IN THE MATTER OF THE RECEIVERSHIP OF CENTRAL FALLS, RHODE ISLAND

REPORT OF THE STATE RECEIVER

MARK A. PFEIFFER
Associate Justice of the Rhode Island Superior Court, Ret.

TO

THE HONORABLE DONALD L. CARCIERI
Governor of the State of Rhode Island

and

ROSEMARY BOOTH GALLOGLY
Director of Revenue, State of Rhode Island

DECEMBER 14, 2010

STATE OF RHODE ISLAND

CITY OF CENTRAL FALLS

OFFICE OF THE RECEIVER

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December 14, 2010

The Honorable Donald L. Carcieri
Governor of the State of Rhode Island
State House, Room 222
82 Smith Street
Providence, RI 02903

Ms. Rosemary Booth Gallogly
Director of Revenue
One Capitol Hill
Providence, RI 02908

Dear Governor Carcieri and Director Booth Gallogly:

I am pleased to transmit herewith my report as the State Receiver in the Matter of the Receivership of Central Falls, Rhode Island, dated December 14, 2010. It has been a distinct honor to have served in the capacity of State Receiver since my appointment on July 16, 2010. As stated as my first priority at the outset, I believe that the State Receivership team has successfully designed and is implementing a plan to keep the City stable through the balance of FY 2011. As delineated in the report, however, anticipated significant deficits for FY 2012 through FY 2016 necessitate that immediate remedial measures be taken at the State level in the 2011 session of the General Assembly to insure that further budgetary problems for the City are mitigated. The City's financial problems are so deep and lasting that significant structural changes must be made to prevent a resumption of the City's slide toward bankruptcy. I have identified a variety of possible long-term solutions that are available to the State to facilitate the City's return to sustained fiscal health. It is imperative that the State act if the City is to avoid fiscal collapse.

I thank you for the opportunity to have served in this capacity.

Very truly yours,

/s/

Mark A. Pfeiffer
State Receiver for the City of Central Falls
Associate Justice of the Superior Court, Ret.

EXECUTIVE SUMMARY

The City of Central Falls is under State Receivership as provided in Rhode Island General Laws § 45-9-1 et seq. The current State Receivership was established on July 16, 2010, which followed a period of judicial receivership that ran from May 19, 2010 to the establishment of the State Receivership.

The State Receiver has stabilized the City's budget for Fiscal Year 2011 using a variety of methods. Given the emergency nature of the initial phase of this work, many of these changes were designed to restore short-term budgetary balance to provide time for long-term improvements to be analyzed and implemented. The City's financial projections include large deficits every year beyond the current fiscal year, totaling as much as $25 million between Fiscal Years 2012 through 2016, exclusive of funding required to address deferred and future capital investment needs. That forecast compares to the City's total Fiscal Year 2011 budget of $16.8 million.

The structural problems that give rise to the forecasted deficits include unsustainable pension costs, other post-employment benefits (primarily retiree health care) and other costs associated with collective bargaining agreements, as well as the failure to receive expected revenue from the Wyatt Detention Facility and a culture of government that has allowed this fiscal crisis to occur without adjusting revenues or expenses or engaging the community in a dialogue about the financial and other challenges the City faces.

The unfunded liability for the City's pension plans and retiree health care benefits totals $80 million. The City would be unable to fund any other service or expense, including public safety, public works or debt service, for nearly five years in order to fund this liability. The problems are so severe that they cannot be solved solely through efficiencies and additional revenue at the City level. These problems have developed over decades of failure to contain costs to affordable levels and to fund benefits promised to employees and retirees.

State action is required if the City is to avoid fiscal collapse in its immediate future. A series of reforms, including pension and retiree health care benefit reform and legislative mandates regarding collective bargaining agreements, are needed to address these structural problems. Incremental improvements and marginal reform cannot solve the City's financial problems, even if it operated as a model of efficiency for decades into the future. The City's problems are simply too large and too deep.

The reform measures pertaining to pensions, retiree health benefits, and collective bargaining agreements included in this report will not be sufficient to restore the City to long-term fiscal health. The City must also pursue a State-subsidized annexation by the City of Pawtucket. Failing that course, the City must pursue the regionalization of services with an adjoining municipality, potentially under a new form of government in which a professional municipal manager provides focus on the prudent, efficient management of municipal affairs. If these measures are not viable or are ultimately unsuccessful, the State Receiver would need to utilize a federal Chapter 9 bankruptcy proceeding to restructure the City's obligations.

It will be necessary in the early weeks of the 2011 session of the General Assembly for the State to agree on a method to subsidize the City in Fiscal Year 2012 while permanent solutions to the structural problems are developed and subsequently executed. Absent such a course, the City will experience severe financial difficulties in

Fiscal Year 2012, cushioned only by the liquidation of the City's few remaining financial assets on hand. Complete fiscal collapse would occur shortly thereafter unless broad-based reform or annual State subsidies are provided.

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I. INITIAL ASSESSMENT AND ACTIONS

A. History of the Receivership

On May 19, 2010, the City of Central Falls ("Central Falls" or "City") filed a Petition for the Appointment of Receiver with the Rhode Island Superior Court, citing fiscal insolvency due to revenue shortfalls and State budget cuts, along with unaffordable collective bargaining agreements and pension obligations. (Appendix 1) The petition was filed by the Central Falls City Council ("Council") and Mayor Charles Moreau ("Mayor Moreau"). On that same day, a Superior Court judge appointed Jonathan Savage, Esq. as temporary receiver of the City ("Judicial Receiver"), establishing oversight of the City's assets, effects, property and business ("Judicial Receivership"). (Appendix 2)

The Judicial Receivership created a state of concern among municipal bond underwriters and rating agencies that were performing services for the State and its municipalities. This reaction within the bond market, which threatened to disrupt State and municipal access to capital markets, combined with the State's overriding interest in assuring the fiscal integrity of its cities and towns, caused the General Assembly to enact an Act Relating to Cities and Towns – Providing Financial Stability, codified as R.I. Gen. Laws § 45-9-1 et seq. ("Act"). On June 11, 2010 Governor Donald L. Carcieri ("Governor Carcieri") signed the Act into law. (Appendix 3) The purpose of the Act is (1) to provide a mechanism for the State to work with the cities and towns undergoing financial distress that threatens the fiscal well-being, public safety and welfare of such cities and towns, or other cities and towns or the State, and (2) to provide stability to the municipal credit markets for Rhode Island and its cities and towns through a predictable, stable mechanism for addressing the issues facing cities and towns in financial distress.

The Act was structured to provide different tiers of State support for, or control over, fiscally unstable cities and towns. The first level of support is the appointment of a 'fiscal overseer' whose primary role is to review, supervise and/or approve certain municipal matters and to develop an operating and capital plan to achieve fiscal stability in the municipality.

If a fiscal overseer reports that the city or town is unable to present a balanced budget, faces a fiscal crisis that poses an imminent danger to the safety and welfare of the city or town or its property, will not achieve fiscal stability without the assistance of a budget commission or should not be granted approval of its tax levy for the fiscal year, then the Director of Revenue may appoint a budget commission. A budget commission has significantly broader powers than the fiscal overseer, including the authority to exercise all powers of a city's or town's elected officials.

However, if a budget commission determines that its powers are insufficient to restore fiscal stability to a city or town, then the Director of Revenue must terminate the budget commission and appoint a receiver. A receiver has all of the powers of the budget commission, but is also provided with the power to file a federal Chapter 9 bankruptcy petition for the city or town.

For a period of five (5) years after the abolition of a fiscal overseer, budget commission or receiver, there is continued oversight and support provided by the State.

That oversight is provided through an officer selected by a city's or town's chief financial officer from a list of names provided by the Division of Municipal Finance of the Department of Revenue.

On June 17, 2010, the Council, joined by Mayor Moreau, adopted a resolution authorizing a Consent Order dismissing the pending Superior Court Judicial Receivership with prejudice after transitioning the Judicial Receivership to a non-judicial state-appointed receivership pursuant to the Act ("State Receivership"). (Appendix 4) The Consent Order was entered with the Superior Court on June 18, 2010. (Appendix 5)

Under the Act, if the Director of Revenue, in consultation with the Auditor General, determines that a fiscal emergency exists, a receiver may be appointed without a fiscal overseer or a budget commission first being appointed. Indeed, on July 16, 2010, the Director of Revenue, Rosemary Booth Gallogly ("Director Gallogly"), after consulting with the Auditor General and acting in conjunction with Governor Carcieri, appointed retired Superior Court Justice Mark A. Pfeiffer as receiver of Central Falls ("State Receiver"). (Appendix 6)

By letter dated July 19, 2010, the State Receiver informed Mayor Moreau of his appointment as the State Receiver, that as such he had assumed the duties and functions of the Office of Mayor, and that pursuant to his powers under R.I. Gen. Laws § 45-9-7(c), Mayor Moreau would henceforth act only in an advisory capacity. (Appendix 7) By a letter of the same date, Gene Noury, the Director of Human Resources and Mayor Moreau's de facto Chief of Staff, was notified that he was laid off effective July 23, 2010 and that he was not to report to work for the week of July 19th. (Appendix 8) Christy E. Healey, who was assigned to the State Receiver on loan from the Governor's Office of

Economic Recovery and Reinvestment, assumed Mr. Noury's responsibilities. (Appendix 9) That same day, William Benson, President of the City Council, was also notified by letter of these changes. (Appendix 10) Also on that first day, July 19, 2010, the State Receiver, along with Ms. Healey, met with department heads and other employees at City Hall to explain the nature and purposes of the State Receivership. A press conference was then conducted in the Council chambers to brief the media on the events that had transpired and to answer a variety of inquiries. Thereafter, the State Receiver met with individual Council members to explain the purposes of the State Receivership. The following week, the State Receiver met individually with members of the General Assembly whose districts included parts of Central Falls to inform them about the purposes of the State Receivership.

B. Purposes of the Receivership

When the State Receivership was established, Central Falls was already approximately three (3) weeks into the new fiscal year, FY 2011. A budget for FY 2011 had not been established, and the actual extent of the FY 2010 deficit was unknown.

Therefore, the State Receivership's first priority was to ascertain the extent of the deficit and to establish a FY 2011 balanced budget, thus allowing the State Receiver's team time to analyze the structural fiscal problems and to identify possible long-term solutions. The State Receiver undertook to produce a FY 2011 budget by mid-September and thereafter to produce a detailed report identifying the structural fiscal problems and long-term solutions, to be presented by the end of the year to Governor Carcieri and

Director Gallogly. This strategy would stabilize the City's fiscal status for the balance of FY 2011 and would allow a new Administration and General Assembly time to craft long-term solutions during the 2011 legislative session.

C. Central Falls Overview

1. City Demographics

With a population of approximately 19,000 people[1] concentrated in an area of one and three-tenths (1.3) square miles[2], Central Falls is the most densely populated city in the State of Rhode Island.[3] The City is one of the State's distressed communities as defined in R.I. Gen. Laws § 45-13-12. A distressed community is a city or town that has one of the highest property tax burdens relative to the wealth of its taxpayers under the criteria established in the statute. The City has a high incidence of families living in poverty, standing at twenty-five and nine-tenths percent (25.9%) compared to the overall rate of nine and six-tenths percent (9.6%) of families in Rhode Island.[4] As of the 2000 census, the median income for a household in the City was $22,628, as compared to a

[1] Population of Rhode Island By State, County and City & Town, Rhode Island, 1990 & 2000, Rhode Island Statewide Planning Program, *available at* http://www.planning.ri.gov/census/ri2000.htm (citing U.S. Bureau of the Census)
[2] City of Central Falls, Rhode Island Economic Development Corporation, *available at* http://www.riedc.com/data-and-publications/state-and-community-profiles/central-falls
[3] Population Density, Rhode Island Cities and Towns, 1990 and 2000, Rhode Island Statewide Planning Program, *available at* http://www.planning.ri.gov/census/ri2000.htm (citing U.S. Bureau of the Census)
[4] American Factfinder, Fact Sheet: Central Falls, Rhode Island, U.S. Census Bureau, *available at* http://www.factfinder.census.gov

median income of $42,090 for the State.[5] Approximately sixty-five percent (65%) of households in the City speak a language other than English at home, and thirty-five percent (35%) of the City's population was born outside of the United States.[6] The 2009 high school graduation rate in Central Falls was forty-seven percent (47%), compared with the statewide average of seventy-five percent (75%).[7] The rate of births to teen mothers is 61 per 1,000, which is more than three (3) times the statewide average.[8]

2. City Property Values

Central Falls has 3,282 real properties, including both residential and commercial categories. Tax exempt properties total 162 (4.9%). Taxable properties are eighty-eight percent (88%) residential and twelve percent (12%) commercial. Of the residential properties, eighteen percent (18%) are single-family; seventy percent (70%) are two-five (2-5) multi-family; five percent (5%) are apartment buildings, with six (6) or more units; four percent (4%) are condominiums; and three percent (3%) are vacant land/other improvements, which excludes dwellings. The multi-family properties can be broken down further with approximately thirty-three percent (33%) of these properties being two (2) family, fifty-three percent (53%) being three (3) family, twelve percent (12%) being four (4) family, and two percent (2%) being five (5) family. Seventeen percent (17%) of commercial properties are considered industrial, thirteen percent (13%) are

[5] American Factfinder, Fact Sheet: Rhode Island, U.S. Census Bureau, *available at* http://www.factfinder.census.gov
[6] American Factfinder, Fact Sheet: Central Falls, Rhode Island, footnote 4, *supra*
[7] Indicators of Child Well-being, 2010, Profile of Central Falls, Rhode Island, Rhode Island KIDS COUNT, April 7, 2010, *available at* http://www.rikidscount.org/matriarch/documents/Central_Falls_2010.pdf
[8] Ibid.

undeveloped/vacant parcels, twenty-eight percent (28%) are commercial with an assessed value over $100,000, eight percent (8%) are commercial with an assessed value under $100,000, and thirty-four percent (34%) are mixed use/combination properties (i.e. retail with living units).

Central Falls completed a property revaluation update in December 2009. Residential property values in the City declined by forty-four percent (44%) of their value as of the prior revaluation update in December 2006. Single-family home values decreased by an average of thirty-nine percent (39%), while multi-family home values declined by more than fifty percent (50%). Commercial property values remained relatively stable, declining by less than three percent (3%).

Prior to the revaluation update, the residential tax rate in the City was $10.78 per $1,000 of assessed value. Following the update, which by its nature is revenue-neutral, in June 2010 the residential tax rate was increased to $19.22 per $1,000 of assessed value. Due to the lower assessed values, this increased tax rate was necessary to raise the same amount of revenue as the prior year for the residential portion of the tax levy; thus, the rate increase did not increase the City's revenues from collected taxes.

Central Falls' homestead exemption prior to the revaluation update was $60,000; following the update, the exemption was reduced to $33,655.[9] Although this change in exemption would normally be effectuated by ordinance, it was implemented in this

[9] The homestead exemption allows certain classifications of property owners to exempt from consideration a portion of the value of their property when establishing their tax bill. In addition to the homestead exemption, the City has a variety of additional exemptions: Veteran – $4,207; Prisoner-of-war – $12,620; Widow of Veteran – $4,207; Gold Star Parent – $4,207; Blind – $12,620; and Elderly – $4,207. An evaluation will be conducted by the State Receiver in 2011 to determine what, if any, adjustments should be made regarding these exemptions.

instance by the Judicial Receiver as part of the revaluation update. The dollar value of the exemption remained static, as required by R.I. Gen. Laws § 44-3-24, at $647.

After the December 2009 revaluation update, the average value of a single-family home in the City is $129,000. The average value of a multi-family home is $139,000. In addition to the low home values, the small number of properties on the tax rolls limits the ability of the City to raise necessary revenue through property tax increases. As an example, a two percent (2%) increase in the tax rates for residential, commercial and tangible personal property would generate less than $200,000 in additional revenue.

3. Crime Data

There are a variety of complexities when comparing police and criminal activity data across municipalities. Factors such as population density, attractive assets (e.g., a community with a shopping mall will tend to have more incidences of shoplifting than a community without a shopping mall), and proximity of transportation resources influence the crime rate in a community. Examining the City of Central Falls from a strict per capita crime measure provides a window on the frequency of crime, but not on the reasons for this crime. Such an examination could omit important comparative information. The figures below are designed to simply provide a sense of the challenges faced by residents of Central Falls in this context. For the purposes of this analysis, it should be noted that Central Falls is the nineteenth (19th) most populated municipality in the State.[10]

[10] Population of Rhode Island By State, County and City & Town, footnote 1, *supra*

According to the 2009 edition of *Crime in the United States*,[11] published by the Federal Bureau of Investigation, the City of Central Falls has the seventh (7^{th}) highest per capita incidence of violent crime among the thirty-nine (39) municipalities in Rhode Island and the sixth (6^{th}) highest incidences of robberies and assaults. The City also has the sixteenth (16^{th}) highest per capita incidence of property crime, with the sixth (6^{th}) highest per capita incidence of motor vehicle theft and the ninth (9^{th}) highest incidences of burglary and arson. These statistics do not indicate whether this is a higher or lower crime rate than one would expect in a community of Central Falls' geographic, business and economic conditions, but they do indicate that Central Falls appears to have more crime than many other communities in Rhode Island. It may or may not, however, have less crime than one would expect in an urban community.

