beds to serve 18 youth.
	Con	Up to 150 youth reassigned to other caseworks adding to burgeoning caseloads, decrease supervision time and compromise safety.

Reduce 5% Prudent Person Reserve(PPR)

PPR Is 5% of Discretionary revenue; this is only 2.5% of total General Fund

Financial Policy #18 says Lane County will strive to maintain a minimum 5% PPR in all funds.

Standard & Poors Publication on 04-Feb-02 was "Top 10 Ways to Improve or Maintain a Municipal Credit Rating

Number one on list was to "Establish or enhance rainy day/budget stabilization reserves." **(flyer attached)**

Important Considerations:

- Cash flow requirments.
- Historic volatility of revenues and expenditures through economic cycles.
- Is the reserve a legal requirement or an informal policy.
- Are their formal policies outlining under what circumstances reserves can be drawn down.
- Will there be a mechanism to rebuild reserves once they are utilized.

Based upon the considerations noted above, the prudent person reserve should not be reduced further.

MEMORANDUM

TO: Lisa Smith
FROM: Linda Wagner
Subject: Alternative Funding for Pathways
Date: 6-13-03

This memo is in response to your request for funding options for the seven Pathways' beds slated for reduction. I know we covered some of these issues during budget deliberations, but it seems prudent to articulate them in this memo.

This review includes 1) an overview of the environment and rationale affecting our original decision making process and 2) a review of new / old options.

Please let me know if you have any further questions regarding this information.

Environment and Rationale – DYS experienced several reductions over the last two years including the loss of six probation counseling positions, reduction in JCP and Basic Services grant funds, and the volunteer coordination position. More recently, the Oregon Youth Authority (OYA) reduced our secure commitment cap from 74 in Aug. of '01 to 34 as of June '03.

The impact of these cuts includes having high-risk juvenile offenders coming back to, and remaining in, the community with fewer resources to respond to their criminal behavior.

Like many other county departments, DYS had already endured dangerous service reduction prior to the county's need to take further cuts for the next fiscal year. Our options for further reductions were very limited. We used the county protocol for prioritizing services.

That process helped us to identify the Pathways beds as "the best option on a list of unpleasant options." In other words, any reduction from the service priority list results in negative impacts on the service deliver system but the seven beds was the most practical for several reasons including:

- Keep Part of Service In Place - It allowed us to maintain part of the service delivery system (7-beds) to build upon at a later time rather than removing an entire service.

- Other Resources for This Population - There are other programs that provide this service. This was one of the critical items in the deliberation process. Unlike some of our other services on the priority list, there are other options for youth placed at Pathways including placement at a state managed residential treatment facility. This option does not have a financial impact for the county – the county does not pay for those state resources. Obviously, it is a limited option, but in existence.

- Cost Per Youth - Another critical item was the return on the investment issues – or, cost per youth as compared to other services on the priority list that were all reviewed for reductions.

  In the past, Pathways has served an average of 28 youth per year. They have worked to shorten the stay and serve more youth. The current average is 36 individuals a year. The current budget is $899,360 - $24,982 per youth. This does not include the after care service as it is unclear if that is paid for through the general fund or the endowment. Assuming it is part of general fund, the cost per youth is lowered to $16,060 ($899,360 / 56).

  Other services for high-risk youth yield a greater return. For example, Shelter Care costs $781,165 and served 85 youth for a cost of $9,190 per youth. Detention costs $1,976,492 and had 1,083 admissions last year for a cost per youth of $1,825.

  It is no new news that juvenile offenders who progress through the system to out of home care represent the highest cost to the system. DYS is very successful at minimizing the percent of offenders who penetrate that level (75% of all juveniles on probation have their cases successfully terminated without commitments to the state's secure custody.) The smaller group of chronic and serious offenders requires more restrictive and costly interventions.

Given our comprehensive review of options during budget deliberations – some of which are outlined above - Pathways holds the most promise for the lowest negative impact. This is **not** to say the program is not important or that it does not provide a valuable service with impressive outcomes. It does. As does other service options which we had to be reviewed as part of the service priority list. The Pathways reduction of seven beds affects the fewest offenders as compared to these other options. Regardless of that fact, there are some other options to consider.

