



STATE & LOCAL GOVERNMENT  
LEADERSHIP CENTER

## Providence Executive Summary

In March of 2011, just a few months after taking office, Providence Mayor Angel Taveras declared that the city was experiencing a “Category 5” fiscal hurricane. Less than a year later, he announced that the city was on the brink of bankruptcy. Taveras and city officials addressed a two-year, \$180 million budget gap through layoffs and attrition, school closures, other service cuts, a modest tax increase, major concessions from the city’s unions, and extracting voluntary payments in lieu of taxes from the major nonprofits in Providence.

These actions came against the backdrop of state takeover and, ultimately, the Chapter 9 bankruptcy of tiny Central Falls. The impoverished city of 19,000 was the first rescue attempt under the Rhode Island Fiscal Stability Act of 2010, with two more communities following shortly thereafter, and several more currently teetering on the edge.

The experiences of these distressed Rhode Island communities yield important lessons about confronting a fiscal crisis:

- **Laws and ordinances need to show a clear way out.** Though the state did not get involved in the City of Providence, the Fiscal Stability Act showed the alternative had Mayor Taveras not taken the helm and dealt with the problem head-on. The city’s 2012 ordinance related to salary and benefits laid the legal groundwork for the renegotiations with the unions.
- **Exposing the extent of the problem is a big part of getting people to the table.** Mayor Taveras’s Municipal Finances Review Panel and another report by the Internal Auditor (commissioned by City Council) showed inarguably just how bad things were. The Mayor willingly handed over every forecast, document, or other set of numbers that the unions or any other negotiating partner asked for.
- **Spread the pain.** All parties were required to sacrifice to deal with the city’s problems, through programmatic cuts, tax increases, and negotiations with all employees and retirees. People do not mind making sacrifices as long as they know they are not being singled out.
- **Take the long view.** After decades of contracts that ultimately proved unsustainable, labor leaders no longer held out for the sweetest deal, but the one that provided some security.

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### *Introduction*

*“I thought we were maybe at a Category 3 hurricane. We’re a Category 5. It’s much worse than I expected.” - Providence Mayor Angel Taveras, on the city’s financial conditions in early 2011*

On February 24, 2011, Providence Mayor Angel Taveras sent pink slips to all 1,926 teachers in the Providence Public School District, alerting them that their jobs would be terminated at the end of the school year. City officials faced a \$57 million shortfall, with the schools facing between a \$28 and \$40 million gap, and the Mayor had already indicated that school closures were necessary. The head of the

teachers union likened this move to the Japanese attack on Pearl Harbor, and teachers protested in the streets. Three months later, pink slips to 78 police officers followed after unsuccessful negotiations to the police and fire unions.

*How did things get so bad in Rhode Island's capital and largest city?* There are two answers here. The short answer is that the city's expenditures and revenues were misaligned. The Great Recession brought a double-whammy of declines in property taxes and a major loss in state aid -- forcing officials to deplete reserves and use other one-time fixes to address ongoing expenses. The city was spending a disproportionate amount on labor and retirement.

The long answer is a familiar story in other Northeastern and Midwestern cities: a one-time industrial hub with a vibrant manufacturing and trade-based economy, the City of Providence has suffered through major economic shifts, population loss, erosion of the tax-base, a heavy mafia presence, and a corrupt mayoral administration. Add to this mix the major influence of organized labor in the political landscape. The city's had a history of unrealistic labor contracts influenced by its industrial past and it was spending too much on retirement.

The problems facing Providence are familiar to Rhode Island, where lawmakers passed several historic pieces of legislation in 2010 in order to address what was viewed as a growing "epidemic" of local fiscal stress by state officials. Though Providence leaders were able to address that city's problems without state intervention, three smaller communities – Central Falls, East Providence, and Woonsocket – were simultaneously receiving varying forms of help from the state. The experiences of Central Falls in particular may have provided some political impetus toward Providence's fiscal recovery.

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### *Assessing the Storm's Damage*

Upon taking office in 2011, Mayor Angel Taveras's Administration was aware that the city's finances were under stress. Unable to come to consensus around a 2011 budget, though it was seven months into the fiscal year, City Council members had expressed serious concerns about the financial conditions of the city. Taveras's first official action in office was to create a Municipal Finances Review Panel, with representation from state, city, and business community.<sup>1</sup> The panel was convened to "expeditiously review the current financial condition of all city departments" – including all "revenues, expenditures, liabilities, obligations, arrearages, projections, assumptions" in order to determine the city's near-term (two-year) budgetary outlook.<sup>2</sup> Their findings revealed dire financial straits<sup>3</sup>:

- A structural deficit of \$70 million for FY2011 and \$110 million for FY2012 – on a \$638 million budget for the city;
- A heavy reliance on one-time fixes such as depleting reserve funds – leaving the city with a total of \$8.4 million in reserves, or a little over 1 percent of the budget, down from over \$70 million in 2008 (over 10 percent of the budget);
- An \$828 million unfunded liability in the city's pension fund (a 34 percent funding level) which covers all employees except teachers, who are in the statewide system;
- Other Post-Employment Benefits unfunded liability of \$1.5 billion.