To prevent and investigate these crimes, the City utilizes two and one-quarter (2.25) police officers per 1,000 residents, the tenth (10^{th}) highest proportion of law enforcement to population in Rhode Island. This indicates that the City employs a higher proportion of police officers per capita than other, more fiscally solvent municipalities. While data do not indicate if this number of police officers is sufficient to address crime, it does indicate that, even given the City's deep fiscal difficulty, it has prioritized public safety to a greater extent than other municipalities.

[11] Crime in the United States, Federal Bureau of Investigation, September 2010, available at www2.fbi.gov/ucr/cius2009/index.html

4. Public Health

A review of public health data underscores the challenges faced by residents of Central Falls. In some communities, the below-described public health issues require additional governmental resources and intervention to improve immediate and long-term outcomes to reduce disease, improve quality of life and provide improved opportunities for children. The City's fiscal challenges prevent additional health intervention at the local government level, creating potential negative health consequences for its residents.

According to the Rhode Island Department of Health ("Department of Health"), the City reports 632.8 birth defects per 10,000 births, compared to the average of 520 for the core cities of Central Falls, Newport, Pawtucket, Providence, West Warwick and Woonsocket, and 436.7 per 10,000 for the State as a whole. This rate is the second-highest referenced core city rate, behind that of Pawtucket.[12] A recent report using 2001 and 2002 data indicates that children born in Central Falls also have higher incidences of low birth weight and out-of-wedlock birth.[13]

A 2010 Department of Health study also indicates that the City has one of the highest incidences of lead poisoning among children, tied with Providence at two and one-fifth percent (2.2%) of tested children.[14] This figure is a substantially higher incidence than found in the Rhode Island population as a whole, which stands at one and one-fifth percent (1.2%). Although Central Falls is only the nineteenth (19th) most

[12] Rhode Island Birth Defects Program Birth Defects Data Book 2010, Rhode Island Department of Health
[13] Vital Statistics Annual Report 2001 and 2002, Rhode Island Department of Health, January 26, 2009
[14] Childhood Lead Poisoning in Rhode Island: The Numbers, 2010 Edition, Rhode Island Department of Health

populated municipality in the State[15], the City has the third (3rd) highest number of reported cases of lead poisoning, standing at twenty-one (21) cases, which is behind only Pawtucket at thirty-five (35) cases and Providence at one hundred fifty-eight (158) cases.[16] This ranking does represent a significant drop from 1996 levels when twenty and one-tenth percent (20.1%) of children in the City who were tested had positive results for lead poisoning.[17]

Young adults and adults face additional public health challenges, including significantly higher incidence of diseases including: chlamydia, at twice the statewide average; gonorrhea, at twice the statewide average; and syphilis, at nine (9) times the statewide average.[18] Adult males also appear to face higher health risks in certain areas, as male residents of Central Falls report a slightly higher incidence of colon cancer (83.3 cases per 100,000 compared to 82.6 per 100,000 for the State) and the highest incidence of lung cancer in the State (147.5 compared to 105.8), while experiencing a lower incidence of prostate cancer (117.4 compared to 153). Female residents had a lower incidence of colon and breast cancer than Rhode Island residents on average, although they had a higher incidence of lung cancer (59 cases per 100,000 compared to 54.3).[19]

Thus, City residents, faced with many health challenges, will need the best government possible to ensure that an appropriate level of municipal financial and other resources will be available to address these health needs. A stronger, better managed municipal government would be able to subsidize and deliver a variety of programs,

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[15] Population of Rhode Island By State, County and City & Town, footnote 1, *supra*
[16] Childhood Lead Poisoning in Rhode Island: The Numbers, footnote 14, *supra*
[17] Central Falls Core Cities Data 1995-2005, Rhode Island Department of Health, December 2006
[18] 2008 Rhode Island HIV/AIDS Epidemiologic Profile with Surrogate Data, Rhode Island Department of Health, March 2010
[19] Rhode Island Cancer Statistics Review 2002, Rhode Island Department of Health in collaboration with the Hospital Association of Rhode Island, Leanne Chiaverini, B.S.; John P. Fulton, Ph.D.; and Dorothy M. Darcy, A.S., CTR

including public health education, screening and treatment clinics, dental care in schools and other services to help residents improve their health and reduce instances of communicable diseases. The City's weak financial position, however, prevents these services from being made available, to the detriment of the residents of Central Falls.

5. City School District

The Central Falls School District ("CFSD") has been overseen by the Rhode Island Department of Education ("RIDE") since July 1, 1991. Following years of financial difficulties prior to that date, the State established the Central Falls Review Commission to assess the financial condition of the City. In its final report, the Commission recommended that the State assume the responsibility for financing the school system. In 1991 an agreement was reached between City and State leadership, which ultimately led to the enactment of legislation transferring the financing and administrative control of the school district to the State. The school committee was replaced with a State-appointed administrator who reported to the Commissioner of Education.[20]

In June 2002 the Rhode Island General Assembly established a seven (7) member board of trustees to replace the State administrator as the governing body of the school district. The Rhode Island Board of Regents ("Board of Regents") appoints the members of the board of trustees from nominations made by the commissioner of elementary and secondary education; at least four (4) members must be residents of Central Falls and

[20] Rhode Island Education Aid, House Fiscal Advisory Staff, October 2010

parents of current or former Central Falls public school students. R.I. Gen. Laws § 16-2-34. Effective July 1, 2003 the Board of Regents approved the CFSD's first board of trustees.[21]

Although the General Assembly thus effected changes in the administration of the school district with the passage of the 2002 legislation, the State has remained the primary source of school funding. Central Falls is financially responsible only for the maintenance of the school buildings and grounds, as the City retained ownership of those properties.[22] Public works and recreational services related to the CFSD are therefore provided by Central Falls in the course of its daily operations. With respect to bonded capital projects, the State has retained a ninety-seven percent (97%) share ratio in recent years[23], with an additional one percent to three percent (1% to 3%) reimbursement available for certain qualifying projects; thus, Central Falls' capital contributions are relatively small. In FY 2009 a bond in the amount of $5.0 million was issued for the purpose of making capital improvements to the schools; an amount of $1.2 million was spent in FY 2010 and the remaining $3.8 million will be spent in FY 2011 for this purpose. Historically, Central Falls has not budgeted funds specifically for the purpose of maintaining the school properties, so no such allocation was included in the FY 2011 budget. By comparison, for FY 2011 the State has authorized $42.9 million to support the City's school department, which is $0.4 million less than the final FY 2010 allocation. This includes $41.8 million from general revenues and $1.0 million from

[21] Ibid.

[22] The school buildings and grounds consist of nine (9) properties with a total assessed value of $40,072,900 after the December 31, 2009 revaluation update.

[23] Rhode Island Education Aid, footnote 20, *supra*

federal fiscal stabilization funds.[24] Historical allocations by the State in education aid to operate the CFSD since FY 1992 are shown below:

Table 1

State Education Aid for the City of Central Falls[25]

Fiscal Year	State Education Aid
1992	$ 10,254,654
1993	$ 15,025,000
1994	$ 16,147,639
1995	$ 18,351,007
1996	$ 19,085,182
1997	$ 19,636,642
1998	$ 21,454,420
1999	$ 24,268,988
2000	$ 27,268,988
2001	$ 31,496,700
2002	$ 33,271,624
2003	$ 34,430,272
2004	$ 35,635,332
2005	$ 37,804,406
2006	$ 41,319,965
2007	$ 43,873,873
2008	$ 44,358,224
2009	$ 44,524,530
2010	$ 43,255,325
2011	$ 42,865,644
TOTAL	**$ 604,328,415**

In this twenty-year period, the State has contributed $604,328,415 for the operation of the City's school system, an amount that otherwise would have been borne by the City's taxpayers.

The 2010 session of the General Assembly established an education funding formula for all cities and towns. R.I. Gen. Laws § 16-7.2-6(d) includes a Central Falls

[24] Ibid.
[25] Ibid.

Stabilization Fund that requires the State and the City to share the financial obligation of the difference between the City's current state aid and the calculated aid under the formula, a calculation that would require Central Falls to begin payments to the stabilization fund in FY 2012 in the approximate amount of $950,000. Pursuant to R.I. Gen. Laws § 16-7.2-10, RIDE was required to report back to the General Assembly by November 15, 2010 regarding, *inter alia*, an analysis of the feasibility of the City contributing to the fund, alternative financing mechanisms and the impact of the Central Falls Stabilization Fund as defined in the categorical program section.

In that report RIDE points out that the Central Falls Stabilization Fund requires that the funding of the CFSD be maintained at the funding level in effect as of the effective date of the formula. The State Receiver's office has met with representatives of RIDE to examine the possibility of Central Falls contributing to the stabilization fund. Based on the City's current fiscal situation, it is unlikely that the City will be able to make any significant contribution to that fund in the foreseeable future. In addition, as RIDE prepared the Board of Regents' FY 2012 budget, new available data demonstrated significant decreases in enrollment for the CFSD that would result in an overall decrease in state funding.

D. Fiscal Overview

1. Fiscal Conditions

As previously noted, the State Receiver assumed control of Central Falls' affairs on July 19, 2010. Upon his arrival, it immediately became apparent that little progress had been made with respect to quantifying the FY 2010 deficit, closing out that fiscal year and developing and implementing a budget for FY 2011. Due to the City's precarious cash flow situation, the Judicial Receiver had required that the Finance Department withhold payment on any invoices unless approved by the Judicial Receiver in advance. Accordingly, the Finance Department had been separating the invoices into 'pre-Judicial Receiver bills' and 'post-Judicial Receiver bills', a system which had become increasingly confusing for City Hall staff to implement and resulted in difficulties in determining the actual accounts payable. Further complicating the FY 2010 fiscal close-out was the fact that the City had actually ceased payment on all invoices by the end of March 2010. Additionally, very few purchases were made using Purchase Orders in the City's computer-based accounting system, so it was impossible to determine the amount of encumbered funds.

2. Closing Fiscal Year 2010 Budget

In order to quantify the accounts payable, the State Receiver's team worked with the Finance Department on a daily basis for approximately three (3) weeks to compile an inventory of all outstanding invoices, regardless of when or how the purchases were made or services procured. It was determined that the accounts payable as of June 30, 2010 was approximately $1.1 million. A majority of this amount consisted of outstanding payments to Blue Cross/Blue Shield and Delta Dental. Additionally, Central Falls owed substantial amounts in utility payments, including gas, electric and telephone.

Once the total accounts payable was quantified, it was determined that Central Falls ended FY 2010 with a deficit of approximately $2.1 million. Revenue collections for FY 2010 totaled $16.1 million, which was $1.7 million less than the budgeted amount of $17.8 million. A majority of the revenue shortfall was due to the inclusion in the budget of an expected payment of $1.2 million from the Donald W. Wyatt Detention Facility ("Wyatt"), which did not materialize. Historically, the City had annually budgeted $500,000 in payments from Wyatt. Wyatt had last made a payment of approximately $280,000 in FY 2009. An additional revenue shortfall resulted from the inclusion in the FY 2010 budget of an anticipated amount of $470,000 in State aid, based in part upon the anticipation of $250,000 in general revenue sharing. The State's FY 2010 Budget as enacted by the General Assembly subsequently eliminated general revenue sharing to cities and towns.

FY 2010 expenditures, including miscellaneous accounts payable, totaled $18.4 million, which was approximately $370,000 over budget. The overage was primarily attributed to overtime in the Fire and Police Departments and an estimated payment of $200,000 for costs associated with the Judicial Receivership. These figures are preliminary, as the year-end audit is not yet complete.[26]

The State Receiver addressed the FY 2010 accounts payable using short-term borrowing mechanisms to generate sufficient cash flow. In fact, on November 3, 2010 the State Receiver authorized the issuance to Navigant Credit Union of a Tax Anticipation Note ("TAN") in the amount of $1.5 million, the maximum amount allowed given the City's projected tax collections. The issuance of this note had been delayed as a result of the litigation concerning the constitutionality of the Act and the State Receiver's authority to act thereunder. (See Section I E 1) The litigation was

[26] It is anticipated that the audit by Braver P.C. will be completed in January 2011.

necessitated by Mayor Moreau's and the Council's obstruction of the State Receiver's efforts to rehabilitate the City.

Obviously, the $1.5 million TAN will not resolve the $2.1 million shortfall. Furthermore, that borrowing must be repaid at the end of the current fiscal year. For those reasons, it is necessary for the City to develop a plan to eliminate the FY 2010 deficit. R.I. Gen. Laws § 45-12-22.3. The plan must provide for the elimination of the debt by annual appropriation in equal or diminishing amounts over no more than five (5) years, R.I. Gen. Laws § 45-12-22.4, or through a long-term deficit reduction bond issued pursuant to R.I. Gen. Laws § 45-9-6(d)(19) and 7(b)(1). (See Sections II E and III C)

It should be noted that it is difficult to accurately calculate the year-ending general revenue balance due to the lack of segregation of funding sources that existed in Central Falls. All payments were made from the general fund and the general fund was reimbursed on a 'due-to/due-from' basis. The Finance Department is in the process of reconciling the general fund and all bank accounts to ensure that the general fund was properly reimbursed for all non-general revenue expenditures. This method of payment also improperly inflates general expenditures, resulting in difficulty forecasting future expenditure requirements. The new Finance Director, hired on August 2, 2010 to replace the predecessor part-time director who had also performed separate contracted services for the City[27], has developed a 'Chart of Accounts' that allows for the proper segregation of fund sources and a more transparent accounting of expenditures within each department.

[27] It should be noted that the hiring of the full-time Finance Director resulted in substantial savings to the City when comparing her annual salary to the total compensation paid to the former part-time Finance Director.

3. Development of FY 2011 Budget

Once the FY 2010 closing balance was calculated, the State Receiver focused on the development of the FY 2011 budget. Using the FY 2010 adopted budget and FY 2009 and FY 2010 actual expenditures as a basis, a baseline budget was developed that revealed a structural budget gap of $6.3 million. (Appendix 11) The anticipated deficit included $3.4 million for the annual retirement contribution to the John Hancock pension fund ("John Hancock Plan").[28] (See Sections II A and B) In addition, Central Falls faced a substantial loss of State revenue for FY 2011. FY 2009 State revenue totaled $4.5 million. This revenue was decreased to $3.7 million for FY 2010. The FY 2011 state revenue estimate is $2.3 million, which is a decrease of fifty percent (50%) from FY 2009.[29] The FY 2011 baseline budget therefore assumed that available revenue would be reduced to $14.8 million from the FY 2010 enacted amount of $17.8 million, primarily due to a $1.9 million reduction in State aid and a $700,000 reduction in the estimated payment from Wyatt.[30] Expenditures, if unconstrained, would total $21.1 million in FY 2011, resulting in the $6.3 million projected deficit.

The State Receiver resolved this gap by proposing revenue increases of approximately $2.0 million and expenditure reductions of $4.3 million. The FY 2011 revenue increase of $2.0 million is derived by reducing the motor vehicle exemption from

[28] The John Hancock Mutual Life Insurance Company administers the pension fund established for the City's Police and Fire employees hired after July 1, 1972. For purposes of developing the baseline budget, the $3.4 million contribution was estimated based upon figures contained within the most recent valuation; an updated valuation conducted in November of 2010 reflected a revised contribution amount of $3.3 million.

[29] This decrease reflects both the elimination of general revenue sharing and the motor vehicle excise tax phase-out.

[30] Despite the lack of payment from Wyatt in FY 2010 and its anticipated inability to make payment in FY 2011, Wyatt included a $500,000 payment to Central Falls in its FY 2011 budget. Accordingly, this figure was incorporated into the Central Falls FY 2011 budget.

$6,000 to $1,000, accounting for $981,000 in additional revenue, and by imposing a supplemental property tax levy of ten percent (10%), for an additional $840,000 for the fiscal year. In addition, by the end of the fiscal year, the State Receiver will conduct an audit of the homestead exemption, which is projected to result in $28,000 in additional revenue, assuming a four percent (4%) reduction in the cost of the exemption. Revenue enhancements were also achieved through upwardly revised estimates based on historical tax collection data and increases in certain permit fees.