Other Options –

1. Reduce Pathways' Daily Rate – This was not reviewed during budget deliberations as, I believe, the contract had already been established.

   The Oregon Youth Authority (OYA) has an established daily rate for this level of service provision. The current OYA rate is $132.48. The county is paying a rate of $176 for Pathways – $43.52 above the OYA rate. This translates into the county paying $222,387 per year to compensate for the difference between the two rates.

   Please see attachments # 1 and #2 for more details on the impact of this rate. Attachment #1 illustrates the financial impact of the higher rate (see row "I"). Also of note, the BRS levered funds do not change when the Pathways rate is reduced to the OYA rate – see rows L on both sheets. That is because the BRS reimbursement is based on the OYA rate, not the difference between the two rates. (FYI – the OYA rate will be reduced in this next FY but the impact is minimal – about $4,000).

   Of course, these impacts are financial in nature. A lower rate will most likely impact additional services Lane is receiving for our higher rate. I checked with the state and the OYA rate factors in other types of BRS requirements. Hence, the reduction should not compromise the program's BRS eligibility but rather additional services Lane is receiving above BRS requirements.

   - **Benefits** – Maintain a fourteen-bed facility and the county's commitment to a community-based residential treatment program for male juvenile offenders with AOD problems.

   - **Costs** – "Extra" services will be reduced. I'm assuming that will impact the aftercare program and the school program, which seem to be "above" the BRS requirements. The extent to which these changes will impact program outcomes is unknown.

2. Close Half of The Existing Detention Pod – Unlike Pathways, alternative options have county cost obligations associated with them. For example, even if we "rented" detention space from another county, there would be bed costs and additional transportation costs.

   Closing half a pod would result in 500 fewer admissions into detention. In addition, the youth campus was funded through a levy that promised both corrections and treatment. The new detention facility was a major component of this plan.

   - **Benefits** – Able to fund the seven beds at Pathways.

   - **Costs** – 500 fewer admissions in detention in order to serve 18 juveniles in Pathways.

3. Close Pathways Completely – It is possible to close the Pathways facility and obligate those funds for treatment services for juvenile offenders with AOD issues. While this is an available option, it holds the least promise.

   Like detention, probation, and other corrections options, "treatment" is another aspect of the youth campus described in the levy. Completely removing this residential option will also compromise that intent – one of the reasons we advocated so strongly during budget deliberations to maintain the seven beds.

   - **Benefits** – Maintains the county's commitment to treating this population.

   - **Costs** – While other treatment options exist in the state, they are limited. Youth will spend more time on waiting lists.

4. Lay off Probation Staff – It would take about 2.8 FTE to make up financial cost of the reduction in the seven-bed facility. As mentioned in the initial part of this memo, DYS has taken 6 cuts in the past to prevent reductions in treatment contracts. So this option has already been utilized to what is considered "unsafe" proportions. In addition, there are currently probation counselors funded through grant funds. The status of this "soft" revenue and positions is precarious. Probation counselors work with an average of fifty juvenile offenders over a year and their personnel costs averages $80,000 per worker for a cost of $1,600 per youth.

    - **Benefits** – Maintains Pathways 14 beds.

    - **Costs** – Up to 150 juvenile offenders would be reassigned to other workers, increasing workloads, decreasing supervision time with all offenders (875 over the year) and compromising community safety.

Another option may be in the grant announcement with the Robert Wood Johnson Foundation for AOD treatment. I just became aware of this opportunity and will investigate the funding requirements. There are, of course, several things we need to review in terms of moving towards soft money for this program. Even with that review, this will not help our immediate need for funding.