In FY2011, the city's requirements for pensions and other retirement programs together ate up nearly a fifth of the city's general fund and 37 percent of the property tax levy – and the city did not even pay the required contributions in full.<sup>4</sup>

City officials viewed the report's findings as a call to action. Though the Administration was aware the city was under stress (a top aide estimated a \$60 million gap for the current fiscal year 2011), these numbers indicated a true financial crisis. As Mayor Taveras put it, "I thought we were maybe at a Category 3 hurricane. We're a Category 5. It's much worse than I expected."<sup>5</sup> As described in this report, addressing the situation was extremely difficult -- requiring tough negotiations, sacrifices from all stakeholders, and no small amount of political capital. And the journey was not without setbacks. Despite progress in 2011, by early 2012 the city was months away from running out of cash, and the Mayor and at least one city council member openly talked about bankruptcy, especially after a key pension reform was thrown out by a court in 2012.<sup>6</sup>

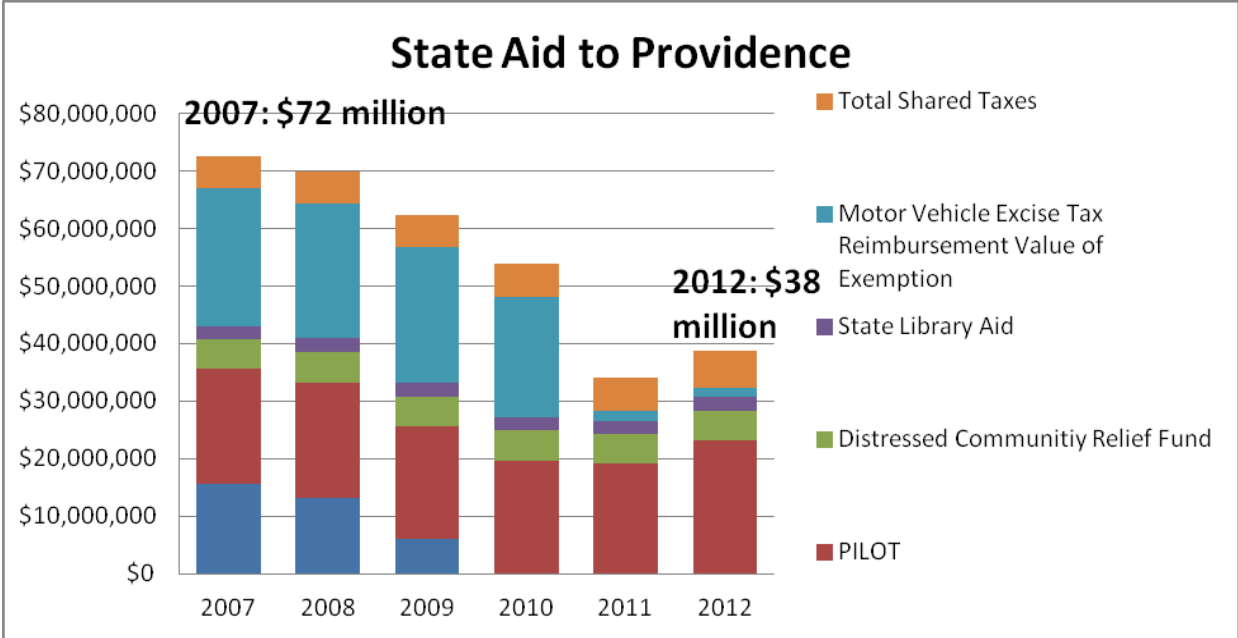
## *The Cause of the Problems: The Short and Long of It*

### *Short-Term Causes*

How did things get so bad in Providence? Two reports – that of the Municipal Finances Review Panel, and a second, later report commissioned by city Council – found that much of the damage had been incurred as the previous Mayor dealt with the fall-out of the Great Recession: a 50-percent cut in state aid and steep declines in city fees and property tax revenues. But as city officials pointed out, not all of the problems were related to the economy. Many issues were “self-inflicted” – including the lack of transparency surrounding the extent of the city's problems.<sup>7</sup>

The Review Panel interviewed departmental staff in order to evaluate where operations to date stood compared to the 2011 budget, on both the revenues side as well as spending. Though the panel did not conduct an official audit, their scrutiny uncovered major discrepancies between the budget and the real world. The panel also identified large unfunded liabilities in the city's retirement systems, as well as inefficiencies in employee healthcare systems.