The $4.3 million in expenditure reductions are largely based on the elimination of the actuarially required contribution to the John Hancock Plan for the fiscal year, totaling $3.3 million. The State Receiver eliminated this payment with the goal of evaluating the status of the pension system as part of this report and making long-term recommendations to address the unfunded pension liability. By way of comparison, as indicated previously, a ten percent (10%) increase in local property taxes was required to increase revenue by approximately $840,000. Raising the revenue necessary to fund the City's required pension contribution to the John Hancock Plan through taxes would require yet another property tax increase of approximately thirty-nine percent (39%), or forty-nine percent (49%) if this appropriation were coupled with the enacted ten percent (10%) increase and funded in FY 2011.

In addition, the FY 2011 budget anticipates $942,182 in personnel savings due to the elimination of vacant positions, layoffs and reductions in salaries and benefits. Many of these changes required negotiations with Central Falls' three (3) labor unions, which are addressed below. Other expenditure reductions include $269,158 in medical benefit savings, including reducing medical waiver bonuses from $5,000 to $1,000 for non-union employees, increasing medical co-shares for non-union employees and conducting an audit of medical benefit eligibility.

The baseline FY 2011 budget was finalized on August 18, 2010. It was thereafter necessary to attempt to actualize certain union concessions that had been included in the budget, but that were not within the State Receiver's authority to unilaterally impose.

4. Personnel Reductions and Union Negotiations

Immediately following the initial budget release on August 18, 2010, the State Receiver began meeting with representatives of the three (3) collective bargaining units representing Central Falls employees. The State Receiver and the American Federation of State, County, and Municipal Employees, Council 94 Local 1627 ("Council 94"), representing forty-two (42) municipal employees, agreed to change the terms of the current collective bargaining agreement, which achieved a total of $159,000 in cost savings for FY 2011. The agreement was ratified by an overwhelming majority of the members on August 27, 2010.

Under the agreement, Council 94 agreed to a ten percent (10%) pay reduction for three (3) quarters of FY 2011, achieved through the implementation of furlough days from October 1, 2010 through June 30, 2011. This equated to a seven and one-half percent (7.5%) pay reduction overall and required that most departments, including City Hall, close at noon on Fridays. Additionally, the bonus payment for waiving medical insurance coverage was reduced from $5,000 to $1,000, and the payment was eliminated for employees who are already covered by the City's medical plan through a spouse or domestic partner.

All non-union municipal employees, currently totaling thirty (30) employees, will also participate in the Council 94 cost-saving measures. In addition, they began paying an increased co-share for medical insurance coverage. The co-share was increased from five percent (5%) to ten percent (10%), which is consistent with the co-share previously in place for unionized staff. These changes represent an additional savings of $131,000 to the City.

The State Receiver also reached an agreement with the International Association of Fire Fighters Local 1485 ("Fire Union"), representing forty-one (41) employees, on September 13, 2010. The agreement was ratified by an overwhelming majority of the membership and included changes to the terms of the current collective bargaining agreement and staffing reductions achieving a total of $289,000 in cost savings for FY 2011.

Under the agreement, the Fire Union membership accepted a reduction to the medical waiver bonus payment from $5,000 to $1,000. The out-of-rank pay structure was revised to limit eligibility, saving an estimated $15,000 per year based upon an audit of such payments made in FY 2010.[31] A four percent (4%) wage increase due to take place on January 1, 2011, which had been negotiated prior to the State Receiver's appointment, will be reduced to two percent (2%), with the remaining two percent (2%) deferred until June 30, 2011. Additionally, the members will defer $500 of their clothing

[31] Prior to the State Receivership, members performing their duties on any date without supervision from a higher-ranking firefighter received wages for that date equal to the regular wages of the absent supervisor. Under the agreement, members are eligible for such out-of-rank differential pay only if they assume the supervisory responsibilities of the absent supervisor.

allowance until July 1, 2011 and will defer payment for six (6) holidays until June 30, 2012. In order to achieve overtime savings, current employees will forego two (2) vacation days in FY 2011 and the Fire Department will hire four (4) new probationary personnel with wages and benefits totaling approximately $30,000 less than the estimated cost of overtime expenditures necessary to maintain minimum staffing levels for the same period of time.

Following several weeks of negotiations with the Police Department, Fraternal Order of Police Lodge #2 ("Police Union"), the State Receiver has achieved $257,000 in savings for FY 2011 by streamlining management within the Police Department and eliminating patrol vacancies. The State Receiver offered an early retirement option for one (1) Major and one (1) Captain, resulting in $94,000 of savings in the current fiscal year. The Office has also eliminated three (3) vacant patrol positions for a savings of $176,000.

In order to eliminate the high-ranking positions, the State Receiver will fill two (2) vacant Lieutenant positions, which will reduce the savings by $13,000 in FY 2011. The duties of the high-ranking positions will be redistributed among the remaining management staff, which will consist of one (1) Colonel/Chief, one (1) Major, one (1) Captain, four (4) Lieutenants and six (6) Sergeants.

An agreement was also reached to achieve an additional $15,000 in savings in FY 2011 by reducing the bonus payment for individuals waiving medical coverage from $6,000 to $1,000, effective January 1, 2011 through the end of the CBA on June 30, 2012. The bonus payment will revert to $6,000 effective June 30, 2012.

5. Adopted FY 2011 Budget

Balancing the FY 2011 budget was extremely difficult to achieve because of the economic characteristics of the community, including the declining values and fixed number of residential properties as previously noted. Recognizing the hardship that a supplemental property tax would represent to many property owners in Central Falls, the amount of revenue generated thereunder was matched by expenditure reductions achieved through union concessions and non-union modifications, as previously described.

The process of establishing the budget was transparent. The State Receiver held a public information session for City residents at City Hall on August 23, 2010, which was attended by approximately sixty (60) individuals. Thereafter, the State Receiver and his staff made themselves available to meet with residents individually and in fact did meet with a number of individuals to hear their concerns and to receive input.

Since the overall tax increase from FY 2010 to FY 2011 was in excess of the mandated State cap of four and one-half percent (4.5%) – the actual increase, including revenue gained from the motor vehicle excise tax and the supplemental property tax, totaling approximately nineteen percent (19%) – it was necessary to obtain approval of the increase from the Division of Municipal Finance of the Department of Revenue. That approval was obtained on September 7, 2010. (Appendix 12) It is worth noting that seventeen (17) municipalities in the State utilized a $500 or $1,000 exemption for automobiles, the latter being the amount that was adopted in the City. After receiving approval from the Division of Municipal Finance, the State Receiver held a public hearing that was attended by approximately forty (40) residents at the City Hall on September 20, 2010. The FY 2011 budget was formally adopted by the State Receiver and a supplemental levy was effectuated on October 1, 2010. (Appendix 13)

6. Outstanding Debt and Bond Ratings

The City's net debt service is as follows:[32]

Table 2

Debt Service Schedule for the City of Central Falls

Aggregate Debt					
Period Ending	**Principal**	**Interest**	**Total Debt Service**	**QSCB[33] Subsidy**	**Net Debt Service**
6/30/2010	$ 1,405,000	$ 899,077.50	$ 2,304,077.50	$ 0.00	$ 2,304,077.50
6/30/2011	1,195,000	1,093,009.17	2,288,009.17	-225,918.19	2,062,090.98
6/30/2012	1,525,000	1,086,775.00	2,611,775.00	-266,525.00	2,345,250.00
6/30/2013	1,565,000	1,004,298.50	2,569,298.50	-236,673.50	2,332,625.00
6/30/2014	1,620,000	918,585.76	2,538,585.76	-206,822.00	2,331,763.76
6/30/2015	1,670,000	830,198.00	2,500,198.00	-176,970.50	2,323,227.50
6/30/2016	1,725,000	737,179.00	2,462,179.00	-147,119.00	2,315,060.00
6/30/2017	1,780,000	635,522.50	2,415,522.50	-117,533.50	2,297,989.00
6/30/2018	1,835,000	529,641.00	2,364,641.00	-87,948.00	2,276,693.00
6/30/2019	1,895,000	423,841.50	2,318,841.50	-58,632.00	2,260,209.50
6/30/2020	1,970,000	317,854.50	2,287,854.50	-29,316.00	2,258,538.50
6/30/2021	555,000	207,555.00	762,555.00	0.00	762,555.00
6/30/2022	585,000	184,105.00	769,105.00	0.00	769,105.00
6/30/2023	615,000	159,405.00	774,405.00	0.00	774,405.00
6/30/2024	645,000	133,455.00	778,455.00	0.00	778,455.00
6/30/2025	680,000	106,155.00	786,155.00	0.00	786,155.00
6/30/2026	720,000	77,251.25	797,251.25	0.00	797,251.25
6/30/2027	760,000	46,486.25	806,486.25	0.00	806,486.25
6/30/2028	675,000	13,837.50	688,837.50	0.00	688,837.50
Totals	**$23,420,000**	**$9,404,232.43**	**$32,824,232.43**	**$1,553,457.69**	**$31,270,774.74**

[32] Aggregate Debt Service Schedule, First Southwest, September 7, 2010

[33] 'QSCB' refers to a Qualified School Construction Bond, a federally-subsidized program that allows state and local governments to issue below-market rate debt to fund certain eligible school construction projects.

At the close of FY 2010, the City's overall debt burden was calculated at three percent (3%) of the full assessed value of the taxable property within the City, with $23.4 million of outstanding principal. As of May 25, 2010 the City's assigned Moody's general obligation bond rating was B3, and as of April 29, 2010 its assigned Standard & Poor's bond rating was BBB, which within the industry equates to junk bond status. Accordingly, both Moody's and Standard & Poor's placed the City on 'review' and 'watch' status, respectively. According to Standard & Poor's, "the downgrade reflects the city's deteriorated financial position and growing structural deficit. . . . [The] CreditWatch placement also reflected the high degree of uncertainty regarding the city's proposed measures at the time to close its structural budget gap."[34]

7. Five-Year Financial Forecast

Municipalities typically engage in multi-year financial forecasting to plan for service expansion or contraction. These forecasts are also used to plan for capital investment. In their most basic form, multi-year financial forecasts can identify potential problems in the future, such as impending deficits that can more easily be addressed through immediate term action, including slowing the growth of wages, or reducing headcount or the filling of vacant positions. These forecasts also provide an opportunity to engage the public in a discussion regarding a community's finances and its ability to meet service demands in the current term and the near future. Central Falls has not engaged in financial forecasting in the recent past.

[34] Standard & Poor's, RatingsDirect on the Global Credit Portal (April 29, 2010)

The five-year financial forecast developed by the State Receiver covers the period from FY 2012 to FY 2016. (Appendix 14) As with any predictions of the future, a variety of assumptions have been made. Among these assumptions are:

- Loss of union contract savings regarding wages and benefits for those negotiated items that were deferred, rather than permanently adjusted.
- Two percent (2%) growth in employee wages – union and non-union – upon expiration of the CBAs.
- Growth in benefit expenses as set forth in Appendix 14.[35]
- Growth in all non-tax revenue categories based upon historical data and an increase beginning in FY 2014 to account for inflation in expense items consistent with the Consumer Price Index.
- Growth in operating expense items consistent with the Consumer Price Index.
- Two percent (2%) annual growth in taxation due to rate increases.
- Real property values and automobile valuations remain flat, neither growing nor declining during the forecast period.
- Restoration of full funding for the Office of the Mayor, City Council, Human Resource Director and a part-time Planner in FY 2012 (for forecasting purposes only; assumes the State Receivership is terminated).
- No change to valuation exemptions for real property and motor vehicle related taxes; no change to the homestead exemption.

[35] It is not possible to summarize these benefit assumptions here given the variety of benefits provided and the number of different growth rates estimated for each.

- Full funding of pension expenses, including the City's Annually-Required Contribution ("ARC") for the state-run Municipal Employees' Retirement System ("MERS") plan, the estimated cost of providing current-year pension benefits to retirees covered by the pre-1972 Police and Fire pension plan ("1% Plan"), and the actuarially recommended contribution to the John Hancock Plan. (See Section II B 2)
- No impact fee payments from Wyatt.

Even with these conservative assumptions, and factoring in changes made by the State Receivership to date, Central Falls will continue to accumulate deficits during the forecast period. This forecast makes clear that the City's revenues and expense patterns are unsustainable; maintenance of the status quo will place at risk the City's ability to continue providing the current level of services.

The deficits for each of the five (5) fiscal years beyond the current fiscal year are projected as follows:

Table 3

Projected Deficits as a Share of Revenue

Fiscal Year	Operating Deficit	Share of Non-Earmarked Revenues
2012	$ 4,888,090	32.94%
2013	$ 5,088,464	33.75%
2014	$ 5,171,759	33.54%
2015	$ 5,290,368	33.74%
2016	$ 5,460,449	34.23%
Total	**$ 25,899,130**	

It should be noted that this forecast assumes continuation of the City's current service model, which may be providing too few services to meet the needs of its residents. Further, this forecast does not account for funding to address deferred capital investment; funding for the City's Other Post-Employment Benefits ("OPEB") liability, which is currently financed on a 'pay-as-you-go' basis; and statutory contributions to the education stabilization fund. (See Sections I C 5, II C and III A 3) As is readily apparent from this forecast, the City's current course is not sustainable.[36]

E. Other Matters

1. Receivership Litigation

Mayor Moreau was relegated to an advisory capacity at the outset of the State Receivership. The State Receiver endeavored to work with the Council members, keeping them advised as to fiscal measures that were being taken to close out FY 2010 and to create a balanced budget for FY 2011. Those actions by the State Receiver, including, but not limited to, the adoption of the FY 2011 budget and corresponding tax increases and the exercise of his power to make appointments to certain boards and authorities, resulted in a series of lawsuits: the first being filed by the State Receiver; the second by the Central Falls Housing Authority; and the final suit brought by Mayor Moreau and the City Council (excluding one of the Council members who was named as party defendant). These causes of action sought to either affirm or challenge the

[36] The deficits projected for FY 2012 and FY 2013 can be reduced by not funding the ARC for the John Hancock Plan and by not funding the pension benefits for the 1% Plan. Existing plan assets would be used to fund these benefits. This strategy would reduce but not eliminate these projected deficits; it would also exacerbate the City's short-term and long-term financial difficulties. Further, the statutory requirement for MERS communities to fund their pensions is an acknowledgment at the State level of the need to fund, rather than draw down, pension plans.

constitutionality of the Act and the State Receiver's authority thereunder.[37] Two (2) of the actions were consolidated administratively by Superior Court Justice Michael A. Silverstein, and all three (3) actions were consolidated for hearing. After hearing, argument and briefing, Judge Silverstein issued two (2) decisions on October 18, 2010 recognizing the constitutionality of the Act and the authority of the State Receiver to act in accordance therewith. (Appendix 15) Specifically, among other findings, Justice Silverstein found that the Act is constitutional in that it applies alike to all cities and towns, addresses a statewide concern, does not alter a municipality's form of government and is substantially related to the public welfare. The Court also granted a permanent injunction enjoining Mayor Moreau and the Council members from interfering with the State Receiver in his administration of the State Receivership. With respect to the action filed by the Central Falls Housing Authority, Judge Silverstein confirmed the authority of the State Receiver to appoint commissioners thereto. Mayor Moreau and the Council have appealed the matter to the Rhode Island Supreme Court; the Central Falls Housing Authority has declined to pursue an appeal. On November 19, 2010 the Rhode Island Supreme Court denied the appellants' request for a stay of the Superior Court judgment and granted the State Receiver's request for expedited review of the appeals. A decision from the Rhode Island Supreme Court is anticipated by the end of February 2011.

Shortly after the conclusion of the Superior Court litigation, the State Receiver sought to resume the Council's performance of the normal business activities of the City

[37] Three (3) different actions were brought in the Rhode Island Superior Court. Mark A. Pfeiffer, in his capacity as Receiver for the City of Central Falls vs. Charles Moreau, in his individual capacity and in his official capacity as Mayor of the City of Central Falls, et. al., C.A. No P.B. 10-5615, is the action filed by the State Receiver. The Council and Mayor Moreau filed Richard Aubin, Jr. in his capacity as a member of the City Council for the City of Central Falls, et. al. vs. Justice Mark A. Pfeiffer, in his capacity as the Appointed Receiver to the City of Central Falls, et. al., C.A. No 10-2984. The Central Falls Housing Authority filed a lawsuit as well, Central Falls Housing Authority, et. al. vs. Mark A. Pfeiffer, in his capacity as Receiver for the City of Central Falls, C.A. No P.B. 10-5580.