One point needs to be made concerning the way this analysis looked at the impact of various reductions. Obviously, the reduction in Pathways results in the least impact on number of offenders – the cost of this program is 10 percent of our budget and serves 1 percent of all offenders. Pathways 7-bed reduction results in 18 high-risk youth not receiving this service while a reduction in other services for high-risk youth impact between 50 and 300 juvenile offenders. All these juveniles are at high-risk and human nature is not 100 percent predictable. There is always the risk that after a reduction, one of them may go on to commit a very serious crime. It is important to keep in perspective that this risk is present - and has occurred - with juvenile offenders receiving any one of these services (probation, detention, Pathways) when each service operated at full capacity.

5. Recommendation – Our initial decision seems validated by this review – reduce Pathways to 7-beds. The second most promising alternative is to reduce Pathways' daily rate if the county is willing to reduce the types of services provided by this program. This reduction should not affect BRS eligibility. If the "rate" option is selected in order to maintain the 14 beds, we will continue to evaluate and monitor the program to see the extent to which this impacts outcomes.

ATTACHMENT # 1: **PATHWAYS CURRENT DAILY RATE:**

ROW:	Conditions:				
A	Pathways daily rate for '02 - '03	$	176.00		
B	OYA approved rate for '02 - '03	$	132.48		
C	ADP		14		
D	# Days		365		

ROW	Cost Calculations:				ANNUAL COSTS:
E	Total TX cost is 75.4% of OYA approved rate 0.754 x $132.48	$	99.89		
F	BRS pays 60.8% of TX cost 0.608 x $99.89	$	60.73		
G	County pays basic need rate of 24.6% 0.246 x $132.48	**$**	**32.59**	**$**	**166,535**
H	County pays 39.2% of TX cost 0.392 x $99.89	**$**	**39.16**	**$**	**200,091**
I	County pays difference OYA & Pathways rate $176 - $132.48	**$**	**43.52**	**$**	**222,387**
J	Total County Daily Cost	**$**	**115.27**	**$**	**589,014**

ROW	Totals:		
K	Annual County Cost County daily costs x ADP x days	**$ 589,014.01**	
L	Total BRS leveraged at ADP for days	$ 310,345.99	
M	Total Pathways Costs for ADP for days	$ 899,360.00	
N	Cost Verification Pathways daily rate x ADP x days		$ 899,360.00

BOLD AREAS = COUNTY PAYMENT

ATTACHMENT # 2: **PATHWAYS WITH OYA RATE:**

ROW:	**Conditions:**				
A	Pathways daily rate for '02 - '03	$	132.48		
B	OYA approved rate for '02 - '03	$	132.48		
C	ADP		14		
D	# Days		365		
	Cost Calculations:				**ANNUAL COSTS:**
E	Total TX cost is 75.4% of OYA approved rate 0.754 x $132.48	$	99.89		
F	BRS pays 60.8% of TX cost 0.608 x $99.89	$	60.73		
G	County pays basic need rate of 24.6% 0.246 x $132.48	**$**	**32.59**	**$**	**166,535**
H	County pays 39.2% of TX cost 0.392 x $99.89	**$**	**39.16**	**$**	**200,091**
I	County pays difference OYA & Pathways rate $176 - $132.48	$	-	$	-
J	Total County Daily Cost	**$**	**71.75**	**$**	**366,627**
	Totals:				
K	Annual County Cost County daily costs x ADP x days	**$**	**366,626.81**		
L	Total BRS leveraged at ADP for days	$	310,345.99	(same as w/ current rate see attch. 1)	
M	Total Pathways Costs for ADP for days	$	676,972.80		
N	Cost Verification Pathways daily rate x ADP x days			$	676,972.80