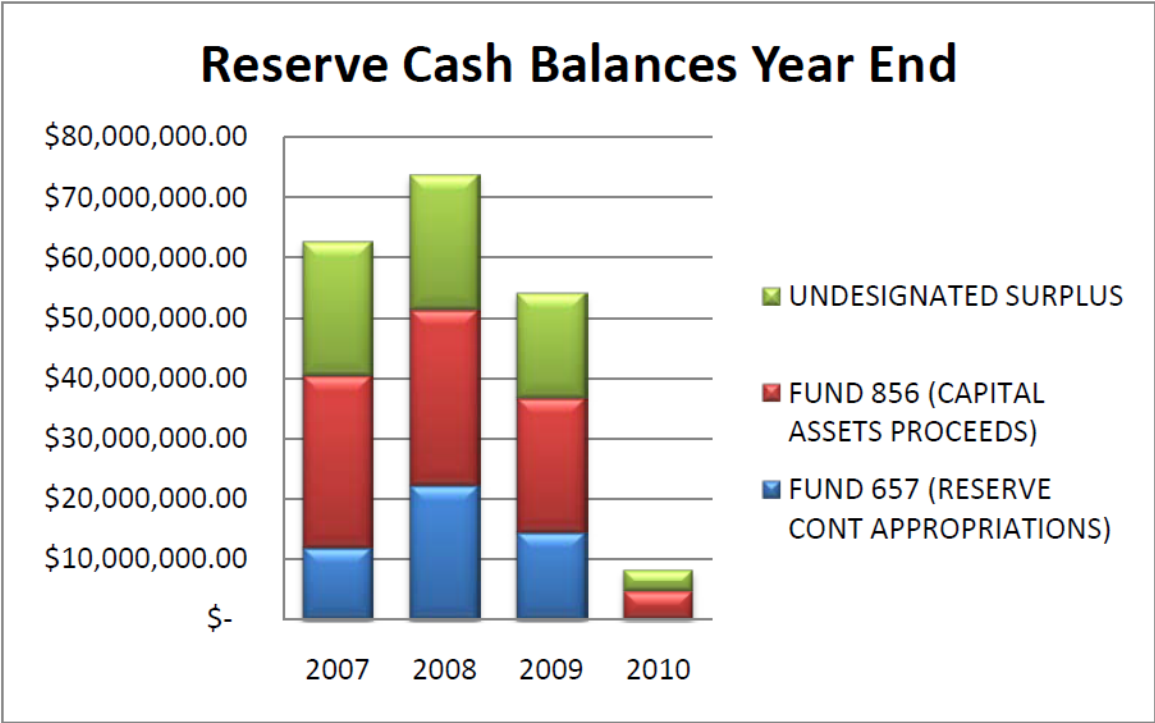
**The Great Recession's scars.** Providence relies on state aid for 40 percent of its budget.<sup>8</sup> It is one of four state-designated “distressed communities,” which qualifies it for state Distressed Communities Aid – about \$5 million annually (see sidebar: “The Specter of Central Falls” for more on how the state of Rhode Island helps cities and towns), or less than 1 percent of the city's budget.<sup>9</sup> The majority of the money that the city receives from the State was cut as Rhode Island struggled through the Great Recession. Statewide, general revenue sharing was cut in half in FY2009 and eliminated entirely in FY2010, a loss of about \$13 million in Providence. Including education aid, state aid to localities was cut 20 percent between 2008 and 2013.<sup>10</sup> Over five years, Providence's share of state aid and shared taxes declined from \$72 million in FY2007 to \$34 million in FY2011. The steepest cuts to the city came not in direct state aid but in the loss of the state reimbursement for motor vehicle excise taxes: it had provided over \$23 million annually for Providence, and was down to \$1.3 million in FY2011.<sup>11</sup> See the chart below for a look at the State's aid to Providence.



Between 2007 and 2012, state aid to Providence was cut nearly in half. Motor vehicle reimbursement and general revenue sharing were cut entirely. Data are from the Rhode Island Department of Revenue.

**Revenue projections were off.** The 2011 revenues that the panel projected were \$17.4 million short of the budgeted amount, and the 2012 revenue shortfall was even starker at \$57.7 million. Back tax collections were off by \$2.5 million, a 23 percent variance from the \$11 million the city budgeted; the city had also budgeted almost twice as much in PILOTs from the state, colleges and hospitals than were actually to be collected (\$1.7 million compared to a budgeted \$3.6 million). The 2011 budget also included \$2.8 million in interest from investments – a funding stream that according to a separate report, totaled only \$252,000 in 2010. An error similar in nature surrounded the fees the city expected to collect: these totaled \$6.17 million in 2010, falling \$1.7 million short of the budgeted \$7.85 million, but the city’s 2011 budget still allowed for \$7.5 million despite the fact that economic conditions had not improved.<sup>12</sup> Even proportionately small errors added up: the budgeted amount for current tax collections were off by half a percent – an admirably small error for a revenue estimate, but a \$1.6 million one nonetheless.

**The budget depended on one-time revenues.** The bulk of the two-year revenue shortfall that the panel exposed came from the heavy use of one-time fixes to address ongoing expenses. The 2011 budget included \$48 million in transfer from the Capital Assets Reserve – a \$6.8 million shortfall in 2011 and a one-time source that would not be available in 2012. A second report found that the city had all but depleted its reserves – including not only the Capital Assets Reserve, the use of which City Charter limits to paying down debt service and making infrastructure improvements, but also its undesignated surplus “rainy day fund” and a third reserve fund called the Reserve Continuing Appropriation.<sup>13</sup> The chart below shows the balances of these funds for the period 2007 through 2010.