(e.g., licensing and ordinances) and in that regard proposed a 'Statement of Policy' to govern that activity. (Appendix 16) This effort followed many weeks of attempting to work with the Council by keeping them informed as to Receivership initiatives by corresponding and meeting periodically with the Council President. At a special meeting of the Council held on November 5, 2010, the Council rejected the arrangement to continue performing its functions subject to the State Receiver's 'Statement of Policy.' Given the Council's unwillingness to accept the 'Statement of Policy' and to work with the State Receiver in governing the City[38], which collectively had an adverse impact on the governance of the City, the Council members were notified on November 7, 2010 through their attorney that henceforth they would be serving only in an advisory capacity to the State Receiver as he may seek their advice from time to time, thereby placing the Council in the same advisory role in which Mayor Moreau had been placed at the outset of the State Receivership. (Appendix 17) The Council members were notified individually of this action on November 8, 2010. (Appendix 18) The State Receiver then formed a three-person body to make recommendations to the State Receiver in performing the functions of the Council pursuant to the 'Statement of Policy' previously developed ("State Receivership Council"). (Appendix 19) One of the first actions of the State Receivership Council was to incorporate a 'public comment' period in its meetings, which had previously been discontinued by the City Council. (See Section II F)

[38] Subsequent to the issuance of Judge Silverstein's October 18, 2010 decisions, the Council held a special public meeting on October 20, 2010 and announced a purported lack of authorization to conduct any City business without the prior specific authorization of the State Receiver. The pending item on the agenda, an application for disability retirement approved by the Board of Pensions & Retirement, was tabled by the Council and subsequently approved by Order of the Receiver to minimize the adverse impact to the applicant.

2. Economic Development

A review of existing redevelopment initiatives in Central Falls suggests that the City is reactive to initiatives by interested parties, rather than being proactive in seeking opportunities. There is no City department with direct authority over economic development matters. The State Receiver has acknowledged and supported several economic development projects such as the Broad Street Regeneration Initiative Action Plan, the Commuter Rail and Transit Oriented Development project, the Blackstone River Bikeway, the Adventure Playground and Community Support Center, the William Wheat Chocolate Mill, and the Central Falls Landing Enhancement Project.

The Broad Street Regeneration Initiative Action Plan is a joint effort between Central Falls, the Town of Cumberland, the City of Pawtucket and the Blackstone Valley Tourism Council to engage local community entities in reviving Broad Street, which traverses all of these areas. A once thriving street for commercial development, Broad Street has physically deteriorated, impacting the ability of these areas to attract businesses. A detailed action plan has been designed consisting of six (6) areas for intervention. These areas include historic preservation, facade improvements, pedestrian and streetscape improvements, traffic and parking management strategies, community safety, and business growth.[39]

Planning for the Commuter Rail and Transit Oriented Development project is in the early stages of establishing a Massachusetts Bay Transportation Authority ("MBTA") commuter rail stop located along Barton Street, between Dexter and Conant Streets. Preliminary engineering for this project was approved on August 18, 2010 by the Federal

[39] Broad Street Regeneration Initiative Action Plan, November 2008

Transit Administration ("FTA"), which provided $2.0 million to the Rhode Island Department of Transportation ("RIDOT"). Implementing this commuter rail project along with already ongoing multi-modal transportation infrastructure projects located near Central Falls will promote and aid the economic development in the local community and region.[40]

The Blackstone River Bikeway has been an ongoing project since the early 1980's. The goal of the project is to connect multiple communities with a sixty-five (65) mile long bikeway. This bikeway will connect to the East Bay Bike Path to the south and to the City of Worcester to the north, resulting in greater potential development in tourism, recreation, health and transportation.

The Adventure Playground and Community Support Center is a project for Central Falls' children and families. It is designed to assist children and their families in developing individual and social skills through activities in a nature-based playground. The feasibility of this project is being evaluated by the Family Care Community Partnership, the Central Falls School Department, the Rhode Island Mental Health Association and the Providence Children's Museum.

The Confectioners Mill Preservation Society is a non-profit corporation that has initiated a project to research, protect and restore the William Wheat Chocolate Mill located on Roosevelt Avenue in Central Falls. This project has the potential to revitalize the area and will complement the Slater Mill in Pawtucket, thereby enhancing tourism for both communities.

The Central Falls Landing Enhancement Project was undertaken by the Central Falls Planning Department to provide for a walking trail and associated lighting,

[40] Policy White Paper, Pawtucket Foundation

landscaping and parking improvements at the site of a former textile mill at the corner of Broad Street and Madeira Avenue. Funding in the amount of $400,000 was made available by RIDOT for the project, to be made on a reimbursement basis. In addition, $100,000 was made available by the Rhode Island Department of Environmental Management ("RIDEM"). Given the City's financial condition and resulting inability to front the costs for the project, the City's otherwise limited resources including a current Planning Department of one (1) staff member, and a cost estimate for the project exceeding the $500,000 budget, the project was delayed for several months. The Office of the State Receiver consulted with RIDOT officials in December 2010 to pursue alternative strategies for completion of the project. As a result of that collaboration, RIDOT agreed to assume the management and total funding of the project, less the portion funded by RIDEM, with oversight to be maintained by Central Falls. In addition to providing this oversight, Central Falls will continue to manage the portion of the project funded by RIDEM. It is anticipated that RIDOT will begin work on the project, which currently remains at the design stage, by January 2011.

These projects are worthy undertakings and should continue to enjoy the support of Central Falls. The City, however, must become more proactive in identifying and implementing additional economic development initiatives. To that end, the State Receiver requested that the Rhode Island Economic Development Corporation ("EDC") prepare an economic recovery plan for Central Falls. An EDC report dated November 8, 2010 was provided to the State Receiver. (Appendix 20) That report delineates a number of action items and recommendations to develop and effectuate an economic development strategy. In 2011, the State Receiver will designate an office within City

Hall to have responsibility for economic development. That office will work with the EDC and other agencies to achieve the goals identified in the report.

3. Human Resource Management

At the inception of the State Receivership, it was immediately apparent that the management of Central Falls' employees had been undefined and inconsistent. The State Receiver could not locate written human resources policies and procedures, ultimately concluding that such policies were virtually non-existent. Upon review of the personnel files of City employees, it was discovered that a majority of the files were incomplete and in need of significant updates. Most files included little or no information concerning the terms of employment; many omitted even the employee's current title and documentation of appointment. Documentation of benefits was also severely lacking, and no electronic filing system was in place. As a result of these deficiencies, it was extremely difficult to determine the City's obligations with respect to its employees, particularly those employees who are not represented by a collective bargaining unit. In addition, the State Receiver encountered challenges in locating copies of the City's current policies of insurance, pension plans and other essential administrative documents, apparent evidence that there had been little attention paid to record-keeping.

Accordingly, the State Receiver instituted several human resources initiatives to standardize administration, increase efficiency and minimize potential liability to the City. An audit was conducted of all current recipients of insurance coverage, including continuation coverage, and several instances of improper coverage were rectified.

Several human resources policies were prepared and distributed, and others are currently in formation. A cell phone policy was instituted to manage the use of City cell phones, and all unnecessary features were removed from the plan to limit its cost. An information technology policy was instituted to streamline service requests and to ensure prioritization of projects under the City's current contract. Policies were distributed that standardized management of staff, outlined hours of work and breaks, and provided a procedure for requesting leave. Mechanisms were established for tracking and managing leave for employees, including a policy governing family and medical leave that is consistent with applicable law. The State Receiver is also in the process of creating an employee handbook that will include all necessary human resources policies and procedures and outline the entitlements and obligations of City employees. Anticipated policies will address, *inter alia*, leave entitlements and discharge, benefits, a code of conduct, employee discipline, use and surrender of City equipment, use of information technology and procedures regarding termination of employment. Individual employment agreements without proper documentation and authority will be prohibited.

The State Receiver also conducted reviews of existing staffing in various Departments and took appropriate action to maximize efficiency, which included not only personnel reductions, but also reductions in work hours, reassignments and hiring of additional staff where necessary to fulfill legal obligations or to secure federal funding. In addition, in order to maximize productivity of existing staff while also limiting the potential liability to the City based upon errors in payroll administration, the State Receiver is in the process of securing necessary technological upgrades, including conversion of the current outdated payroll system to a fully computerized, web-based system that incorporates automated leave accruals, salary changes, grants management and tax reporting.

4. City Infrastructure

Municipal budgets are generally separated into two (2) documents – the operating budget and the capital budget. The capital budget is a critical document, as it allows cities to view capital funding needs years into the future so as to prudently plan repair and replacement projects, coordinate construction with other agencies to reduce inconvenience and cost for residents, and to properly plan the financial implications of capital investments, especially those supported by bond financing.

Central Falls does not have a capital budget. This void creates a significant risk for the City and, if not addressed, can be expected to result in poor capital investment, higher costs to taxpayers and uncoordinated financial and construction activities.

To begin to address this deficiency, the State Receiver engaged the assistance of RIDOT to assess the overall condition of Central Falls' infrastructure and public works. An initial assessment, completed in October 2010, found an unfunded capital liability of $10.5 million related to roadway and sidewalk repair and replacement projects. An executive summary of the full report is appended. (Appendix 21) This evaluation does not include required capital investment in public buildings and schools, fleet acquisition and maintenance, information technology and other critical areas.

Given the substantial capital deficit for road and sidewalk construction, it is reasonable to assume current underinvestment in other areas of capital infrastructure.

Given this assumption, the City is likely facing a substantial unfunded capital investment liability. This liability presents a risk for the City and its taxpayers, as capital investments can only be delayed for so long. Deferring maintenance only serves to increase costs over time, and capital assets will eventually fail if not properly maintained. Protracted underinvestment in capital projects creates the potential future need for significant capital investment due to infrastructure failure, all within a budget which is already so severely strained as to require receivership.

The development of a capital budget will begin during the current fiscal year. The State Receiver intends to develop a five (5) year capital investment and maintenance plan by the end of calendar year 2011. The implementation of this plan will depend upon the measures adopted by the State and Central Falls to return the City to fiscal health and how quickly those measures succeed.

II. STRUCTURAL PROBLEMS

A. Collective Bargaining Agreements ("CBAs")

Unionized municipal employees, constituting seventy-one percent (71%) of the Central Falls' workforce, are represented by three (3) collective bargaining groups whose contracts expire as follows:

Table 4

Expiration of Collective Bargaining Agreements for the City of Central Falls

Council 94	June 30, 2011
Fire Union	June 30, 2012
Police Union	June 30, 2012

The CBAs for each of these bargaining groups provide the compensation levels, conditions of employment and terms of present employment benefits and post-employment retirement benefits. A schedule of the pension benefits provided under each CBA is attached. (Appendix 22) As is the case in most municipalities, labor costs represent a large portion of the City's annual operating budget, totaling sixty-eight percent (68%) for FY 2011, including both current employee and retiree costs with the exception of the $3.3 million contribution to the John Hancock Plan and, as later discussed, any funding for future OPEB liabilities. (See Sections I D 3 and II C II) For FY 2012, the City's labor costs are projected to increase by thirty-five percent (35%), primarily due to both the elimination of the temporary wage reductions agreed to by the

City unions and the restoration of contributions to the John Hancock Plan. As a result, the terms, conditions and compensation set forth in union contracts are critical to the City's overall fiscal health, as they constitute a significant cost center for the City.

A review of Central Falls' CBAs indicates that these agreements are very restrictive, severely limiting management's ability to properly adjust to changing circumstances. Examples include: the extent to which retiree benefits and associated increases are stipulated in active employee contracts; minimum staffing levels[41]; the requirement that promotions be given to the applicant with the most seniority who scored at least a sixty-five (65) on a one-hundred (100) question multiple choice examination, regardless of qualifications or service and disciplinary records[42]; a prohibition on use of call personnel until all full-time personnel have been activated[43]; automatic disability pension approval after twelve (12) months of incapacity[44]; and a clause that treats prior departmental practices as if they were full provisions of the agreement that can only be changed during bargaining.[45] The CBAs also arguably impinge on management's ability to properly manage and direct the day-to-day operations of the City's government. Although a survey of wages and benefits in surrounding communities has not been conducted to establish market comparability, the wages and benefits paid to City employees under these contracts exceed the City's ability to meet current financial

[41] See Agreement Between City of Central Falls, Rhode Island and Fraternal Order of Police Lodge 2, Contract Agreement for July 1, 2009 to June 30, 2012, Article VII Section 2 and Agreement Between the City of Central Falls and Local 1485 International Association of Firefighters, AFL-CIO, July 1, 2009 to June 30, 2012, Article 27

[42] See Agreement Between the City of Central Falls and Local 1485 International Association of Firefighters, AFL-CIO, July 1, 2009 to June 30, 2012, Article 11 Section 1

[43] See Agreement Between the City of Central Falls and Local 1485 International Association of Firefighters, AFL-CIO, July 1, 2009 to June 30, 2012, Article 6 Section 4

[44] See Agreement Between City of Central Falls, Rhode Island and Fraternal Order of Police Lodge 2, Contract Agreement for July 1, 2009 to June 30, 2012, Article XIV Section 1

[45] See Agreement Between City of Central Falls, Rhode Island and Fraternal Order of Police Lodge 2, Contract Agreement for July 1, 2009 to June 30, 2012, Article XVIII

obligations, fund capital investment and meet legacy costs associated with prior and current pension benefits and OPEB.

These issues could have been created and/or exacerbated by the fact that unions in the public sector play an important and powerful role in selecting – or at least influencing – the managerial side of the bargaining process. As will be discussed later, this report addresses a series of steps to add balance to the labor-management relationships in the City. Properly conceived and executed, these changes can be made fairly and with mitigated impact on employees while still reducing the risk that continuously accretive compensation and benefits will force layoffs or disrupt services.

B. Status of Pension Funds

1. Sources Utilized

The following sources, cited once here for the sake of simplicity, have been used in the pension and OPEB sections throughout this report:

- Status of Pension and OPEB Plans Administered by Rhode Island Municipalities, Dennis E. Hoyle, Acting Auditor General, March 2010 ("Auditor General's 2010 Report").
- Status of Pension Plans Administered by Rhode Island Municipalities, Ernest A. Almonte, Auditor General, July 2007 ("Auditor General's 2007 Report").
- City of Central Falls 1% Pension Plan Actuarial Valuation Report, Nyhart, July 1, 2010 ("Nyhart 1% Plan Report").

- City of Central Falls, RI GASB 45 Financial Report Fiscal Year Ending June 30, 2010, Nyhart, November 15, 2010 ("Nyhart GASB 45 Report").
- City of Central Falls Pension Plan: Actuarial Valuation Report July 1, 2010, Nyhart, November 23, 2010 ("Nyhart John Hancock Plan Report").
- Municipal Employees' Retirement System State of Rhode Island Actuarial Valuation Report as of June 30, 2009, Gabriel Roeder Smith & Company, July 14, 2010
- Actuarial Analysis – Extending MERS Coverage to Police and Firefighter Employees of the City of Central Falls – Active Information, Gabriel Roeder Smith & Company, November 19, 2010 ("GRS Active Employee Analysis"). (Appendix 23).
- Actuarial Analysis – Liability for the Current Inactive Members of the City of Central Falls John Hancock and 1% Pension Plans, Gabriel Roeder Smith & Company, November 29, 2010 ("GRS Inactive Member Analysis"). (Appendix 23).

2. Background on Pension Liabilities

In order to understand Central Falls' difficulty with its unfunded pension liability, it is helpful to put the issue in perspective by examining the same problems that exist in other municipalities and in the State itself. In a best-case scenario, pension programs require financial contributions from employees and employers, and these contributions are deposited into a trust fund. The trust fund invests the proceeds of these contributions in equity and bond markets and then uses the proceeds to make annual pension payments to retired employees. As is common to a number of governmental units nationally, prior generations of policymakers failed to make sufficient contributions to these trust funds and often allowed employees to make insufficient contributions as well. Many pension trust funds also have historically assumed – and continue to assume – long-term investment performance that has been shown to be unrealistically high. These practices give rise to an unfunded liability, or a cost that is not offset by an asset that will pay for it. As this funding failure – by both employers and employees – occurred for many years in certain plans, the accrued unfunded liabilities have become significant. While some local governments took strong steps in past years to address this issue, a number of municipalities in Rhode Island continue to underfund their non-MERS pension plans. As a result, pension liabilities for a number of local governments have grown to the point where they are threatening the fiscal stability of the governments that established the plans.

According to the Auditor General's 2010 Report, the following unfunded liabilities throughout the State are present in each classification of pension plan:

Table 5

Statewide Unfunded Pension Liabilities

Plan Type	**Unfunded Pension Liability**
All MERS Communities	$ 91.7 million
Independent Local Plans	$ 1.9 billion
State Employees	$ 1.7 billion
Teachers Plan	$ 2.7 billion
Total	**$ 6.4 billion**

The $1.9 billion pension liability for independent pension systems covers thirty-six (36) systems and 13,974 members. As expected, larger communities have a larger portion of this liability, with Providence accounting for nearly one-half ($804.8 million) of this liability.

