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City of Pittsburgh
Act 47 Recovery Plan Development

Interim Coordination and Information Sharing Report to the ICA

April 8, 2004

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I. The City's Structural Budget Gap

Preliminary Fiscal Gap Projection

- The Act 47 team is finalizing development of a detailed, line-by-line, multi-year budget projection model
- Preliminary analysis indicates that – absent further corrective action – the structural gap between the City's ongoing revenues and expenditures will soon exceed **$100 million** annually and continue to widen significantly
- The Act 47 team will refine these projections on a year-by-year basis from FY2005 – FY2009 as part of the Recovery Plan development

II. Strategies to Close the Structural Gap

Closing the Structural Gap

- Given the severity of the City's structural deficit, the elements of a lasting solution must include a balanced mix of corrective actions:
  - Expenditure reductions and cost growth containment
    - Government right-sizing
    - Productivity and efficiency reforms
    - Employee compensation restructuring
  - Revenue initiatives
    - Maximized collections
    - New/expanded sources

Recovery Plan to Emphasize Results Achievable at the *City* Level

- Significant components of the overall City budget – such as debt service and employee pension contributions – are substantially fixed
  - Only minor improvements in these line items are possible
- The Act 47 Recovery Plan will address these opportunities, but cannot depend on them in resolving the City's financial problems

Expenditure Reduction

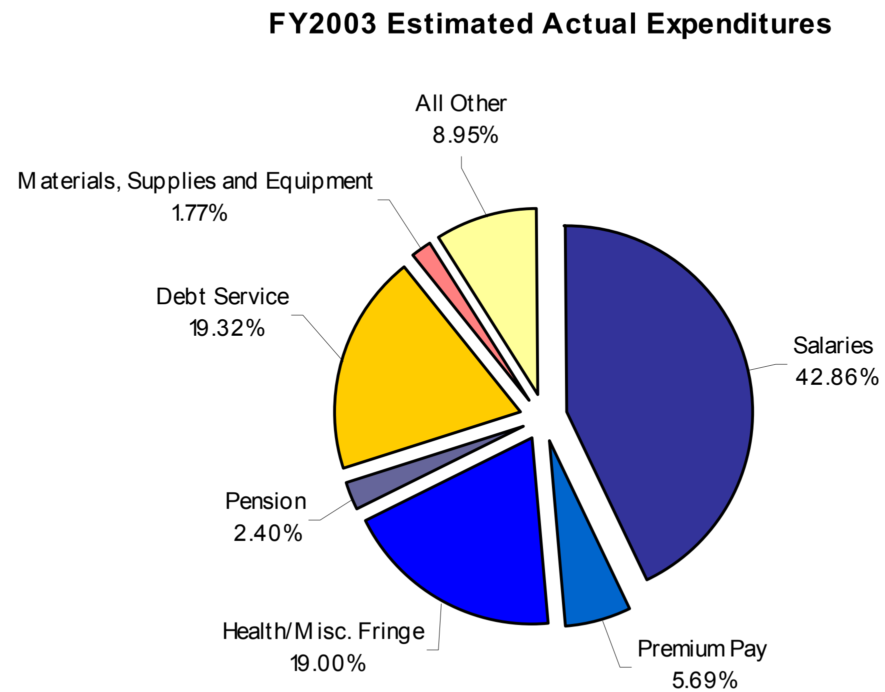
- As the first step toward restoring fiscal stability, the Act 47 team is evaluating local stakeholder ideas and national best practices toward achieving maximum productivity savings. For example:
  - The Act 47 team has already endorsed the City-County 911 merger, approved in March and expected to save $750,000 to $1.1 million beginning in FY2005. The merger will also allow the City to avoid approximately 4.4 million in capital expenditures
  - While the fixed character of much of the City's large debt service burden (approaching $90 million annually for years to come) provides limited options for savings, if the requirements of Act 11 can be satisfied, the City could take advantage of a refunding options in 2004 and 2005 to provide modest but real savings in 2004-2007

Expenditure Reduction

- Scores of additional, specific expenditure savings measures will be proposed in the Act 47 Recovery Plan, ranging across all departments and cost centers. Tens of millions in expenditure savings must be achieved as part of the long-term budget solution
  - Some initiatives will involve restructured service levels
    - This will include analysis of opportunities to reduce staffing in service areas where Pittsburgh significantly exceeds comparable cities (e.g., Fire Department)
    - The potential for some targeted staffing restorations will also be reviewed (e.g., recreation centers and pools, beginning in FY2005)
  - As with the 911 center, other recommendations will build on recent discussions with Allegheny County and the Pittsburgh School District for increased functional consolidation in areas such as purchasing (e.g., uniforms, utilities, telecommunications, vending, and information technology services) and in pooled service delivery (e.g., police training, including consolidation of training facilities)
  - Some initiatives will involve technology investments in areas such as information technology for the Police Department