From the Corrective Action Plan to Restore Sound Fiscal Management, page 6.

**Expenditures were over budget.** Some of the most significant variance on the expenditure side of the ledger came from labor-related costs, for at the local level of government, most of the budget is comprised of labor-related costs: salaries, wages, and benefits, etc. Salaries for 2011 were already \$3.4 million over budget due to an unbudgeted dental care insurance coverage, and for 2012 stood to be \$4.3 million over budget due to health insurance increases.<sup>14</sup> The city’s 2011 budget counted on \$3.6 million in union concessions, which were entirely unrealized.<sup>15</sup>

**Pension liability.** The city’s retirement system covers all employees except teachers, who belong to the State Employees’ Retirement System. In 2011, the city’s retirement system was only 34 percent funded, and faced an \$828 million funding gap. The projections for post-retiree healthcare were even worse: a nearly \$1.5 billion unfunded liability, a less than 1 percent funded ratio. The Review Panel’s report stated that “The poorly funded status of the plan is the result of inadequate funding in prior years (failure to make 100% of annual required contributions), generous benefits and cost of living increases, liberal disability pension provisions and the ability to collect benefits at an early age.”<sup>16</sup>

City of Providence: Pension and OPEB Plans		
	Retirement System Status as of June 30, 2010	Retiree Healthcare (OPEB) Plan Status as of June 30, 2009
Actuarial value of assets	\$427,891,000	\$1,040,000
Actuarial value of liability	\$1,256,375,000	\$1,498,491,000
Unfunded accrued actuarial liability	\$828,484,000	\$1,497,451,000
Funded ratio	34%	0.07%
Net obligation*	\$132,767,000	\$53,983,000

\*The amount that was not contributed to the plan that should have been to meet the annual required contribution.

**Unsustainable Growth in Annual Required Contribution (ARC).** The city's outlays were \$109 million in FY2010, 18 percent of the total city budget and 37 percent of the property tax levy. If the city had paid 100 percent of its ARC for OPEB, the expenditure would have been \$150 million – 24 percent of the city budget and more than half of the property tax levy. The ARC was projected to grow dramatically for the next 25 years, surpassing \$210 million in 2039.

**Healthcare Inefficiencies.** Because of the variety in the collective bargaining agreements with different groups of employees over generations, the city was operating with more than 60 different health benefit plan options (six for the active employees, and dozens for the retirees).<sup>17</sup> Additionally, city employees' copays were low when benchmarked against municipal employees in the State retirement system. These inefficiencies were a major cost-driver for the city.

### *The Long Story*

Though the actions of the previous administration and a lack of transparency surrounding city finances may have exacerbated the problems, there is no question that Mayor Taveras inherited an albatross – as did Mayor Cicilline before him. The story of how Providence's finances deteriorated is long and complicated.

**Long-term economic shifts.** From its settling in the 1630s through the early 19th century, the city of Providence enjoyed unchecked economic growth—serving first as a major trade hub for cotton, rubber, metals, and slaves and sugar in the Triangle Trade, and then as a manufacturing center for textiles, tools, jewelry, and machinery. With skilled and unskilled jobs abounding, waves of foreign workers arrived to shape Providence's population in an "immigrant ballet," as one unofficial local historian described it. In the end of the 19th century, nearly two-thirds of the Providence population was foreign stock (foreign-born and their native children). As the workforce grew, it also organized; the Knights of Labor first arrived in 1882, with other major unions following later. The Great Depression hit the city hard. Even before the stock market crash of 1929, the local economy struggled as plants and jobs moved south and abroad for lower costs of business. This long-term stress was magnified by the hollowing-out that occurred in many Northeastern cities in the 1950s. The city's population was 248,674 in 1950, but it had dropped to 179,116 in 1970 – a loss of 28 percent and the steepest decline of any city in the US for the same period. It has hovered around this level ever since.

Today, Providence and other Rhode Island cities and towns remain sensitive to economic downturns; 25 percent of Providence residents live in poverty, and the metropolitan area's unemployment rate, while down from a recessionary peak of 12.5 percent, is still nearly 10 percent (compared to 7.5 percent nationally).<sup>18</sup>

**Revenue erosion.** The city relies heavily on state aid (about 40 percent of revenues) and on property tax (more than half of general and school revenues).<sup>19</sup> The cuts in state aid were discussed above. While the expansion of healthcare and higher education sectors has been critical to Providence's economic transition, it has sharply eroded the taxable property base. The city relies heavily on major non-profit employers – universities and hospitals comprise eight of the ten largest employers in the city.<sup>20</sup> There are over 3,000 non-profit public charities in the City of Providence.<sup>21</sup> Nearly 40 percent of the city's property is tax-exempt, thanks to the sprawling presence of higher education institutions such as Brown University and state government buildings, and the assessed value of this property is over \$3 billion. The state distributes PILOT at 27 percent of the taxes that would have been collected on this property, amounting to \$23 million in 2011.<sup>22</sup> Services provided to these non-profit institutions are estimated at between \$36 and \$41 million annually, leaving about a \$13-18 million funding gap.<sup>23</sup> According to a nine-member commission charged with examining the city's tax structure, Providence also has relatively high homestead and rental exemptions, and has disproportionately shifted the burden from residents to commercial/business taxpayers – an impediment to investment and growth.<sup>24</sup> In fact, a recent national study found that Providence has the highest commercial tax rates of any city in the country.<sup>25</sup>