BOLD AREAS = COUNTY PAYMENT

Revenue Detail Summary
General Fund - General Expense

REVENUE ONLY

		FY 1999-00	FY 2000-01	FY 2001-02	Current Year FY 2002-03 Modified Budget	Yr to Date Actual	Yr to Date Variance	Variance %	Projected June	Projected YE Balance	Budget Year FY 2003-04 Proposed	Approved	Projected Growth
5700000	**GENERAL EXPENSE**												
412113	Payments In-Lieu Of Taxes	126,861	144,360	430,041	145,000		(145,000)	-100.00%	74,405	(70,595)	145,000	145,000	0
416111	Current Year Property Tax	18,681,274	19,875,536	20,895,227	22,706,590	20,951,014	(1,755,576)	-7.73%	802,642	(952,934)	23,338,820	23,338,820	632,230
416112	Prior Years Property Taxes	529,448	480,043	862,349	635,640	864,930	229,290	36.07%	61,542	290,832	825,000	825,000	189,360
416113	In Lieu Of Taxes	94,403	292,266	265,943	242,000	262,435	20,435	8.44%	0	20,435	260,000	260,000	18,000
416114	Severance Tax	384,452	171,691	279,276	280,000	151,299	(128,701)	-45.96%	0	(128,701)	200,000	200,000	(80,000)
416151	Transient Room Tax	1,707	1,653	1,200	1,200	1,072	(128)	-10.67%	100	(28)	1,200	1,200	0
416152	Car Rental Tax	119,599	210,356	267,542	233,000	268,410	35,410	15.20%	0	35,410	233,000	233,000	0
416190	Miscellaneous Taxes					25,356	25,356		0	25,356			0
416800	Tax Penalties			1,488			0		0	0			0
410000	**TAXES AND ASSESSMENTS**	**19,937,744**	**21,175,905**	**23,003,065**	**24,243,430**	**22,524,516**	**(1,718,914)**	**-7.09%**	**938,689**	**(780,225)**	**25,003,020**	**25,003,020**	**759,590**
426310	Metro Cable Franchise	244,161	260,009	425,877	160,399	280,376	119,977	74.80%	0	119,977	245,000	245,000	84,601
426320	Rural Cable Franchise	117,661	100,894		145,532	158,564	13,032	8.95%	0	13,032	100,000	100,000	(45,532)
420000	**LICENSES AND PERMITS**	**361,822**	**360,903**	**425,877**	**305,931**	**438,941**	**133,010**	**43.48%**	**0**	**133,009**	**345,000**	**345,000**	**39,069**
434111	Circuit Court Fines	43,662	44,768	38,958	35,000	38,130	3,130	8.94%	3,466	6,596	35,000	35,000	0
436100	Local Fines			63,676					0	0			
436140	County 1065 Assessment	456,810	335,736	389,312	375,000	344,373	(30,627)	-8.17%	29,643	(984)	375,000	375,000	0
436150	Fines From Other Courts					13,016	13,016		0	13,016			0
436511	County Infractions Forfeitures	4,752	47,833	46,548			0		0	0			0
436512	Forfeitures Other			185,864	181,453	22,520	(158,933)	-87.59%	0	(158,933)	150,000	150,000	(31,453)
430000	**FINES, FORF, AND PENALTI**	**505,224**	**428,337**	**724,357**	**591,453**	**418,039**	**(173,414)**	**-29.32%**	**33,109**	**(140,305)**	**560,000**	**560,000**	**(31,453)**
446190	Miscellaneous Sales	93											
440000	**PROPERTY AND RENTALS**	**93**											
451301	FEMA	336,835											
451401	Housing & Comm Developmen	809,143	10,952	147,153	290,000	288,373	(1,627)	-0.56%	55,000	53,373	70,000	70,000	(220,000)
451451	O & C Timber Sales	9,882,479	9,458,944	14,112,863	14,282,220	14,225,766	(56,454)	-0.40%	0	(56,454)	14,396,480	14,396,480	114,260
451510	Department Of Justice		268,581	86,613	135,000		(135,000)	-100.00%	0	(135,000)	50,000	50,000	(85,000)
453520	DOC Grant-In-Aid	114,781	0						0	0			
453830	Veterans Affairs	12,356	12,141	14,598	16,696	14,024	(2,672)	-16.00%	0	(2,672)	12,500	12,500	(4,196)
454140	Timber Sales	396,489	52,031	328,982	25,000	247,187	222,187	888.75%	0	222,187	35,000	35,000	10,000
454210	Department of Revenue	1,202,104	1,773,115	1,266,166	1,350,000	1,717,864	367,864	27.25%	0	367,864	1,600,000	1,600,000	250,000
454230	Liquor Tax	737,367	966,198	988,033	900,000	811,273	(88,727)	-9.86%	73,000	(15,727)	950,000	950,000	50,000
454255	Amusement Device Tax	49,759	64,139	101,477	60,000	15,694	(44,306)	-73.84%	4,000	(40,306)	60,000	60,000	0
454260	Cigarette Tax	383,325	514,851	425,679	500,000	298,547	(201,453)	-40.29%	27,140	(174,313)	450,000	450,000	(50,000)
450000	**REVENUE FROM OTHER AG**	**13,924,638**	**13,120,950**	**17,471,563**	**17,558,916**	**17,618,727**	**59,811**	**0.34%**	**159,140**	**218,952**	**17,623,980**	**17,623,980**	**65,064**
466669	Maintenance Reimbursement		1										
466890	Miscellaneous Fees/Reimburse	110											
466910	Miscellaneous Svc Charges	810	17,209	25,084		3,353	3,353		0	3,353			0
466940	Telephone Calls	754	452	288		103	103		0	103			0
466950	Private Donations		30				0		0	0			0
466980	Refunds & Reimbursements	1,699	7,747	0	128,787		(128,787)	-100.00%	0	(128,787)	64,973	64,973	(63,814)