While a number of communities with independent pension systems have appropriately managed their pension liabilities, a number have not done so, creating a broad-based financial challenge for municipalities in Rhode Island. As discussed above, the City of Providence faces an $804.8 million unfunded liability for its non-MERS pension plan, with an annual contribution of $48,509,000. The City of Pawtucket faces a $112.6 million unfunded liability, with a total non-MERS required annual contribution of $8.9 million. As of June 30, 2010, Central Falls' non-MERS unfunded liability is $46.6 million, requiring a $4.6 million annual contribution to the non-MERS pension systems in FY 2010. As the City continues to experience financial challenges and fails to make these payments, however, this liability will grow, exacerbating Central Falls' fiscal distress.

It is important to note that the City's and State's unfunded pension liabilities are based on a number of assumptions that could prove to be overly optimistic. The City's $46.6 million unfunded liability for its locally administered plans, the City's $1.4 million liability for its MERS Plan and the State's $1.7 billion liability all assume long-term returns on invested assets that may be unrealistically high. Central Falls assumes a seven and three-quarters percent (7.75%) return on investments for its current Police and Fire pension system (i.e. John Hancock Plan) and seven and one-half percent (7.5%) for its closed pre-1972 Police and Fire system (i.e. 1% Plan), while the State and MERS plans assume a long-term annual return on investments of eight and one-quarter percent (8.25%). While the past is not necessarily an indicator of future investment returns, the return on invested assets over the 2002 to 2009 period was approximately four percent (4%) for the State and five and two-fifths percent (5.4%) for the City. The ten-year market return for the MERS system for the period ending 2009 was one and nine-tenths percent (1.9%).

While poor prior year investment performance is already factored into the actuarially-estimated liability, assumptions of future investment performance remain as previously stated. The unfunded pension liabilities for Rhode Island governments would increase significantly if the assumed rate of return for future earnings was adjusted downward to more closely match recent investment returns. This would further exacerbate the financial challenges faced by Rhode Island governments, as weak investment returns will require municipalities and the State to increasingly fund pension liabilities from current appropriations.

3. City Pension Obligations

As previously discussed, there are three (3) pension plans in Central Falls. These plans have significant unfunded liabilities as detailed below[46]:

[46] Figures for the MERS plan are current as of June 30, 2009. Figures for the non-MERS plans are taken from June 30, 2010 valuation reports as cited previously.

Table 6

Pension Liabilities for the City of Central Falls

Plan	Total Liability	Actuarial Value of Assets	Unfunded Liability	Funded Ratio
MERS	$ 6,656,557	$ 5,212,157	$ 1,444,400	78.3%
Police and Fire	$ 40,109,123	$ 6,516,889	$ 33,592,234	16.2%
1% Plan	$ 14,218,372	$ 1,251,926	$ 12,966,446	8.8%
Total	**$ 60,984,052**	**$ 12,980,972**	**$ 48,003,080**	

MERS is an agent, multiple-employer public employee retirement system administered by the State and funded by participating municipalities. Contribution requirements for employees are established by statute; the employer contributions are established by annual valuations, the payment of which is mandated by statute. Currently, the employee contribution rate is six percent (6%) and the municipal contribution rate is eight-point-three-eight percent (8.38%), based upon an actuarially determined rate. Rhode Island law stipulates that State aid may be withheld if a municipality fails to make the required contribution to MERS. R.I. Gen. Laws § 45-21-42(c). As a result of this requirement, Central Falls has consistently funded this plan. The City's ARC for the MERS plan was $183,695 for FY 2009 and $184,911 for FY 2010. According to the GRS Active Employee Analysis, sixty-eight (68) employees and thirty (30) retirees are covered by the MERS retirement plan for Central Falls, comprising the City's Council 94 and non-unionized employees/retirees.

The Police and Fire Pension Fund was established by the Public Laws of Rhode Island, 1925 for all Police and Fire employees hired prior to July 1, 1972. This plan is referred to as the '1% Plan.' The value of plan assets on July 1, 2010 was $1,251,926[47],

[47] The 1% Plan is commonly understood to be a so-called 'pay-as-you-go' plan because current appropriations are used to fund pension benefits. This typically occurs when pension plans exhaust their

with an unfunded actuarial accrued liability of $12,966,446. All employees eligible to participate in this plan have retired; presently fifty-seven (57) individuals are participating in the plan. The ARC for this plan is $1,368,261, with a current pension payroll of approximately $111,000 per month. The plan also provides disability and death benefits in addition to pension benefits.

The third pension plan, the John Hancock Plan, covers all Police and Fire employees hired after July 1, 1972. Unlike the MERS plan, there are no state-aid intercept or other coercive provisions that compel the funding of the ARC, although failure to do so can result in negative audit reports with a corresponding negative impact on a municipality's bond ratings. The John Hancock Plan also provides disability and death benefits in addition to pension benefits. As shown below, the City has recently failed to fund this plan:

Table 7

Recent Funding History for the John Hancock Pension Plan

	FY08	**FY09**	**FY10**	**FY11**
Required Contribution	$ 2,108,373	$ 2,573,298	$ 2,573,298	$ 3,254,777
Actual Contribution	$ 1,230,082	$ 0	$ 0	$ 0

Based on the Nyhart John Hancock Plan Report, the John Hancock Plan was sixteen and one-fifths percent (16.2%) funded, with $6.5 million in assets and $40.1 million in liabilities on a present value basis.[48] The plan covers one hundred fifty-five

plan assets. The State Receiver has identified a series of demand accounts in local financial institutions totaling $1,251,926 which may constitute plan assets.

[48] The City's Finance Department has identified $249,000 in funding located in a checking account at a local financial institution, the account having a designation as being related to the John Hancock Plan. The City is currently researching the origin and history of this account to determine whether or not it is a plan asset.

(155) individuals, seventy-six (76) of whom are currently employed, two (2) of whom are deferred but vested, twenty-eight (28) of whom are receiving disability retirement pensions and forty-nine (49) of whom are receiving regular retirement pensions. The plan's ARC is comprised of both current costs, the so-called 'normal cost,' for benefits being earned this year, and a substantial payment for prior years in which the plan was not funded, the so-called 'unfunded liability.' The FY 2011 ARC for the John Hancock Plan is comprised of:

Table 8

Composition of the Annually Required Contribution for the John Hancock Plan

Normal Cost	$0.9 million
Unfunded Liability	$2.4 million
Fiscal Year 2011 ARC	**$3.3 million**

Employees are projected to contribute $262,217 this fiscal year to fund a portion of this cost. Absent additional funding, existing plan assets are presently expected to be exhausted by the end of FY 2013.

Central Falls' failure to fund its pension plans will greatly increase the cost of government for residents or, alternatively, will reduce the amount of services they can receive. Because pension assets are assumed to earn a certain rate of return, as previously discussed, failure to fund required contributions has essentially created a high-interest loan from the pension funds to the City. The contributions required but not made must still be transferred from the City to the pension funds. To the extent that they are not, the City must make up these payments as well as the lost interest that they were assumed to have earned.

It should be noted that the cost of these pension benefits, which total in the millions of dollars for all of the City's plans, is being paid by current residents and taxpayers, although the benefits were generally earned years ago. This creates significant generational inequity, as today's taxpayers are burdened with the significant costs of pension benefits for services that, in many instances, they did not receive. This problem is particularly pronounced in Central Falls and represents a significant drain on current resources due to the failure of previous generations to appropriately fund the benefits they extended to municipal employees.

C. Other-Post Employment Benefits (OPEB)

1. Background on OPEB Liabilities

The State and municipalities often offer health insurance and other benefits to retirees. These benefits are known as OPEB because they are 'other' than pension benefits, primarily relating to health insurance coverage.

Rhode Island governmental units have generally committed to providing health insurance to retirees. At times these benefits also apply to the surviving spouses of former employees after the former employees have died. This cost is mitigated in many instances when retirees become eligible for Medicare coverage, as is the case in Central Falls, allowing the municipal and State liabilities to cease while the federal government assumes responsibility for the retiree health insurance costs.

Historically, these OPEB have been funded on a 'pay-as-you-go' basis as current liabilities: they are paid from current resources and compete for funding against other current priorities such as public safety, public works and economic development. While these benefits are not necessarily problematic, sufficient funding has not been set aside to pay for the cost of these benefits over time, forcing a reduction in the amount of services that current and future taxpayers can receive in order to pay for these costs.

The OPEB liability is essentially the cost of providing health and a typically small life insurance benefit to current and future retirees for the period of their assumed eligibility. This liability is the total amount of money required to be in a trust fund in order to pay these benefits in perpetuity, given a variety of assumptions regarding cost (e.g. retiree health and longevity) and revenues (e.g. investment returns on trust fund assets and the timing and size of payments into the trust fund).

As prior and current taxpayers have generally not funded trust funds for OPEB, the City and the State face large unfunded liabilities or, stated another way, must make substantial deposits into a trust fund in order to fund the benefits promised to employees and retirees. The Auditor General has estimated that the OPEB liability for local governments in Rhode Island totals $2.4 billion, with State OPEB liabilities totaling $788 million.[49] In FY 2011 the State has begun to fund its OPEB liabilities on an actuarial basis.

[49] Auditor General's 2010 Report

2. City OPEB Liabilities

Although retirees do not generally participate in the collective bargaining process, Central Falls' OPEB are largely stipulated in CBAs, thereby significantly reducing the City's ability to address the impact of this large and growing cost center. A summary of OPEB provided under each of the three (3) CBAs and to non-union retirees is attached. (Appendix 24)

OPEB in Central Falls, as elsewhere, has historically been funded on a 'pay-as-you-go' basis as part of the health insurance, life insurance and other budgetary line items each year. This issue has become increasingly important over time because the cost of health insurance has grown substantially. Additionally, this problem has become more apparent due to the Government Accounting Standards Board's Rule 45, which requires governments to report their OPEB liabilities.[50] The City's unfunded actuarial accrued liability for OPEB was calculated at $32,011,503 as of July 1, 2010.[51]

The City's OPEB liability grew from $30,693,955 in FY 2009 to $32,011,503 in FY 2010. This is an increase of $1,317,548, or a one-year increase of four and three-tenths percent (4.3%). Over the same period, however, the City's overall revenue declined by eight and seven-tenths percent (-8.7%). While unaffordable in its current form, the City's OPEB liability is also growing faster than the City's revenue, excluding extraordinary revenue adjustments as were made in FY 2011, making it even more unaffordable with the passage of time.

[50] Statement Number 45: Accounting and Financial Reporting by Employers for Postemployment Benefits Other than Pensions, Government Accounting Standards Board, June 2004
[51] Nyhart GASB 45 Report

Like the City's pension liability, the City's OPEB liability is comprised of two (2) main components: the 'normal cost,' which represents the cost of benefits earned and provided in the current year; and the 'unfunded liability,' which represents the cost of benefits promised but not funded in prior years. For FY 2010, the normal cost is \$634,942 and the unfunded liability is \$1,305,678; the total cost for health insurance for active employees and retirees for FY 2010 is \$2,027,948[52], sixty-four percent (64%) of which is related to benefits previously promised but not funded.

The Nyhart GASB 45 Report assumes that the City's overall spending on health insurance in FY 2010 is \$1.47 million. This amount represents an estimate of the FY 2010 'pay-as-you-go' cost, or the cost of providing health insurance today to active employees and retirees, which meets current funding needs but does not set aside funding to pay the cost of benefits that will be paid in the future. If health expenditures continue to grow and the City fails to set aside a reserve fund to help address these costs, the City will be required to appropriate an increasing amount of its operating budget to fund health insurance benefits. This result is untenable, as health care costs already comprise a fast-growing portion of the City's budget. Failure to fund a reserve fund also prevents the City from receiving financial returns on money invested that could then be used to offset the amount of funding the taxpayers are required to pay.

The City is currently not required by law to fund its OPEB liability, although a small number of municipalities regionally and nationally have begun to voluntarily fund OPEB trust funds to avoid repeating their past mistakes in failing to fund pension

[52] The City's OPEB liability also includes \$87,328 to compensate for the timing of payment. This cost is small compared to the overall OPEB liability and therefore does not receive special consideration in this report.

liabilities. In Rhode Island, however, only a few municipalities have begun to fund OPEB: namely, Bristol, Barrington, Cranston, Newport, Warren and Westerly.[53]

D. Wyatt Detention Facility

Wyatt is operated by the Central Falls Detention Facility Corporation ("CFDFC"), a non-profit corporation created in 1991 through an Intergovernmental Agreement ("IGA") between the United States Marshals Service ("Marshals Service") and the City. The creation of CFDFC was authorized by R.I. Gen. Laws § 45-54-1 et seq. (the "Detention Center Act"), which allows municipalities to pursue economic development through the acquisition or construction of correctional facilities. As a tax-exempt entity, Wyatt was expected to make an annual impact fee payment to the City. In this way, Wyatt would still provide the City with the benefit of economic development – tax revenue for the City – but would do so in the form of an impact fee payment rather than through taxes.

The mission of the CFDFC is to design, build and manage a publicly-owned detention facility in the northeastern United States. Wyatt is a quasi-public entity governed by the CFDFC's five-member Board of Directors appointed by the Mayor of Central Falls with the approval of the City Council. The Board, comprised entirely of Central Falls residents as required under the Detention Center Act, appoints the Chief Executive Officer, who oversees the management and operation of Wyatt without additional administrative oversight by Central Falls or the State.

[53] Auditor General's 2010 Report

Wyatt opened in November 1993 and has a current maximum occupancy of approximately seven hundred (700) detainees. Wyatt presently houses medium- and maximum-security detainees for federal law enforcement agencies including the U.S. Marshals Service. Wyatt began housing detainees of the Immigration and Customs Enforcement Agency ("ICE") in 2005[54], although this arrangement was suspended after the death of an inmate in custody in 2008.[55]

The IGA between the CFDFC and the Marshals Service is a one-year agreement that automatically renews each year unless terminated by the CFDFC or the Marshals Service. The agreement requires the Marshals Service to pay a per diem rate per detainee, subject to adjustment based upon the cost of building and operating Wyatt.

The creation of Wyatt was initially financed with the issuance of revenue bonds in the amount of $30,106,000; the expansion of Wyatt was funded in 2005 as part of a $106,380,000 bond issuance. Per diem payments from the Marshals Service were to be applied to repay the bonds issued to build and expand Wyatt. In recent years Wyatt experienced a shortfall in projected revenues due primarily to a decrease in the number of detainees transferred to the facility as well as other factors. This shortfall has created financial difficulties for Wyatt, forcing the CFDFC to suspend paying the annual impact fee payment to Central Falls each year. The loss of this fee revenue has contributed to the City's financial difficulties, which have been exacerbated by the City's inability to appropriately budget for and adjust its spending to reflect this loss. Table 9 provides additional information regarding Wyatt's financial contributions to the City as well as the City's ability to accurately budget for this revenue item.

[54] Donald W. Wyatt Detention Facility Web Site, History of the Facility, *at* http://www.wyattdetention.com
[55] Wyatt Deficit Revealed, Providence Journal, W. Zachary Malinowski, March 10, 2010, *available at* Wyatt Detention Facility Web Site, Press, *at* http://www.wyattdetention.com

Table 9

History of Revenue Provided by Wyatt to the City of Central Falls

Fiscal Year	Budgeted Impact Fee Revenue	Actual Impact Fee Received
2011	$ 500,000[56]	$ 0
2010	$ 1,200,000	$ 0
2009	$ 525,000	$ 282,287
2008	$ 492,288	$ 596,436
2007	$ 452,113	$ 388,536
2006	$ 308,451	$ 308,451
2005	$ 308,451	$ 308,451
2004	$ 342,707	$ 102,817

Although consistent with the economic development mission that underpinned the creation of Wyatt, the impact fee payment is a discretionary payment that holds a lower priority than payments to bondholders, establishment and proper funding of a variety of reserve funds, necessary facility upkeep and maintenance, and other expenditures. In other words, the City is the last beneficiary of payments by Wyatt, although the very creation of Wyatt was designed to benefit the City.

The CFDFC is currently in technical default on its bonds and, as a result, the State Receiver does not anticipate payment from the CFDFC in the current fiscal year. Notwithstanding this default and evidence to the contrary, the City did budget $1.2 million in funding from Wyatt in the FY 2010 budget that preceded the State Receivership. It should also be noted that bondholders have notified the CFDFC that they will seek legal action against the CFDFC if Wyatt makes a payment to the City in the current fiscal year. Accordingly, the State Receiver is working on a contingency plan in the event that Wyatt does not make its budgeted payment of $500,000 in the current

[56] The State Receiver estimated $500,000 in revenue from Wyatt based upon Wyatt's inclusion of that amount in its FY 2011 budget as an expenditure to be made to the City.

fiscal year[57]. It is not reasonable to expect that payments from Wyatt will resume in the near future unless Wyatt's finances are substantially improved. Improvement could occur if ICE resumes referring detainees to Wyatt, if the bonds are restructured with the assistance of the State[58] or if the State assumes management of the facility with its assumption of the impact fee payment as a State obligation.[59]

The State Receiver has requested from the CFDFC a variety of reports and various data pursuant to the Access to Public Records Act, R.I. Gen. Laws § 38-2-1, et seq. With regard to the information that has been received and reviewed to date, it appears that Wyatt is experiencing significant financial distress, having lost money each year since its expansion. The bonds used to finance Wyatt appear to be back-loaded, meaning that current debt service costs will grow over time in a substantial way.[60] This will create additional fiscal stress, as Wyatt is already running a deficit while paying the current smaller debt service costs. Wyatt has also been unable to attract ICE back to the facility, creating a continued revenue problem for Wyatt and, by extension, for the City.