**“The Rogue Retirement Board”.** Providence has a long and storied tradition of labor disputes, with disruptions mounting through the decades—from garbage rotting on city streets in 1981 (though sanitation workers were not legally allowed to strike), to the cancellation of a visit by the Obama Administration in 2009 after the Local 799 (firefighters) threatened to protest.<sup>26</sup> In 2009, confronting a \$17 million deficit due to cuts in state aid and underperforming city revenues, Mayor Cicilline won some concessions with the teachers union and Local 1033, which includes City Hall employees, and 2010 brought an even tougher round of negotiations with the Local 799 of the International Association of Firefighters and Fraternal Order of Police. The eventual agreement with Local 799 was particularly hard won, as the firefighters had operated without a contract since 2001.<sup>27</sup>

Under Rhode Island law, labor disputes with public safety employees are settled in arbitration. The contract arbitration processes with fire and police unions had resulted in a continuation of some of the factors that drove the city's costs up the most, in particular the 5 and 6 percent compounded COLAs that were greatly inflating the pensions of some 775 municipal retirees.<sup>28</sup> These COLAs were agreed to in 1989, when a labor-majority city pension board voted for 5 and 6 percent compound COLAs, despite their expense. The Board also lowered the number of years of minimum service from 25 to 20. In 1991 the Cianci Administration signed these into law via consent decree, making them irreversible when – just five months later – the state Supreme Court ruled that the pension board did not, in fact, have the authority to change COLAs. State lawmakers also played a role in sweetening city employee benefits, dating as far back as 1977 when legislation passed that tipped the balance of the Retirement Board toward the unions and away from the city. In 1983, when city officials called upon home rule to force the state to stop interfering, the Board changed from one that implemented policies set by City Council to a policy-making body in its own right.<sup>29</sup>

In 1989, the police union signed a collective bargaining agreement that for the first time included a 6 percent compound COLA.<sup>30</sup> Nine years after Cianci signed the law, the Supreme Court finally settled the matter: the 6 percent compounded COLAs would stand for all public safety employees who retired prior

to 1991; general employees would get 3-percent compounded COLAs. After 1991, all public safety retirees would get 3 percent simple COLAs on the first \$12,000 of their pensions, while other employees would not be entitled to a COLA.<sup>31</sup> This turn of events, when coupled with the city's failure to pay its full annual required contribution, laid the groundwork for the pension funding level to drop from 57 percent in 1991 to 34 percent in 2010. In 2011, the extent of the damage was made clear when the Mayor's office published the names of at least twenty retirees whose pensions were well over \$100,000. One retired fire chief was bringing home at least \$196,000, in tax-free accidental disability payments; he had collected at least \$2 million from the city over the previous 20 years.<sup>32</sup>

Local governments spend most of their expenditures on people. Salaries & benefits, overtime, vacation time, sick leave, disability, pensions – the costs add up. In Providence, as in any local government – or any organization, for that matter—there was room for inefficiency and even abuse. An investigation revealed that the cost of unused sick and vacation time was \$32 million—money that came from current salaries line-items, meaning positions would need to remain open annually until the money is paid out, estimated at \$2-3 million per year.<sup>33</sup> Another investigation found that almost half of the \$29 million that the city was paying annually on pensions was going to accidental disability payments, which are tax-free.<sup>34</sup> The city is self-insured and spends \$95 million on health insurance for its employees, and has no monitoring mechanism to identify whether covered individuals are eligible or not under the plans offered.<sup>35</sup> Because of the laws protecting employees, it can be an extremely complex undertaking to address labor cost-related issues. The teacher pink slips are a good example. Faced with certain school closures, Taveras claimed that it was necessary to terminate rather than lay-off the teachers because of uncertainty around a state law that makes it illegal to hire based on seniority. Would the same law prohibit laying off based on seniority? Additionally, the teachers' contract stated that laid-off teachers would automatically enter into a substitute teaching pool which granted them paid sick leave; if, hypothetically, one of these full-time substitutes were called upon to fill in for a sick teacher, but happened to be sick that day, then the city would have to pay a temporary substitute to teach that day – essentially paying three people to teach for one day.<sup>36</sup> City officials estimated that this would in fact increase the city's costs rather than decrease them, leading to the decision to terminate rather than lay off. Most teachers were rehired in time for the 2011-2012 school year, following a new contract which limited sick days (among other concessions).