Revenue Detail Summary
General Fund - General Expense

REVENUE ONLY

					Current Year FY 2002-03						Budget Year FY 2003-04		
		FY 1999-00	FY 2000-01	FY 2001-02	Modified Budget	Yr to Date Actual	Yr to Date Variance	Variance %	Projected June	Projected YE Balance	Proposed	Approved	Projected Growth
467900	Miscellaneous Internal Services			120,294			0		0	0			0
460000	**FEES AND CHARGES**	**3,373**	**25,439**	**145,666**	**128,787**	**3,455**	**(125,332)**	**-97.32%**	**0**	**(125,331)**	**64,973**	**64,973**	**(63,814)**
477100	County Administrative Charges	864,694	713,975	665,122	613,140	612,649	(491)	-0.08%	0	(491)	740,644	740,644	127,504
470000	**ADMINISTRATIVE CHARGES**	**864,694**	**713,975**	**665,122**	**613,140**	**612,649**	**(491)**	**-0.08%**	**0**	**(491)**	**740,644**	**740,644**	**127,504**
486100	Investment Earnings	880,860	813,135	347,291	400,000	247,714	(152,286)	-38.07%	22,500	(129,786)	125,000	125,000	(275,000)
486900	Miscellaneous Interest				300,000		(300,000)	-100.00%	0	(300,000)	0	0	(300,000)
480000	**INTEREST EARNINGS**	**880,860**	**813,135**	**347,291**	**700,000**	**247,714**	**(452,286)**	**-64.61%**	**22,500**	**(429,786)**	**125,000**	**125,000**	**(575,000)**
496110	Fund Balance	8,776,462	6,315,369	4,307,993	5,638,705	5,071,368	(567,337)	-10.06%	0	(567,337)	4,508,530	4,508,530	#########
496120	Non Discretionary	108,237	841,208	625,944			0		0	0			0
498520	Transfer Fr Sp Rev Funds (200	420,309	209,938	96,895			0		0	0			0
498560	Transfer Fr Int Svc Fnds (600)						0		0	0	527,540	527,540	527,540
499999	Audit Adjustments	(637,346)							0	0			
490000	**FISCAL TRANSACTIONS**	**8,667,662**	**7,366,515**	**5,030,832**	**5,638,705**	**5,071,368**	**(567,337)**	**-10.06%**	**0**	**(567,337)**	**5,036,070**	**5,036,070**	**(602,635)**
400000	**TOTAL RESOURCES**	**45,146,109**	**44,005,159**	**47,813,775**	**49,780,362**	**46,935,409**	**(2,844,953)**	-5.72%	**1,153,438**	(1,691,514)	**49,498,687**	**49,498,687**	**(281,675)**