To help address some of these issues and ensure community participation and oversight, the State Receiver appointed an individual to fill one (1) of two (2) vacancies

[57] The State Receiver has identified $504,055 in unexpended school construction funding that can be applied to the budget as revenue, if necessary. This would address, for one year only, the loss of $500,000 in revenue from Wyatt.

[58] The bonds issued to finance the expansion of Wyatt which mature in 2013 carry a six and three-quarters percent (6.75%) interest rate; the $98,970,000 in bonds maturing on July 15, 2035 carry an interest rate of seven and one-quarter percent (7.25%). There are a variety of mechanisms to refinance these bonds in the Indenture of Trust (Indenture of Trust Dated As of June 1, 2005 By and Between Central Falls Detention Facility Corporation and U.S. Bank National Association) that may allow the State to significantly reduce the interest cost of these bonds. Given its current and persistent bond default, it is unlikely that the CFDFC could restructure these bonds as successfully as could the State of Rhode Island.

[59] Given the State's expertise in correctional administration, it may be possible for the State to assume responsibility for Wyatt and the impact fee payment without negatively affecting the State's budget. Restoration of ICE as a client and refinancing debt could substantially improve Wyatt's finances, creating sufficient or surplus revenue.

[60] The bonds used to expand Wyatt feature a sinking fund into which debt payments are made twice each year. These payments grow over time, from $1.67 million in FY 2014 to $7.465 million in FY 2035, with a large bullet maturity payment of $13.075 million due on July 15, 2035.

on the CFDFC Board of Directors. This appointment was made on November 19, 2010, an action date that was delayed due to the litigation regarding the State Receiver's authority to make such appointments. (See Section I E 1) The State Receiver anticipates making another appointment to fill the remaining vacancy in January 2011.

E. Deficit Reduction

The City currently projects a $2.1 million deficit from FY 2010 that has been carried forward into FY 2011.[61] According to the provisions of R.I. Gen. Laws § 45-12-22.3, the City must submit a plan to the Auditor General that will resolve these deficits over no more than a five (5) year period. It is expected that the City will not be able to borrow from the capital markets to address this deficit, as the City's multi-year financial projections show large and growing deficits during the repayment period for these bonds or notes. Investors are unlikely to loan money to the City to finance a prior-year deficit when future years are also projected to have significant deficits. The City should therefore anticipate the need to fund its FY 2010 deficit using cash appropriations. Unfortunately, the City's operating deficit is both large and structural, and surplus balances in addition to the $600,000 of unexpended bond proceeds[62] are not projected. Furthermore, the City is unlikely to be able to amortize this deficit over the coming five

[61] The State Receiver has identified approximately $600,000 in unexpended bond proceeds and has declared them surplus and available for other purposes. These proceeds may only be used for specific purposes under state and federal law. Although all of these assets could be used in a particular way in the current fiscal year to partially address the FY 2010 deficit, the State Receiver may instead apply these assets to fund a portion of the City's debt service budget ratably across the remaining term of the bonds of which they were part. This approach would have a small yet positive impact on the FY 2010 deficit.
[62] See footnote 61, *supra*

(5) years given the large operating deficits projected: a ratable amortization of the $2.1 million deficit would add $420,000 to the deficits already projected for the next five (5) fiscal years.

Additional financial support from the State may be needed to address this deficit. Even if the City were to apply the entire $600,000 of unexpended bond proceeds to address the FY 2010 deficit, a $1.5 million deficit would remain which would need to be addressed by the end of the current fiscal year. R.I. Gen. Laws § 44-35-10.

F. Culture of Governance

The fiscal difficulties facing Central Falls are multi-faceted. The status of the pension plans, particularly the John Hancock Plan, and the limitations placed on the City by its CBAs and OPEB are the primary challenges pertaining to fiscal instability. The lack of any significant predictable revenue stream from Wyatt also impairs the City's fiscal health.

These problems have been developing for many years. As it relates to the John Hancock Plan and the associated CBAs, the City's governing authorities have been approving contracts for years that the City could not truly afford and then have compounded the problem by systematically underfunding the very obligations that they created. Regarding Wyatt, Central Falls' elected officials seem to be resigned to the fact that Wyatt is presently making no impact fee payments to the City, rather than encouraging improved fiscal oversight, operational improvements and better management, which could enhance the likelihood of creating a reliable revenue stream for Wyatt and, by extension, for the City. As previously noted, the City has also failed for many years to establish financial systems and controls necessary to monitor its fiscal position. Furthermore, the City has not engaged in any serious financial planning, including capital budgeting. Moreover, similar deficiencies were found in human resource management, economic development, planning and infrastructure management.

These types of problems and the degree to which they exist in Central Falls generally suggest a long-standing, underlying problem. In fact, they are symptomatic of an underlying problem, which the State Receiver in this instance would describe as a culture of governance that represents neglect and/or failure to manage the City in a manner that would have averted the current fiscal crisis. Without denigrating many hard working and effective municipal employees and officials in Central Falls, that culture has produced a system of government that in many respects is not professionally equipped to manage the affairs of the City. It has also produced a governmental entity that insulates its elected officials from public accountability and diminishes citizen involvement in the affairs of the community. Examples of this problem were reported to the State Receiver, describing a mayor who was sporadically present at City Hall in the weeks preceding and during the Judicial Receivership and a Council that months prior to the Judicial Receivership had limited the opportunity for public input at Council meetings. The rather sparse attendance at the public hearings held by the State Receiver on August 23, 2010 and on September 20, 2010, which were designed to provide opportunities for residents to obtain information and to ask questions, is emblematic of citizen disengagement from their government.

There is also an ongoing criminal investigation at City Hall being conducted by the Rhode Island State Police and the Federal Bureau of Investigation, as widely reported in the media, relating in part to the City's program for boarding and securing of vacant buildings determined to be unsafe by City officials. When property owners fail to respond to orders requiring the boarding and securing of these buildings, the City must maintain public safety by making such arrangements on behalf of the owners. Accordingly, the City historically secured a vendor to perform the work, provided compensation to the vendor and sought reimbursement from the property owner secured by a lien on the real estate, if necessary.

However, in 2007, with the foreclosure crisis ongoing, Intercity Maintenance Inc. ("Intercity") was selected as the sole vendor to provide these services in exchange for an agreement to defer payments from the City until the liens on the subject properties were satisfied by the property owners. In February 2009, the City administered a procurement request incorporating deferred payments into the bid specifications. Intercity was the successful bidder.

In 2010, in the wake of the investigation and media coverage of the City's board-up process, the Judicial Receiver reached an agreement with a separate vendor, Ron Thornley d/b/a Consulting & Project Management, to provide these services. In an effort to control costs, at each board-up the Judicial Receiver was involved in identifying the extent of the necessary work.

After the appointment of the State Receiver, the Council passed an ordinance adopting the 2010 Rhode Island Property Maintenance Code governing the boarding-up process. The State Receiver is the process of consulting with legal counsel and the

Rhode Island Division of Purchases in an effort to improve procedures and to administer an efficient and successful procurement process consistent with State law. The ongoing investigation, however, creates a cloud over the City's government that will continue until the investigation is concluded and will likely last for many years afterward. The morale of the City's officials, employees and citizenry can best be described as low.

Exacerbating the concern regarding morale, the former Chairperson of the Central Falls Housing Authority was arrested by the State Police Financial Crimes Unit on November 6, 2010 and charged with a check kiting scheme. A few weeks before the Chairperson's arrest, the State Receiver had replaced that individual, who was serving in a hold-over capacity, with a new appointee. That action had led to one of the previously discussed lawsuits in which the former chairperson unsuccessfully sought to block the new appointee from replacing him. (See Section I E 1)

In conjunction with these problems, the morale at City Hall has also been adversely impacted by unprofessional leadership which begins at the top of the management structure with the Mayor. An example can be found in a decision of the Rhode Island District Court – City of Central Falls vs. Department of Labor & Training, Board of Review (Sandra Salisbury), A.A. No. 10-167 (October 19, 2010). (Appendix 25) In that case the District Court upheld an award of unemployment benefits to a claimant, finding that there was substantial record evidence to support the Board's finding that the claimant had been subjected to ill treatment by city officials.[63]

[63] See page 7 of the decision in which the Court noted: "At the hearing before the Board of Review, claimant testified that she had been verbally abused by her superior, the Director of Human Resources. She also described a meeting held in City Hall during the work day that evolved into a political meeting regarding the mayor's bid for reelection. She specifically stated that during this latter meeting the mayor stated to her – 'F-- you'. The use of the f-word in its various forms by the Mayor toward the claimant at the meeting was confirmed by Mr. Todd Oldrick, Mr. Len Coutu and Mr. John LaBossiere." (Citations have been omitted for the purposes of brevity but can be found in the appended judicial decision.)

It is impossible to assess which came first, lack of citizen involvement or detached public servants, but most likely each contributed to the other. Attempting to assign blame as to how this culture of governance came to exist, or to allocate such blame to specific individuals, is frankly not useful. Suffice it to say that it must be addressed, just as the underlying fiscal problems must be solved. Therefore, in focusing on specific solutions to the fiscal problems that burden Central Falls, it is equally important that any reform recognize the need to develop competent, capable management and a leadership structure in the City's government that is focused on serving citizens efficiently and effectively. The reform should involve performance management, regular and open communication with the public, and the development of systems, processes and operating standards that will help to ensure the appropriate management and responsible expenditure of public funds. Reforms should also focus on re-engaging citizens in their government, including the use of community forums on critical issues facing the City and meetings with neighborhood groups to identify and to prioritize their specific needs.

III. STRUCTURAL SOLUTIONS

Given the forecasted deficits, it is readily apparent that additional tax increases and reductions in expenditures alone cannot solve the fiscal crisis that exists. Four (4) ongoing structural problems make it imperative that Central Falls cease operating as it has in its recent past. These problems are: (1) the unfunded pension liabilities, primarily associated with the John Hancock Plan, and unfunded OPEB liabilities; (2) the restrictive provisions of CBAs; (3) the lack of impact fee payments from Wyatt; and (4) a culture of governance that has failed to effectively identify and address the critical issues facing the City. One or more of a variety of solutions to each of these structural problems must be pursued for Central Falls to become a viable municipal government.

A. Pensions and Benefits

Central Falls must restructure its CBAs to realign costs and benefits to a level commensurate with the City's ability to pay. This issue will be replicated in a number of other municipalities across the State, suggesting that the General Assembly needs to consider new laws of general application that would establish more stringent and uniform ground rules with regard to benefits and CBAs.

The current structure of non-MERS municipal pension systems in Rhode Island has created a large number of small pension plans. These plans have potentially different benefit structures, early retirement provisions and differing abilities to amend the plans to benefit specific individuals or classes of employees, among other characteristics. The significant unfunded pension liabilities for these plans serve as a testament to the need for reform. The level of benefits are unsustainable, and a number of municipalities, including Central Falls, have failed to appropriately fund these systems, presumably because they were unable to afford to do so in the context of all other municipal spending needs.

Thus, the State Receiver recommends consideration of the enactment of laws of general application to:

- Standardize and consolidate pension systems across the State, with a focus on significantly underfunded plans. Doing so would lower costs, reduce the likelihood of abuse and could increase investment returns if MERS' historically stronger investment returns continue.[64]
- Analyze the potential of cost savings and other benefits from issuing pension obligation bonds to finance municipal unfunded pension liabilities as related to existing retirees.
- Develop a single system of health insurance for public employees. This would have a high probability of not only reducing administrative and management costs, but also the basic cost of the benefits themselves.

Minimum standards could also be mandated for employee benefits, including minimum cost-sharing between employers and employees, perhaps with higher contribution levels for employees and retirees.

[64] This recommendation relates to all independent pension systems. The City of Central Falls' pension system has produced slightly better investment returns than has MERS over the 2002-2009 period (see the Auditor General's 2007 and 2010 Reports). Much of this increase in investment performance has likely been consumed by the City's significant pension management costs, estimated to be one percent (1%) of assets on an annual basis (see Nyhart John Hancock Plan Report).

It is understood that these will be difficult discussions. Taxpayers and policymakers no doubt wish that these issues had been addressed long ago, when the pension and OPEB liabilities could have been handled at a much lower cost. Addressing these issues now, while difficult, will spare the State, its municipalities, public employees and taxpayers the much more severe action that will be required if these structural problems are allowed to continue unaddressed.

1. Unfunded Pension Liabilities

As previously discussed, reform of the City's pension systems will focus on the John Hancock Plan, as the 1% Plan is winding down and the MERS plan is being funded according to its required funding schedule. As noted, the John Hancock Plan benefit is unaffordable. Thus, it is necessary to evaluate what, if any, benefits may be gained from amending the benefit levels of the John Hancock Plan.

The State Receiver, working with the Employees' Retirement System of Rhode Island, engaged an actuarial study by Gabriel Roeder Smith and Company ("GRS") to ascertain the cost of transitioning active City Fire and Police personnel from the John Hancock Plan into MERS and to calculate the legacy cost of presently retired personnel under the John Hancock Plan. These studies, GRS Active Employee Analysis and GRS Inactive Employee Analysis, are attached as Appendix 23.

The GRS Active Employee Analysis examined a variety of options to restructure pension benefits, including:

- Shifting Police and Fire employees into the standard MERS benefit system.

- Shifting Police and Fire employees into the standard MERS benefit system with a 20-year retirement provision.
- Analyzing both options above with an optional cost of living adjustment ("COLA") applied.
- Analyzing a new, less generous pension benefit as part of an analysis to determine the scope of the City's pension funding crisis, incorporating a benefit structure that would:
    - Accrue benefits at one percent (1%) per year.
    - Allow retirement after twenty-five (25) years of service.
    - Calculate final average salary based on the average of the final five (5) years of earnings.
    - Provide for no COLA.

This research was conducted to determine if a shift to MERS or to MERS with a less generous benefit structure for current employees would create enough financial savings to resolve the City's financial problems. The results, contained in Appendix 23, demonstrate that none of the options are affordable for the City. Although a shift with respect to any option is less expensive, from a budgetary perspective none of the options address the cost of retiree pension benefits because a higher payment that is not being made would be replaced by a lower payment that would be required under law. Pension reform as outlined above is part of the solution; it is not the solution by itself.

Reform of municipal finances and operations will be required to stabilize the City and may also provide sufficient financial flexibility to fund the alternative pension benefit options described above. It should be noted, however, that the City is carrying a substantial deficit assuming no contribution to its largest pension plan, meaning that financial savings must be developed and applied to many areas of the City's operations and not merely to the Police and Fire pensions for active employees. Given the severity of this problem, it will be necessary to consider fundamental changes to the retirement benefit structure in Central Falls, including the possibility of securitizing the liability for current retirees and shifting active employees to a different retirement benefit program.

Understanding that a number of other municipalities are facing problems similar to the City's, and as the State itself grapples with its own unfunded pension liabilities, it would be appropriate to develop a single, coordinated reform package that applies simultaneously to both the State and the municipal levels of government. This undertaking will help to ensure a coordinated approach to a vast problem that could cause significant difficulty for both levels of government and could create substantial hardships for residents and businesses if left unsolved at either level.

As described previously, it is recommended that independent pension systems be consolidated into a single State-wide system, subject to strict regulation and oversight. This consolidation should be mandatory for low-performing or severely underfunded plans, but could be permissive for other plans. Even if consolidation is not effectuated, reform of pension funding and benefit levels should be considered, including:

- Increasing the age at which employees can retire with full pension and health insurance benefits.
- Limiting the amount of additional public sector employment income a retiree can earn once retired.
- Adjusting pension benefits based on projected social security benefits.