### *“Necessary, but not sufficient”: Addressing the Crisis*

Though a new state law allowed for a clear plan for state assistance in dealing with financial crises, the newly elected Mayor was determined to avoid state intervention and the resulting stigma of distress and potential bankruptcy. Once the panel identified the sizable gaps that needed to be filled, Taveras and his staff undertook to fill it by every means necessary – a two-year dance on the brink of financial ruin, with each action “necessary, but not sufficient” on its own to chip away at the gap.<sup>37</sup>

- **\$18 million** in savings: \$6 million each in new contracts with police, fire, and 1033
- **\$16 million** in savings from a new teacher contract
- **\$18 million** in savings from pension and healthcare reforms
- **\$15 million** through “other” measures

These measures produced a combined \$67 million in savings. The remainder of the \$110 million gap was closed on the revenue side, through fee and property tax increases and payments from non-profits. The major actions taken and obstacles overcome are described below.



**Labor contracts.** Cicilline’s 2009 and 2010 contracts with city unions were purported to save money, but were unsustainable based on the shortfalls identified by the panel. The newly-elected Mayor opened these contracts up again to gain some concessions from the employees. The Local 1033 – general employees – was the first to come to an agreement, for a four-year savings of \$26 million. In May of 2011, after failing to reach a deal with the police, Taveras threatened to lay off 78 officers. The police and firefighters reached a deal shortly thereafter. On the heels of the Central Falls bankruptcy filing in August 2011, and just in time for the new academic year, the Mayor and teachers union also came to agreement over a contract that saved \$54 million over four years through fewer sick days and other concessions. In these contracts, the city included a clause allowing for “suspension” of retiree healthcare coverage in the event that the employee or spouse has access to other coverage.<sup>38</sup> This clause did not apply to current retirees, who were not in the union.

**Pension & retiree healthcare reforms.** In early 2011, the General Assembly passed a law allowing Providence and other cities with locally-administered pension plans to move retirees to Medicare even if their original contracts promised them health coverage for life. In July of 2011, the city passed an ordinance to allow for this transition (requiring police and fire retirees to enroll in Medicare and precluding the requirement to pay the coverage gap between Medicare and the city retirement benefits), then informed 283 retired fire and police who were eligible for Medicare that they would no longer receive lifetime health benefits through the city’s plan. These retirees filed suit against the city in a class action lawsuit claiming that the move was illegal and in January of 2012, Superior Court Judge Taft-Carter sided with the retirees, granting them an injunction that blocked the city’s move on the preliminary grounds that it violated constitutionally-protected contracts with the retirees. On the heels of this defeat, and after the state of Rhode Island’s 2011 pension reform law did not go far enough toward giving the city the tools it needed to deal with the pension liability (Taveras and other mayors had wanted the state’s backing in getting rid of 5 and 6 percent compounded COLAs for retirees, among other cost-drivers), city officials passed an ordinance in April 2012 that changed retiree pensions – in particular, capping pensions and eliminating the COLAs.<sup>39</sup> The ordinance laid the groundwork for more negotiations. In a second round of talks with fire and police unions, and this time with retirees, Taveras extracted another round of concessions, including the move to Medicare, a cap on pensions, a 10-year suspension on COLAs, and the elimination of the 5 and 6 percent compounded COLAs.<sup>40</sup> Because the city’s retirees are no longer represented by unions and are not organized, each individual retiree had to sign onto the agreement. Most of the 1300+ individuals signed on, with around 70 opting out of the settlement and persisting with legal action on their own, and in March of 2013 the suit was dropped.<sup>41</sup> The deal saved the city over \$18 million in one year and reduced the unfunded liability by \$170 million.

**Cuts.** Taveras took a 10-percent pay cut upon taking office, and implemented an immediate 10 percent across-the-board cut to agencies, to be applied how department heads saw fit. The goal was to continue to deliver services while trimming budgets where they could. This meant that cuts needed to come through the payroll, which accounts for more than 70 percent of spending.<sup>42</sup> City agencies shaved over 200 positions through attrition and laying off of 10 percent of non-union employees, for a savings of over \$1 million, but the bulk of savings in each department came through the renegotiated contracts with labor and the major pension and healthcare changes.<sup>43</sup>

**School closures.** The Mayor announced early on that he would need to close at least four schools due to budget problems and a drop in enrollment, for a savings of between \$3 and \$4 million.<sup>44</sup>

**Revenue increases.** In 2011, City Council passed an ordinance requiring homeowners to register their cars at their home address in order to receive the city's 50 percent owner-occupied homestead exemption – both reducing the number of exemptions and adding to the car registration rolls, and adding \$4.8 million in revenue. City officials also raised commercial property tax rates. Taveras was able to hold the line on school funding through the State's accelerated funding for school aid for distressed communities.

**Payments from non-profits.** In January 2012, though the Mayor had narrowed the deficit to \$22 million, the city was just months away from bankruptcy. The decision from Judge Taft-Carter, though it cost the city “only” \$6-8 million, was enough to push the city over the edge without major actions. For months, Taveras had been in negotiations with large non-profit institutions, with the intention of extracting \$7.1 million in voluntary payments. Negotiations with a few of these organizations were heated and protracted. Prior to 2011, the hospitals were operating without an agreement, while the colleges were on a 20-year memorandum of understanding written in 2003. Eventually, the city was able to extract \$3.9 million from Brown, \$1.1 million combined from others (RISD, Providence College, Johnson and Wales), and an additional \$1 million from Lifespan and other hospitals.