Revenue Detail Summary
General Expense Video Lottery & Transient Room Tax

		FY 1999-00	FY 2000-01	FY 2001-02	Current Year FY 2002-03						Budget Year FY 2003-04			
					Modified Budget	Yr to Date Actual	Yr to Date Variance	Variance %	Projected June	Projected YE Balance	Proposed	Approved	Projected Growth	Notes:
Fund 228														
COUNTY	COUNTY ORGS													
416151	Transient Room Tax	1,508,350	1,480,342	1,756,897	2,848,080	2,684,589	(163,491)	-5.74%	164,000	509	2,860,765	2,860,765	12,685	
454215	Video Lottery Proceeds	297,525	306,509	267,482	386,417	498,261	111,844	28.94%	0	111,844	426,917	426,917	40,500	
5770ECON	ECONOMIC DEVELOPMENT													
454215	Video Lottery Proceeds	297,525	306,509	267,482	386,417	498,261	111,844	28.94%	0	111,844	426,917	426,917	40,500	
5770060	Lane County Tourism													
416151	Transient Room Tax	150,835	148,034	155,690	150,808	144,053	(6,755)	-4.48%	6,800	45	152,316	152,316	1,508	
5770061	Visitor Services													
416151	Transient Room Tax	1,055,845	1,036,240	1,089,827	1,055,656	1,008,371	(47,285)	-4.48%	47,500	215	1,066,213	1,066,213	10,557	
5770062	Rural Tourism													
416151	Transient Room Tax	150,835	148,034	155,690	150,808	144,053	(6,755)	-4.48%	6,800	45	152,316	152,316	1,508	
5770063	Museum													
416151	Transient Room Tax	150,835	148,034	155,690	150,808	144,053	(6,755)	-4.48%	6,800	45	152,316	152,316	1,508	
5770064	Tourism Capital													
416151	Transient Room Tax			200,000	1,340,000	1,244,059	(95,941)	-7.16%	96,100	159	1,337,604	1,337,604	(2,396)	
Fund 216 PARKS														
454215	Car Rental Tax	695,346	735,359	824,917	875,000	828,016	(46,984)	-5.37%	0	(46,984)	426,917	426,917	(448,083)	

BVV ✓
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Top 10 Ways To Improve or Maintain A Municipal Credit Rating

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Standard and Poor's has widely disseminated information to investors and issuers outlining how a credit rating is established. We have also developed GO credit benchmarks for the industry-wide ratios utilized to analyze municipal bond issues. These ratios are the foundation of the quantitative measures Standard & Poor's utilizes when establishing a credit rating. Municipal market participants focus on ratio or median comparisons in order to fine-tune credit analysis. For investors, credit benchmarks help to make credit distinctions. For bond issuers, the benchmarks are often used as a framework for comparing credits with the focus often being on improving a credit rating.

Best Practices Make a Difference

In addition to quantitative factors, qualitative information factors heavily into credit analysis. The whole concept of credit ratios/benchmarks excludes management factors, administrative characteristics and other structural issues facing a government entity that can be an overriding factor in a rating. Management can contribute significantly to many of the individual credit benchmarks used by our industry and can positively impact ratings in a number of ways. Conversely, the lack of strong management is usually a significant factor in a weakened credit profile. The economy will determine a rating category to a large extent but management will be one of the deciding factors in fine-tuning the rating. The management or administrative structure of a government will move a rating up or down more significantly and swiftly than any other element of a credit review.

When it assesses management, Standard & Poor's includes analysis of the political framework that governs as well as the day-to-day management staff. The priorities of the two can be different. There could be a strong management team in place but if there is political instability or lack of political will to make difficult decisions, management will be ineffective in many cases. Standard & Poor's also focuses on the "whole of government." Oversight and management controls covering all of the disparate operations of a government with a focus on accountability at each department or function are critical to strong credit rating.