- Changing defined benefit pension plans from a primary source of retirement income to a baseline level which is supplemented by a defined contribution system in which the costs are shared by employers and employees.
- Strengthening provisions to prevent large temporary increases in wages from increasing the salary used to calculate retirement benefits. These provisions would reduce the likelihood that actions designed to increase pension benefits – such as temporary promotions, negotiated wage increases in the last several years of employment, temporary assignment to duties with additional compensation, and others – would be used to inappropriately augment pension benefits for the life of the retiree.
- Excluding non-salary items from consideration in establishing retirement-eligible income, including overtime and allowances.
- Given the prevalence of disability retirement in public safety positions, establishing a system of partial disability retirements, as occurs in the United States Armed Forces, to ensure that the City is not paying full disability retirement costs for employees who have less than complete disability and who can still work after retirement.
- Requiring periodic audits of all disability pensions to reduce the potential for abuse.
- Requiring a minimum of ten (10) years of service in any retirement system before an employee is able to transfer into that system the years of service earned in a less generous pension system. This would prevent employees from working twenty (20) years in a system that accrues a benefit of one and

one-half percent (1.5%) per year, for example, and then transferring into a system with richer benefits, only to retire shortly thereafter with all years of service calculated at the higher benefit level. This measure has important financial implications, but also ensures that employees who retire from a pension system with higher benefit levels actually provide a meaningful amount of service in positions covered by that system.

- Calculating retirement earnings based upon total career earnings rather than a final year's average. Alternatively, establishing pension benefits based on the average earnings over a number of years of service.
- Analyzing the possibility of the issuance of a pension obligation bond to fund the outstanding retiree pension liability to determine if this would reduce costs or provide other advantages compared to direct cash appropriation.
- Requiring regular financial stress-tests for pension systems, allowing only sufficiently strong systems to offer COLAs to retirees.

2. Collective Bargaining Agreements

As previously stated, the CBAs not only set forth the labor-management relationship, they also control the cost structure for most municipal activities. In Central Falls these CBAs have become unaffordable. Other municipalities have similar problems, but, unlike Central Falls, they have not yet 'run out of money,' making the problem less apparent and/or less public.

The State Receiver recommends the enactment of legislation of general application to balance the labor-management structure while requiring the adoption of sound modern business practices by local governments. At present, these issues must be bargained with union leadership. The lessons of failed municipalities have shown that modernization should not be solely a dynamic between the government and its unions; it should be something owed by both government and unions to the taxpayers who fund municipal operations.

The State Receiver recommends that the General Assembly consider the enactment of legislation that precludes any city or town from entering into or amending a CBA on or after July 1, 2011 that would include any of the following provisions:

- Any retirement benefits other than a standard pension system provided by statute with design characteristics as mandated therein and a so-called '457 deferred compensation plan.'
- Any additional health insurance benefits other than the standard benefits as defined by statute.
- Any minimum staffing or 'must fill' requirements in which employees must be called in to work regardless of the specific needs of their department.
- Any requirement that would prevent or disadvantage a regional service delivery model.
- Any requirement that would prevent the timely layoff or discharge of employees when said layoff or discharge is related to the unavailability of funds.

- Any requirement that would prevent or unnecessarily delay the reorganization or restructuring of a department.
- Any evergreen and/or automatic roll-over agreements.

Furthermore, if municipalities retain the authority to alter pension and OPEB benefits in their CBAs, the General Assembly should consider mandating that cities and towns require current and long-term financial impact analysis of any such changes before entering into the associated agreements. These analyses should be accompanied by a written certification from each community's finance director and chief executive officer that proposed changes are affordable in the short- and long-term.

The State Receiver also observes that CBAs tend to be accretive, which allows poor decisions from many years ago to burden taxpayers for years or decades to come. It may be appropriate to mandate that all CBAs be negotiated anew – not renegotiated, but negotiated from a 'blank sheet of paper,' as it were – every decade to ensure that bargaining agreements remain modern, commensurate with the municipality's ability to pay and in the best interests of the public.

3. Other Post-Employment Benefits

OPEB costs represent a significant financial liability for cities and towns and for the State of Rhode Island as a whole. The State should consider approaches to reduce the amount of this liability as well as the rate at which it is growing. To that end, it is recommended that the General Assembly consider mandating certain requirements pertaining to OPEB both for itself and for municipalities, such as:

- Require all governmental employers to ensure that Medicare is the first payor for health insurance claims for all eligible retirees.
- Eliminate OPEB for future retirees by only allowing retirees to purchase health insurance through their prior employer, with the retiree share of this benefit at one hundred percent (100%) of the premium cost. Preclude CBAs from including contrary provisions.
- Alternatively, mandate a schedule of vesting for retiree health insurance such that employees who retire with fewer years of service or who retire at younger ages pay a higher monthly premium cost for their retiree health insurance benefit than do those who retire with more years of service or at a later age. Limit the portability of prior service into a municipality for purposes of vesting in health insurance benefits.
- Require employee contributions, similar to funding for pension liabilities, for employees' future retiree healthcare costs.
- Pool all municipalities into a single State OPEB investment trust as suggested by the Auditor General to provide a diversified, professionally managed investment option for all municipalities[65], which may first require the standardization of benefits throughout municipalities. This option is already permitted, but not mandated, by State law. See R.I. Gen. Laws § 45-21-65.

[65] Auditor General's 2010 Report

B. Form of Government

As is apparent from the above analysis of pension, OPEB and CBA reform, these measures by themselves will not solve the fiscal crisis that exists in Central Falls. The following forms of governmental initiatives constitute additional options to address the City's fiscal problems.

1. Annexation

Annexation with an adjoining municipality is an option for addressing the fiscal crisis in Central Falls. The City is one of the most densely populated communities in the nation. It is also geographically a small community, encompassing approximately one and three-tenths (1.3) square miles. Such characteristics place high service demands on the City government and limit economic development opportunities, thereby restricting the City's ability to increase its revenues to meet these higher service needs.[66] Based on comments made to the State Receiver during the administration of the State Receivership, there appears to be some recognition on the part of local elected officials that Central Falls cannot afford to continue to exist as a stand-alone municipality.

Annexation would also represent an opportunity for fiscal improvement in the annexing municipality. The choice of annexing municipalities is typically limited to

[66] Higher population density can increase road maintenance needs by concentrating the same number of vehicles on fewer lane-miles of streets and by increasing the need for public safety and public health services. Geographically small communities with high population density also experience economic development challenges, as they are more likely to be 'built out' than a more rural community and often lack the 'green field' sites which are typically attractive to developers.

adjoining communities.[67] In the case of Central Falls, the choices therefore would be limited to the City of Pawtucket, the Town of Lincoln and the Town of Cumberland. In evaluating possible annexation candidates, it would first be necessary to determine which, if any, of the possible annexing communities would have the requisite population and scale to make the combination feasible. The population of each community is as follows:[68]

Table 10

Population Counts for Municipal Annexation Analysis

Municipality	Population
Central Falls	18,928
Pawtucket	72,958
Lincoln	20,898
Cumberland	31,840

Annexing the City into either the Town of Lincoln or the Town of Cumberland could create a significant disruption in the receiving community, as annexing Central Falls would significantly expand the community's population. This could disrupt services, as the population served by Cumberland would increase by fifty-nine percent (59%) after annexation, or by ninety-one percent (91%) for the Town of Lincoln.

The City of Pawtucket could more easily assume responsibility for serving the residents of Central Falls, as its service population would expand by only twenty-six

[67] It is also possible for the City to be 'annexed' into a new, regional municipal government that can provide all services to Central Falls and which can provide services to other cities and towns under contract. This overlay government would not require an existing municipality to annex the City and could present the opportunity for cost reductions and more professional management for communities that are too small to hire professional managers.
[68] Rhode Island City & Town Resident Population Estimates, Rhode Island Department of Labor and Training Labor Market Information, *available at* http://www.dlt.ri.gov/lmi/census/pop/townest.htm (citing U.S. Census Bureau)

percent (26%) in this scenario.[69] Significant areas of Pawtucket also match the urban environment found in Central Falls, which is not the case with respect to Lincoln or Cumberland. Furthermore, Pawtucket is an incorporated city as is Central Falls, unlike Lincoln and Cumberland, which are towns. Pawtucket also has an elected city mayoral and council form of government as does Central Falls. Furthermore, Central Falls and Pawtucket already work closely together in a number of areas, including public safety mutual aid.

Upon first consideration one may anticipate that Pawtucket would have little interest in considering the prospect of annexing a city that is burdened with fiscal insolvency issues and is in fact in State Receivership. However, several reasons may exist to substantiate an interest on the part of Pawtucket to proceed with evaluating annexation. First, post-annexation, Pawtucket would become the second-largest community in the State, surpassing the population of the City of Warwick. The size of the resulting city may open up new revenue streams for Pawtucket due to greater influence in State government and because its larger size and socio-economic indicators may be more attractive to grant makers. Second, as Pawtucket presently struggles with its own operating deficits in addition to the cost of CBAs and unfunded pension and OPEB liabilities, annexation may provide an opportunity for that city to address those problems in connection with the annexation process. Furthermore, Pawtucket could

[69] The suggestion has arisen from time to time that the City could be broken into three (3) sections and each of the three (3) adjoining communities could acquire its respective part of the City. The State Receiver does not support this strategy for three (3) reasons. First, the City would not be left intact geographically. Thus, community identity would be lost. If Pawtucket were to annex the City, the City would still have an identity within the City – just as Darlington is a defined area within Pawtucket. Second, it would be an odd and confusing result to have a community broken into three (3) municipal sections when the State-financed school district serving that population would remain intact but would span three (3) different municipalities. Capital budgeting, operations and other considerations would militate against such a result. Finally, the legal structure that would be necessary to facilitate such a three-way split would entail political dynamics that would make it difficult, if not impossible, to conclude such a transaction.

derive fiscal benefit from annexation through economies of scale realized from consolidation and added tax and revenue streams acquired from Central Falls.

The State would also be spared additional direct and ongoing expenses in subsidizing the City of Central Falls if it were annexed to another community. As a result, it would not be unreasonable for the State to financially incentivize Pawtucket to proceed with the annexation, as doing so will reduce the State's costs. That subsidy could take a variety of forms – direct appropriation, distressed community subsidy or targeted revenue-sharing in recognition of the benefits of annexation to the State – and could be granted for an extended yet limited period of time.

It is beyond the scope of the State Receiver's task and resources to establish the precise fiscal benefits to Pawtucket if annexation were to proceed. An extensive analysis would be required which most likely should be initiated by the Division of Municipal Finance of the Department of Revenue, in conjunction with elected officials and various departments of Pawtucket, the State Receiver on behalf of Central Falls, the General Assembly and such non-governmental resources as the State may deem necessary. In the first instance, however, a determination would have to be made regarding whether Pawtucket would have an interest in making such an evaluation. This interest would have to be explored with Mayor-Elect Donald Grebien, the Pawtucket City Council and Pawtucket's General Assembly delegation. It would also be necessary to consult elected officials serving Central Falls, including the City's General Assembly delegation.

Annexation may require voter approval, legislative authorization or additional endorsement by governing authorities of the annexing community and Central Falls. These requirements would have to be fully analyzed. The analysis would begin with a review of each municipality's charter. It would also include an analysis of the State Constitution home rule charter provision and reserved powers the State may have in setting the boundaries of cities and towns independent of such provision.

It should be determined in the early weeks of the 2011 General Assembly session whether there is sufficient interest on the part of Pawtucket to proceed with an evaluation as discussed above. If such an interest exists, the evaluation should proceed with all due haste. During the period of evaluation it would be necessary for the State to continue to subsidize Central Falls until the evaluation is completed and, if then proceeding to annexation, during the period of transition.

2. Charter Change / Regionalization

If annexation is not a viable option, regionalizing certain services in Central Falls must be considered to reduce their cost to the City. Municipal services will generally be more expensive in smaller communities given the fact that some costs – the cost of a police chief, for example – are somewhat fixed but are spread across fewer taxpayers. This disproportionate expense can be addressed either by expanding the number of taxpayers who pay for the same service, or by reducing the number of people involved in providing that service. Both options point to a regional service model, where municipalities share services, allowing continued service provision with fewer staff while also increasing the number of taxpayers who are paying for that particular service.

The Central Falls' Charter currently requires Council approval to procure services. Section 4-909 of the Charter and Related Laws provides:

> All contracts or award of bids or the privatization of any public or municipal service for the duration of more than eleven (11) months or in excess of $5000.00 require the approval of the city council.

However, there is no specific provision within the Charter or any City ordinance that specifically authorizes the regionalization of Fire, Police, public works or other municipal functions. A thorough review of the Charter, ordinances and CBAs, along with statutory collective bargaining provisions, would be necessary to ascertain what obstacles may exist regarding regionalization. It would likely be necessary to have strong enabling legislation of general application enacted by the General Assembly to make regionalization feasible. Moreover, any move toward regionalization may best be implemented at the expiration of the CBAs related to the services being regionalized (e.g., Central Falls Fire and Police CBAs expire on June 30, 2012).

In any event the regionalization section of the Charter should be strengthened as part of an overall Charter review process. This provision should also require permanent structures of professional municipal management in Central Falls. Hiring municipal management professionals would create a more positive outcome for the community in that managers lacking basic qualifications would be excluded from consideration by ordinance and/or by the selection committee.

Due to the City's fiscal challenges, the State should require it to conduct a Charter review process involving residents, businesses and other interested parties to determine the most effective and representative form of government for the municipality. The State Receiver believes that a council-manager form of government would be the most effective form for eliminating the ineffective culture of governance that has come to exist and for creating a model that is needed to produce and sustain the City's return to fiscal stability. Accordingly, the entire charter would have to be altered, as would the City's ordinances, to conform to this new form of government if it is adopted.

In summary, assuming as before that annexation is not a viable option, the State should consider requiring that the City pursue a Charter review calling for a council-manager form of government as a condition of State financial support of the City's operations. This direction will require carefully drafted legislation to be enacted by the General Assembly. The City expends significant State resources each year and will require further subsidies in the future. Requiring this review and a Charter change will help to ensure that funding is used efficiently and effectively.

3. Labor Mitigation Measures

Changes to stabilize and restructure the finances of Central Falls will necessarily impact its workforce. As mentioned previously, employee costs represent the largest share of expenditures in most municipalities; in Central Falls those expenses are sixty-eight percent (68%) of the City's budget. Restructuring (whether it comes through annexation, regionalization of services, or a reduction in personnel) will impact employees in meaningful ways, generally requiring changes to wages and benefits as well as the potential for reductions in the size of the public workforce.

While fiscal crises generally expose that employees were paid wages and benefits in excess of their employer's ability to finance them, this condition is not generally the fault of the individual employee. As such, it would be appropriate to consider ways to mitigate the impact of these reductions. Doing so will also help to improve the morale and therefore the productivity of the remaining workforce.

To mitigate the negative impacts of layoffs, the State should consider a variety of mechanisms to assist displaced employees. First the State should create a standard program for 'lateral transfers' that would allow active employees and those laid off due to budget shortfalls to transfer to an equivalent position in another municipality. This program should include:

- A statutory bar on any community entering into a CBA or other agreement that would limit the application or effect of this program.
- A time limitation on the period in which laid-off employees can be hired as a lateral transfer to that ensure municipalities do not unknowingly re-employ individuals whose skills have eroded due to prolonged unemployment.
- An approval process for active employee lateral transfers in which the 'giving' and 'receiving' department managers must approve the transfer.
- An approval process for laid-off employee lateral transfers in which the 'receiving' department managers must approve the transfer, including the right to conduct various tests to ensure fitness for duty.

As part of this program, the State should consider prioritizing or requiring the re-hire of laid-off personnel for a period of time to ensure that valuable work experience is not lost and to reduce the cost and inconvenience of training new employees.

Laid-off employees often possess important job-related experience and have often received extensive training and professional development. Hiring these laid-off employees can save significant time and money for municipalities, although these employees understandably must become accustomed to new policies, procedures and workplace environments. As such, the State may be well-served to consider a package of financial and other incentives for those municipalities that hire displaced employees. Such a package could include:

- Direct cash subsidies to entice municipalities to hire laid-off employees.
- Direct subsidies that improve a municipality's financial position, such as funding to reduce the municipality's unfunded pension liability, for each laid-off employee hired by the municipality.
- Allowing employees who are laid off but rehired within a short period of time to include the time period of their layoff when calculating seniority.

C. Deficit Reduction

In 2011 Central Falls is unlikely to close out its FY 2010 (prior year) deficit without State assistance. As previously discussed, the City cannot devise a plan to eliminate the deficit through annual appropriations within a five (5) year period, and it may also be unlikely that a long-term bond is a viable option for eliminating the deficit. (See Section II E) Therefore, State assistance will likely be required to facilitate the elimination of this $2.1 million deficit. The assistance could be extended in the form of a direct appropriation or a State guaranty of a City deficit reduction bond, subject to annual appropriation, either of which course would require legislation enacted by the General Assembly. It should be noted, however, that a State guaranty may be insufficient to successfully market a bond with more than a one (1) year maturity, given the requirement of an annual appropriation.