**Holding the line on services.** Other than the school closures, the city did not have to make major cuts. The Mayor did not close libraries, communities, or recreation centers, nor did the average citizen “feel” the fiscal crisis. In fact, despite the drastic measures undertaken to address the crisis, Taveras enjoyed a 10 percentage point jump in approval between 2011 and 2012 – from 52 percent in a March 2011 poll to 65 percent in October 2012.<sup>45</sup>

### *The Specter of Central Falls*

As these actions were unfolding in the state's largest city, tiny Central Falls was going through its own epic journey. This city of only one square mile and 19,000 residents – a quarter of whom live in poverty – had been the catalyst for Rhode Island's Fiscal Stability Act of 2010, which created a three-step process of intervention into highly distressed communities. Though the process was not applied in the city of Providence, the law and the experiences of stakeholders in Central Falls played some role in how events unfolded in Providence – depending on whom you ask.

In May of 2010, facing crushing liabilities (including \$80 million in unfunded pension liabilities and \$21 million in debt) and a structural deficit (\$21 million in expenses compared to \$16 million in revenues), elected officials in Central Falls applied for judicial receivership, a process by which a judge helps officials restructure payments to debtors. State-level officials were concerned about a possible contagion effect that this move might have on bond ratings and municipal borrowing costs for state and local issuers in Rhode Island. In response, the General Assembly passed and Governor Carcieri signed what has become known as the Fiscal Stability Act.<sup>46</sup>

The law allows for a three-step intervention into a local government which has met at least two of several criteria in the law (including request by a local government, a credit downgrade, a budget deficit, or failure to file audit for two successive years):

- **Step 1: Overseer** who has the power to oversee, monitor, review, and advise – but does not preclude elected officials' ability to govern;

- **(If necessary) Step 2: Budget Commission** of five members (three appointed by the state, one who is the chief executive of the city or town, and one who is from the city/town council), and which has all the powers of the overseer plus the authority to govern on behalf of the city/town;
- **(If necessary) Step 3: Receiver** which has all the power of the overseer and the budget commission, and operates in place of the city/town elected officials.

Because of the extreme nature of Central Falls' budget crisis, the State went immediately to Step 3, the receiver, without first having an overseer or budget commission. Though the Mayor and some Council members fought the ruling, it was upheld by the State Supreme Court.

In many ways, up to this point, the story of Central Falls was very similar to that of Providence and several other communities in the state: out-of-control pension costs, combined with shrinking tax base and declines in state aid, to create an unsustainable path. But the two cities took very different paths due to differences in leadership. Mayor Taveras and City Council took the problems facing Providence head-on, while elected officials in Central Falls fought the tough decisions they would have to make. Ultimately, these decisions were implemented over the vocal objections of elected officials by three state-appointed receivers, with the bulk of actions to restore stability undertaken by the former Judge Robert Flanders.

To Flanders and some state officials, one of the greatest attributes of the “third tier” of the Fiscal Stability Act is that it removes local politics—so embedded in the political culture in Rhode Island—from the process of restructuring, renegotiating contracts, and cutting budgets. As receiver, Flanders made many painful cuts in Central Falls to close the \$6 million budget gap (about a 33 percent gap compared to city revenues). In addition to closing a library and a community center and reducing City Hall hours, Flanders also asked employees and retirees for major concessions. When they refused, he filed for Chapter 9 Bankruptcy protection on behalf of the city in August 2011. The path out of bankruptcy was record quick (the city emerged just 13 months later) and came – as did Providence's recovery—through shared sacrifice: about a third through concessions from active employees, a third came through restructuring of programs and cuts, and a third from cutting benefits to retirees. The retirees, many of whom were near poverty, ultimately lost up to 55 percent of their pensions – in a move that made them “the canary in the coal mine” according to their lawyer.<sup>47</sup> No other city or state had yet taken away benefits from current retirees.

### *Not Quite Shared Sacrifice*

Just weeks after the Fiscal Stability Act became law, the General Assembly passed a second law establishing the pecking order by which debtors of a city or town are paid. Bondholders of all debt, including general purpose general obligation bonds, were given priority lien on tax dollars in the event of a budget restructuring via intervention or bankruptcy—putting them ahead of employees, retirees, and, of course, taxpayers who will bear the brunt of any service cuts. In Providence, debt was not cited as a driver of financial hardship. The city did not default, but was downgraded on the heels of the Review Panel's release. The changes to state law make it difficult if not impossible for a locality to ask bondholders to take a haircut. Bond ratings agencies viewed these laws together as credit positive, but some critics have raised the question of fairness. Across the country, in San Bernardino, Vallejo, and Stockton, this very issue of bondholder versus retiree is playing out in bankruptcy court. Regardless of the philosophical issue of fairness, the laws in Rhode Island leave no room for misinterpretation: at the end of the day, the bondholder is made whole.