The "Top 10" list below of ways to improve or maintain your credit rating is generally applicable to other enterprise operations of government such as water, sewer, or solid waste. The relative importance of these factors may vary from credit to credit. It is important to remember that credibility is an important part of a rating review process and management assessment. Every government has challenges. Identifying problems or issues and detailing how these will be addressed establishes credibility and fosters a positive working relationship not only with a rating agency but a government constituency as well.

Top 10 List

1. Establish or enhance rainy day/budget stabilization reserves.
A formalized financial reserve policy is a consistent feature of most of Standard & Poor's highly rated credits. It has been standard operating procedure for some governments for decades. Others focused attention on this immediately following the recession of the early 1990s, when many regions of the country experienced sustained revenue weakness that required severe budget reduction measures. Many state and local governments were afforded the opportunity during the decade-long economic expansion through 2001 to accumulate reserves. As economic trends have weakened over the past year, the importance of reserves from credit standpoint is again highlighted. It clearly provides a measure of financial flexibility to react to budget shortfalls in a timely manner.

No one level or type of reserve is considered optimal from Standard & Poor's perspective. Many different types of reserves have factored into an improved government credit profile. Some important considerations when establishing a reserve are as follows:

- What the government's cash flow/operating requirements are;
- The historic volatility of revenues and expenditures through economic cycles;
- Will the fund be a legal requirement or an informal policy;
- Are formal policies established outlining under what circumstances reserves can be drawn down; and
- Will there be a mechanism to rebuild reserves once they are utilized.

It is important to keep in mind that use of budget stabilization reserves is not in and of itself a credit weakness. The reserves are clearly in place to be used. A balanced approach to utilizing reserves is important in most cases, however, as full depletion of reserves in one year without any other budget adjustments creates a structural gap in the following year if economic trends continue to be weak.

2. Establish regular economic and revenue reviews to identify potential budget problems early.
Establishing a formal mechanism to monitor economic trends and revenue performance at regular intervals is a key feature of stable financial performance. This is particularly true if a government relies on income tax or consumption-based taxes that respond rather quickly to economic fluctuations. Evaluating historical performance of certain revenues is important to this analysis because each government will have different leading or lagging economic indicators that signal potential revenue variance issues based on their economic structure. The earlier revenue weakness is identified in the fiscal year, the more effective the budget balancing response can be.

3. Prioritize spending plans and establish contingency plans for operating budgets as a fallback financial strategy.
Although budget shortfalls had been a scarce commodity until 2001, they have been widespread recently. Across the country, budget discussion has rapidly shifted from surplus revenue and tax relief to spending reduction in order to end the fiscal year in balance. What is done with surplus funds can be as important as how shortfalls are addressed. If revenue growth is abnormally high and potentially unsustainable, program and service expansion can create significant budget shortfalls as the economy cycles downward.

Contingency planning should be an ongoing exercise for governments. Budgets tend to inflate in good times: governments will expand services, fund generous employee pay packages, and accelerate financing for quality-of-life projects that would never be considered in a slow growth or declining economic environment. It is good public policy to have contingency plans and options to address budget imbalance when it occurs. This would include an analysis of the following:

- What part of the budget is discretionary;
- What spending areas can be legally or practically reduced;
- The time frame necessary to achieve reductions of various programs;
- Where revenue flexibility exists; and
- A course of action on the revenue side under different economic scenarios.

4. Have a formalized capital improvement plan in order to assess future infrastructure requirements.
Highly rated credits will have a long-term capital improvement program that comprehensively assesses the infrastructure requirements of the government and a plan to fund these requirements over a five-year (or longer) time frame. Having a realistic plan that is comprehensively developed and updated annually is a requirement of all highly rated local governments. Developing these programs for state government is difficult because the scale of projects and the scope of responsibilities are so broad. Many have accomplished this task despite these obstacles, which is a positive credit factor. It is also important to incorporate the impact of capital projects on the operating budget on a short- and a long-term basis.

Governments have been getting into non-traditional projects, whether they be economic development (contributing infrastructure to a developer or industry) or quality of life (stadiums). These come with an upfront budget cost, but can have multiyear budget impacts. Project can be sold as self-supporting projects but may potentially be a drain on taxing resources.