The State Receiver will submit to the Director of Revenue a specific plan whereby the State would assist Central Falls with the elimination of the FY 2010 deficit. The State Receiver intends to submit this plan by February 2011.

D. Efficacy of Chapter 9 Bankruptcy Proceedings

In the event that pension and OPEB reform, combined with governmental restructuring proposals, prove to be inadequate or insufficient to remediate the fiscal crisis that exists in Central Falls, or if the proposals recommended herein are not adopted, it may become necessary to consider a Chapter 9 Bankruptcy petition to address Central Falls' fiscal problems. Chapter 9 of the United States Bankruptcy Code is a vehicle designed exclusively for municipalities and certain other municipal governmental instrumentalities. It affords a distressed community protection from its creditors while it seeks to confirm a plan to adjust its financial obligations. Normally the plan of adjustment is filed with the bankruptcy petition, but there is a mechanism to petition the court for additional time to develop and propose a plan after a Chapter 9 case is filed.

Due to concerns surrounding sovereign immunity, a bankruptcy court has considerably less power over the administration of a Chapter 9 public debtor than it has over a Chapter 7, 11 or 13 private debtor. The function of a bankruptcy court in a Chapter 9 case is generally limited to determining whether a municipality is eligible to file, confirming a plan of adjustment and assuring implementation of the plan. It is anticipated that Central Falls would qualify as an eligible debtor under Chapter 9.

A Chapter 9 filing does afford a municipality the ability to restructure its obligations, including CBAs, pensions and other benefits. Thus, although the State Receiver is not presently aware of any written decisions or precedent discussing a municipality's attempt to reject or restructure its contractual, but unfunded, pension liability, it appears likely that Central Falls' unfunded pension liability relative to the John Hancock Plan and the underlying CBAs could be rejected or restructured via a Chapter 9 filing.[70] In bankruptcy this process of voiding or modifying existing contractual obligations is known as 'rejecting an executory contract.' If the City were to attempt to reject or modify the John Hancock Plan with a Chapter 9 filing, it would also be necessary to reject or modify the corresponding CBAs since the pension plan is incorporated by reference into each CBA. A Chapter 9 filing would not only provide an avenue of relief from the unfunded pension liability for those presently employed, but it would also extend to retirees since those obligations also fit within the definition of an executory contract recognized in Chapter 9.[71]

[70] The analysis is limited to the John Hancock Plan since it poses the primary problem for the City as it relates to unfunded pension liabilities.

[71] U.S. Code Section 365(a) provides that a "trustee, subject to the court's approval, may assume or reject any executory contract…." An executory contract is a contract in which performance remains due by both parties. At first blush, one might erroneously conclude that the obligation of a pension fund to a retiree cannot be rejected as an executory contract because the retiree has presumably completed his obligation to pay into the pension fund and performance remains due only by the pension fund to pay benefits to the retiree. However, Code Section 365 deals with executory contracts as a whole, not the obligations contained therein. The contracts at issue in this scenario are the pension plans. Ordinarily a union and/or employer will have a continuing obligation to pay into the pension fund while the pension fund will have a corresponding obligation to pay certain benefits. Thus, bankruptcy courts have found that pension plans constitute executory contracts subject to rejection under Code Section 365. See, e.g., In re The Bastian Company, Inc., 45 B.R. 717, 722 (Bankr. W.D. N.Y. 1985); In re McFarlin's Inc., 46 B.R. 88, 90 (Bankr. W.D. N.Y. 1985); In re American R. Co. of Porto Rico, 110 F. Supp. 45 (D.P.R. 1952) aff'd. 202 F.2d 149 (1st Cir. 1953).

Thus, municipalities may be able to rewrite pension plans, not only for those not yet retired, but for those who are retired and receiving benefits. In this same fashion, benefits afforded such as OPEB, namely retiree health benefits, are arguably alterable as well. However, the State Receiver is not aware of any Chapter 9 proceedings to date that have been used to modify the pension entitlements of existing retirees, although Chapter 9 seemingly permits such action. Furthermore, as previously discussed, the terms of a CBA as it relates to current employees could be rewritten.[72]

On the other hand, a Chapter 9 filing could also result in municipal debt obligations being rejected. Therefore, while Chapter 9 facially offers opportunities for a distressed community to manage its unfunded pension and OPEB liabilities, practically speaking, any such filing may be more damaging than helpful to the subject municipality. As previously discussed, the initial establishment of the Judicial Receivership created a state of concern among municipal bond underwriters and rating agencies that were performing services for the State and its municipalities. One need only imagine the state of concern that would arise within that industry if a State Receiver were to place a subject municipality into a Chapter 9 proceeding, in which executory contracts, including municipal debt obligations, could be rewritten by the court. Clearly a State Receiver should be cautious to embark upon a course that would threaten to impair the ability of

[72] It should be noted that a single Chapter 9 filing arguably could be used to modify the pension obligations of more than one distressed municipality. Assuming that Rhode Island has more than one distressed city or town with significantly underfunded and unaffordable pension obligations, it may be possible to establish a municipal governmental entity to serve as the obligor/administrator with respect to the various pension liabilities and to place that entity into Chapter 9 to facilitate a restructuring of the various obligations. Considerable legal analysis would be necessary in order to establish the validity of this approach.

the subject municipality, other cities and towns and/or the State itself to access capital markets needed in order to function.[73]

Thus, the question arises whether a municipal bond or note can be placed in a secure position to immunize it from rejection by the court in a Chapter 9 proceeding. Although bankruptcy cases are filed in U.S. Bankruptcy Court and federal law generally applies, state laws are at times applied in determining property rights. For instance, state law governing the validity of liens may apply when protecting certain property from creditors. Therefore, a state statute could be enacted that would arguably create a security interest in favor of bond holders as to future revenues, thereby allowing the lien to survive a Chapter 9 bankruptcy proceeding. Positive support for this proposition can be found in In re County of Orange, 189 B.R. 499 (CD. Cal. 1995), in which a state statutory lien was recognized against certain specified revenue securing tax anticipation borrowings. The State Receiver has prepared draft legislation that if enacted in Rhode Island would create such a statutory lien. (Appendix 26) Arguably, the statutory lien established thereunder would cause the obligation to be protected from rejection by the federal court in the event of a Chapter 9 filing here in Rhode Island. If the legislation were introduced into the General Assembly, it would be possible for the legislature to request an Advisory Opinion from the Rhode Island Supreme Court to confirm the validity of the lien created by that statute.

Even if the statutory lien were to survive judicial scrutiny, other factors (e.g. expense, delay and uncertainty of outcome as mentioned by numerous commentators on

[73] It should be noted that Central Falls is currently able to pay its bills, including payroll expenses, only through the issuance of a TAN through a local credit union which was willing to help the City.

this subject) may militate against the use of a Chapter 9 filing.[74] Given the many problems associated with Chapter 9 reorganization, even assuming the enactment of a statutory lien provision, a State Receiver should utilize this option only as a last resort. However, if no other viable solutions emerge to solve the City's fiscal problems, Chapter 9 may become a necessary option for Central Falls.

E. Wyatt Detention Facility

Reforming pensions, limiting OPEB liabilities and restructuring local government can make fundamental improvements in the fiscal performance and quality of services provided by Central Falls. Separate and apart from these changes, however, it will remain necessary to address the lack of impact fee payments made to the City by Wyatt. Fundamental flaws also exist in the current legal, management and operational structures of the facility that in turn create other substantial financial risks for the City. Assuming even a low probability of financial insolvency for Wyatt, the magnitude of the impact of an insolvency – both from a financial and an economic development perspective – is sufficiently serious to be of significant concern to the State Receiver.

Fundamental questions exist regarding the management structure of Wyatt and the propriety of a quasi-governmental corporation operating a detention facility. The authority to manage penal institutions is a significant responsibility, one most often entrusted to the public sector given the need for public influence and oversight in setting

[74] Chapter 9 is a Very Tough Slog, The Bond Buyer, by Dan Seymour, October 20, 2010, *available at* http://www.bondbuyer.com/issues 119_450/chapter 9_muni_bankruptcy-1018801-1.htm

safety and community standards. Similarly, detention is most often a public service function performed by federal, state or county – not municipal – governments. These services typically benefit from the broad base of policy, research, medical and safety resources that can be brought to bear by higher levels of government. Municipal and quasi-municipal governments generally lack these resources and expertise and are better served by engaging a state or federal governmental entity to provide detention services.

Returning to the question of financial stability, it is clear that the financial challenges faced by Wyatt are significant. External financial audits of the CFDFC have indicated since 2008 that serious concerns exist regarding Wyatt's ability to remain a functional entity. Audits in 2008 and 2009 have referenced continued technical default on the bonds that financed the construction and expansion of the detention facility itself. The loss of ICE as a client, and the inability to attempt to convince the agency to use Wyatt again, has resulted in a loss of an estimated $500,000 per month in revenue that has not been offset by referrals from other clients.

According to the 2008 financial audit, "This default along with the loss of revenue raises substantial doubt about the Corporation's ability to continue as a 'going concern.'"[75] The 2009 audit reiterated and expanded upon this concern:

> At December 31, 2009, the Corporation is in technical default of a covenant calculation contained in its bondholder agreement. The corporation has also incurred significant operating losses consecutively in 2009 and 2008. This default along with the consecutive losses raises substantial doubt about the corporation's ability to continue as a going concern.[76]

[75] Central Falls Detention Facility Corporation Financial Statements, December 31, 2008, Batchelor, Frechette, McCrory Michael and Company

[76] Central Falls Detention Facility Corporation Financial Statements and Supplemental Information, December 31, 2009, O'Connor & Drew, P.C.

According to the 2009 audit, Wyatt has approximately $104 million in bonds outstanding which, given their back-loaded structure, will cost more than $238 million when interest costs are considered. This represents a substantial financial burden – and a substantial financial risk – that is only magnified by the serious concerns expressed by the two (2) firms that have conducted independent audits for Wyatt. Combined with questions regarding the appropriate structure for detention services, it is recommended that the State undertake discussions regarding the future of Wyatt.

The State of Rhode Island has significant expertise in detention and correctional services. State control of the facility could address the concerns regarding management and operations that led to ICE severing its relationship with Wyatt. Returning to pre-cancellation occupancy levels with ICE would resolve all or a meaningful portion of the facility's annual deficit, although this contingency alone would not likely be sufficient to address its potentially problematic debt structure. State oversight would also provide a mechanism for controlling the cost of compensation paid to administrators, which itself currently comprises a significant financial burden on the facility. For example, the last reported annual salary of Wyatt's Chief Executive Officer appointed in December 2009 was $233,096, excluding benefits. In contrast, the reported total salary payable to the Director of the State Department of Corrections in FY 2011 is $149,925, excluding benefits.[77]

Given these financial and 'going concern' issues, the risk of $104 million in outstanding bonds and the overall structure of non-profit/local government management of detention services, it is appropriate for the State to consider legislation that would

[77] State of Rhode Island and Providence Plantations Personnel Supplement, Fiscal Year 2011, Donald L. Carcieri, Governor, *available at* http://www.budget.ri.gov/CurrentYear/PersonnelSupplement.php

allow it to assume responsibility for and control of Wyatt. This would allow oversight of the facility by detention and correctional experts and could address in the near term the financial issues faced by the facility. The changes would also negate the present requirement that directors must be residents of Central Falls, thereby expanding the pool of individuals who could be drawn upon to provide the necessary expertise and knowledge to perform the fiduciary duties of a director.[78] Doing so would also be consistent with the authorizing legislation that allowed the construction of Wyatt. That legislation sought to achieve an economic development goal for the City. Wyatt's failure to make impact fee payments to the City has defeated the benefit initially sought by the City in hosting Wyatt. State management and operation are likely to successfully address this issue, given the breadth and depth of experience and institutional support it would bring to this role. Furthermore, as previously noted[79], the debt structure associated with Wyatt could most likely be improved, and costs reduced, with a State takeover.

F. The Path to Solutions

It is difficult to formulate a single path for addressing long-term fiscal viability for Central Falls. As reflected in the discussion and analysis contained in this Report, a given direction taken within one area of reform can alter or negate the direction that may be taken regarding other possibilities. This difficulty notwithstanding, it is essential that

[78] Even if the State declines to assume control of Wyatt through legislation, the State may wish to consider amending the Detention Center Act to allow non-residents of Central Falls to serve on the board of directors.
[79] See footnotes 58-60, *supra*

the State's policymakers embrace a range of solutions that include the three (3) basic areas of reform:

- CBA, pension and OPEB reform measures, including how the impacts of such measures should be allocated among prospective employees, present employees, future retirees and existing retirees.
- Reorganizing Wyatt as a governmental entity in order that it can fulfill the economic development objectives originally contemplated, including making significant impact fee or other payments to the City.
- Annexation of Central Falls by the City of Pawtucket or, failing that, designing and implementing a broad regionalization of City services with adjacent communities, rather than having such services continue to be provided by the City itself.

The State Receiver has recommended a broad range of specific reforms for consideration, allowing policymakers to become better informed about the issues and challenges facing Central Falls and other municipalities. Once these policymakers have embraced an overall strategy for addressing the City's problems, a critical path analysis could be designed that would outline the tasks that must be completed and the most efficient timeline for completing them in order to restore fiscal viability to Central Falls and to minimize the expense to the State in attaining that result.

IV. CONCLUDING REMARKS

Through the deficit reduction actions previously described, the State Receiver has been able to avert the City's fiscal insolvency in FY 2011, subject to such additional assistance as will be needed from the State to resolve the FY 2010 deficit of $2.1 million. The stabilization of the City through FY 2011 will allow time for Governor-Elect Lincoln Chafee and the General Assembly leadership to address the long-term structural problems that have been identified in this Report. As previously discussed, solutions to these problems will require that the State act aggressively to mitigate the unfunded pension and OPEB liabilities that burden the City. Legislative solutions necessarily must be laws of general application to all municipalities; such legislation thus will have the added benefit of assisting other cities and towns in addressing similar problems. Unfortunately, mitigation of unfunded pension and OPEB liabilities by itself will not restore the City to fiscal soundness. Efficiencies to be derived through governmental reform will be necessary as well.

The possibility of annexation must first be explored in the immediate term. If that option is not deemed to be feasible due to the annexing municipality's unwillingness to proceed, the inability of the State to provide sufficient financial incentives to facilitate the annexation, or the conclusion that such option would not result in a fiscally sound municipality, the next option that should be explored is the regionalization of services, such as Fire and Police, with another municipality. This process could be achieved through enabling legislation. It could also be implemented through a Charter change for the City that would simultaneously strengthen the ability to regionalize and effectuate a much-needed change to a council-manager form of government. Since annexation or regionalization with Charter change will require time to plan and implement, some form of State subsidy would also be required during the intervening period.

Finally, if none of these measures prove to be viable or are insufficient to address the City's long-term fiscal problems, then a Chapter 9 filing, preferably after the enactment of a 'Securitization of Municipal Bonds' statute, must be considered as the action of last resort. If this option were not utilized, having exhausted all other possibilities, the State would have no choice but to indefinitely appropriate sufficient funds to prevent the City's fiscal collapse.

The State Receiver acknowledges that these proposals pose significant challenges in Central Falls and throughout the State for CBA members and their union representatives. However, if a solution to structural deficits, which must include pension and OPEB reform, is not fashioned, the very obligations that unions and their representatives seek to protect are at certain risk of default or court-mandated modification through a Chapter 9 proceeding.

It has been an honor for the State Receiver to have had an opportunity to serve in this capacity, working together with local leaders, including union members. This process has been difficult, given the uncertainty faced by the City's elected officials, employees and citizens since the inception of the Judicial Receivership and the State Receivership that followed. Although considerable disagreements have developed with many of these individuals during the course of the State Receiver's tenure, genuine thanks are extended to many individuals who did not allow disagreements to devolve to a level of incivility. In fashioning the options herein presented, the State Receiver is mindful that many of them may ultimately serve as a template for that which may eventually be legislated. The specifics of any such legislation and the implementation of solutions may follow different courses. Evolution toward a specific solution is not only understandable, but is an essential part of the legislative process.

One conclusion, however, is inalterable: the structural solutions for long-term fiscal stability for the City's residents will not be achieved until the problems causing the serious fiscal instability are addressed at both a City and a State level. It is clear that the State cannot allow the City to default on its obligations given the adverse impact such a default would have on the ability of other municipalities and the State to access capital markets. It is imperative that Governor-Elect Lincoln Chafee, Speaker Gordon Fox and Senate President Theresa Paiva-Weed determine a course of action in the early weeks of the 2011 General Assembly session so that there is an opportunity to do the critical path planning and financial modeling that will be necessary to timely execute the component parts of the selected overall solutions. Those solutions, whatever form they may take, will also lay the groundwork for averting similar crises in other municipalities throughout the State.

Respectfully submitted,

/s/

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