### *The “Shotgun Behind the Door” or a “Safety Net”?*

State officials and some involved with the Central Falls bankruptcy claim that the experiences of the employees and retirees in Central Falls served as a “bloodied flag” for stakeholders in other distressed communities, including Providence – providing political impetus for stakeholders to sit down at the negotiating table. However, others believe it is “not quite the stick” it is meant to be, or at least it wasn’t for Providence, where Mayor Taveras was able to extract the concessions needed in a much more expedited timeline than if the city had entered into the three-step intervention program. In fact, at least one advisor to the mayor believes the law inadvertently took some of the punch out of the Mayor’s announcement that the city would have to file for bankruptcy because it acted as a “safety net” for unions and non-profits, who may not have believed that the State would allow the capital and largest city to file for bankruptcy.

However, the political impact of the law is not its real strength. From a policy standpoint, the law accomplishes what state officials expected of it: creating a clear path out of distress for struggling communities. Learning from experiences of communities in Massachusetts and Michigan, the State Director of Revenue – who oversees the law – worked with lawyers and analysts to ensure that there would still be a state role even after the work of the overseer, budget commission or receiver ends. There is a continued period of state involvement in the form of oversight/monitoring, in order to ensure that elected officials stick to the long-term plans.

### *The “100 Year Statute”*

Though the law was written for Central Falls, it was purposely designed to be broadly applicable to other communities, large or small. The three “tiers” allow for the judicious use of state authority to intervene. Currently, the State has had three communities under the Fiscal Stability Act: Central Falls, which was under receivership, and Woonsocket and East Providence, both of which are under budget commissions.

### *Other State Actions to Help Cities and Towns*

As Rhode Island continues to recover from the state budget crisis, state officials have not been able to restore entirely the deep cuts in state aid that occurred in 2009-2010. However, there are programs in place to help struggling communities, and state lawmakers have taken other steps to help them deal with the loss in revenue.

- **Distressed Communities Aid:** The State provides about \$10 million annually for eight designated distressed communities, in recognition of these cities’ and towns’ high tax effort and low taxable base. Providence receives around \$5 million annually and this aid was not cut through the recession.
- **Accelerated release of school aid:** Usually the timing of this aid means schools must begin the academic year without it; Gov. Chafee’s 2013 budget provided for early release of the funds (requiring the state to float tax anticipation notes).
- **Pension Study Commission:** Though the State’s historic Retirement Security Act of 2011 did not include actions to improve the funding of the 22 locally-administered pensions, it did convene a

pension study commission helmed by the State Director of Revenue and including state, local, and business members. For over 18 months, the Commission has been systematically reviewing the planning assumptions and outcomes of every locally-administered pension plan. Local administrators are called upon to submit Funding Improvement Plans outlining how they will deal with mounting liabilities, unrealistic assumptions of mortality and rates of return, and committing to make progress or meet their ARC. The Commission has also increased public awareness of these problems.

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### *What Does the Future Hold?*

In April 2013, Bank of America announced that it was vacating the office at 111 Westminster Street, Providence – a beloved, historic, art-deco style building nicknamed the Superman Building for its resemblance to the Daily Planet building in an old television show. The developer has requested \$39 million in state tax breaks and a 17-year property tax stabilization deal from the city in order to turn it into residences – money which would further burden current commercial property tax payers. State and local leaders find themselves torn between adding another fiscal burden on a hard-pressed public, and seeing the city’s largest building stand empty – its tower no longer lit red, white and blue for Independence Day.

In many ways, the Superman Building illustrates the crossroads at which Providence finds itself: a major private-sector employer leaves, a downtown building empty, a choice between the present and the future. While city residents did not see services interrupted over the past years, the crisis has been felt in other ways. Roads are in dire need of maintenance – a \$140 million need, according to the city. A Fall 2012 poll found that voters gave fairly high marks to city services through the Recession, but nearly 60 percent were dissatisfied with the upkeep of roads and 38 percent were dissatisfied with the quality of public schools (voters were split there).<sup>48</sup> Meanwhile, despite the landmark pension victories won by the Taveras Administration, the funding level is still below 40 percent. The city will have to devote 15 percent of its general fund to retirement-related programs going forward through 2016 (the latest year which has been projected). This leaves a shrinking share of money in the budget for the current generation of taxpayers.

The state and local budget and pension crises in Rhode Island have dominated the headlines for several years now. Leaders of the state’s philanthropic community feel that while budget and labor problems may have distracted elected officials from the unemployment and poverty that have plagued the state through the recession, the fiscal reforms have been necessary. Their hope is that these actions may better prepare state and local governments to withstand the effects of federal deficit-reducing actions – especially as sequestration takes hold in the healthcare and defense sectors, and in programs such as HeadStart, the program for low-income children which is already only able to serve about 20 percent of qualifying children in Rhode Island.<sup>49</sup>

What does the future hold? In a September 2012 poll, 38 percent of voters felt that the city was headed on the right track in overcoming its challenges, while 37 percent felt that it was on the wrong track. Some might say not bad for a city that brushed bankruptcy that year.

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