5. Establish a debt affordability model to evaluate your future debt profile.
Recently, state and local governments have developed debt affordability models. The impact of these models on a long-term credit rating will be dependent on how the model is established and used by the government and the track record in adhering to the affordability parameters established in the model. There is no question that the process enhances the capital budgeting and related policy decisions regarding debt.

6. Develop a pay-as-you-go financing strategy as part of your operating and capital budget.
Pay-as-you-go financing can be a sound financing policy. Not only does it lower debt service costs but it provides a lot of operating budget flexibility when the economy or revenue growth slows. This is a more significant financing option when tax revenue growth in many areas can be considered extraordinary. A better match can be achieved between non-recurring revenues and non-recurring expenditures if this type of financing is done. It is important again to note that this is applicable to enterprise operations of a government as well.

7. Consider the affordability of actions or plans before they become part of your budget by analyzing revenue and spending as part of a multi-year financial plan.
It is important to do this on a comprehensive basis. During a sustained economic recovery, program enhancements and tax reductions are natural. Pension funds that performed at record levels provided incentive to expand or enhance benefits. As these program enhancements and tax reduction programs are incorporated on a long-term basis this is fine. It is important that the management team understands the implications of any funding change but also the elected officials because they will be ultimately responsible for the decisions necessary to restore out year budget balance.

A multi-year planning process is a critical exercise. The reality of government finance today is that even when there is legal authority to raise taxes, there may not be a practical ability to do so, as it is very politically unpopular. Standard & Poor's realizes that the out-years of a multi-year plan are subject to significant change. They provide a model to allow evaluation of how various budget initiatives impact out-year revenues, spending and reserve levels. These plans will often have out-year gaps projected which allow governments to work out, in advance, the optimal way to restore fiscal balance.

8. Long-term planning for all liabilities of a government, including pension obligations and contingent liabilities, would be optimal and would allow for comprehensive assessment of future budgetary risks.
This area of analysis should be comprehensive and include the "whole of government" approach. The nature of government services creates unexpected contingent obligations or "off balance sheet" liabilities that could ultimately affect taxing resources. The solid waste area is a recent example of this. While many waste disposal projects were financed with revenue bonds, changes in the industry have dramatically changed the revenue generating capacity of many plants. In many instances, local or state governments have stepped up to support these obligations with general tax resources although they had no legal obligation to do so.

9. Establish and maintain effective management systems.
This was another really positive use of surplus revenues by governments across the country. Investing in systems that improve the efficiency and effectiveness of a government unit and enhance overall service delivery is a positive financial management tool. Governments made significant technology investments in the 1990s. Many financial and budgetary systems were fully overhauled. To the extent that financial systems are improved and the ability to monitor revenues and expenditures are enhanced, a government will be much better positioned for the next "rainy day." Governments have also turned to the Internet to provide or augment services where it is cost effective, which can also have a positive budget impact.

10. Have a well-defined and coordinated economic development strategy. Economic development programs have expanded rapidly over the last 15 years. The question for state and local governments now is not whether there should be a formal economic development program but rather how significant a resource commitment should be dedicated to running these programs and offering incentives. These are clearly government policy decisions involving cost benefit analysis that are generally outside the credit rating process. However, if these economic development programs and strategies generate employment, enhance diversification, and generate solid income growth, they could have a positive impact on a government credit rating over the long term. The revenue base of a government could also benefit from an improved economic profile, which would also positively impact a government's credit rating. Economic development strategies have increasingly become regional in nature and there has been a more coordinated approach between state and local governments. This would likely lead to a more positive and cost effective method of generating economic development.

Governments in general were more cautious during the record economic expansion that ended in March 2001. Many improved their financial structure by observing the positive management actions listed above. This clearly enhances flexibility and ability to respond to a changed economic climate. Credit rating upgrades far exceeded downgrades during the record economic expansion but this trend has slowed over the past several months. Although the economy has weakened, Standard & Poor's expects that credit quality will be sustained and possibly improved for those governments that employ some of "best management practices" identified above.

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