Significant Workforce Savings Essential

- Even with optimized productivity gains, the City's overall ongoing budget gap cannot be closed without significant restructuring of workforce spending, which makes up more than 2/3 of total City expenditures
- Absent corrective action, personnel costs "per employee" are projected to grow at an unsustainable rate due to skyrocketing health benefit costs, escalating pension contributions, and the recent pattern of wage increases in excess of growth in recurring revenues



Significant Workforce Savings Critical

- Workforce cost restructuring must address both current costs and out-year spending growth rates
- Anticipated measures include:
  - Multi-year wage freeze, and potential restructuring of pay premiums, overtime control, and automatic step progressions
  - Health benefit plan redesign, along with cost-sharing for health care premiums
  - Workers' compensation reforms
  - Paid leave and attendance controls
  - Long-term adjustment to post-retirement benefits
  - Increased flexibility for job assignments, scheduling, and optimized productivity
- Recommended workforce changes should equitably address both management and union-represented City workers

Significant Workforce Savings Critical

- In addition to pay and benefit restructuring and reforms, Pittsburgh's long-term financial stability requires targeted workforce reductions (e.g., Fire Department, certain administrative and support functions)

Increased Revenue Strength

- Along with significant expenditure reductions and cost containment, the magnitude of the City's fiscal gap requires significant and recurring revenue gains to avoid draconian service impacts
- In addition to achieving immediate budget gap closure, it will be important to generate and maintain ongoing revenue growth and vitality so as to keep pace with inflationary and other long-term cost pressures
- Maximizing collections (e.g., real property tax collections) will be part of this strategy, but new and/or increased sources of revenue will also be recommended
- While the Act 47 team has not yet finalized its specific recommendations for an optimal revenue mix, analysis of multiple options as suggested by City and regional leaders is underway

Revenue Options Evaluation Criteria

- As further detailed in the attached Appendix A, the following criteria are among those being used to evaluate and compare options for strengthening revenues:
  - Revenue generation capacity
  - Legal process and/or constraints
  - Equity/distributional Impact (both socio-economic and geographic)
  - Practice in other jurisdictions/competitiveness issues
  - New collection/administrative costs
  - Reliability/stability
  - Economic effects and externalities
- No single revenue option will likely rate highly on all criteria; pros and cons of each must be considered and balanced

Existing Revenues Under City Control – Key Considerations

- **Property Tax**
  - Significant revenue generation capacity
  - Burden falls exclusively on City residents and property owners
  - Existing administrative and collection apparatus (new investments may be necessary to improve collection rates)

- **Parking Tax**
  - Significant revenue generation capacity, but yield eroding as rate has increased
  - Burden falls across residents, commuters, and visitors
  - Current rate is extraordinarily high relative to other cities, with potential adverse impacts on economic competitiveness at existing levels

Existing Revenues Under City Control – Key Considerations

- **Resident Earned Income Tax (EIT)**
  - Burden falls on declining residential population base, and current rates are already highest in the region
  - Burden generally proportional across income groups, although excluding unearned income from tax disproportionately benefits more affluent individuals
  - Increase would make City less competitive relative to other jurisdictions for residential and business location decisions

- **Non-Resident Earned Income Tax (EIT)**
  - City currently levies a 1 percent non-resident EIT
  - Non-resident EIT rate could be raised pursuant to Act 47 authority
  - Burden falls on non-resident commuters
  - Increase would make City less competitive relative to other jurisdictions for business location decisions

Existing Revenues Requiring State Authorization to Change Rates – Key Considerations

- **<u>Occupational Privilege Tax (OPT)</u>**
  - Current $10 per year rate unchanged since 1965
    - Rate would be roughly $60 annually had it been indexed to inflation
  - Significant revenue generation capacity
  - Burden falls on resident and non-resident workers
  - Tax is regressive (as are all flat-rate taxes), but burden could be mitigated to some degree by excluding low-income workers
  - Low incremental collection costs
  - Generally stable and reliable, but it must be increased regularly or indexed to maintain “real” (i.e., inflation-adjusted) value as a revenue source

Potential New Revenues and Tax Reform Requiring State Authorization – Key Considerations

- **<u>Gross Payroll Tax</u>** – Potentially a substitute for existing Business Privilege Tax (BPT) and Mercantile Tax
  - Significant revenue generation capacity
    - Rate of 0.50% or 0.75% would be projected to replace all revenue lost from eliminating BPT and Mercantile Tax, and generate net new revenue by broadening existing tax base
  - Burden would fall on a broad base of employers located in City
  - Could lower collection and administrative costs, relative to existing BPT and Mercantile Tax, although some incremental “start-up” administrative costs likely
  - As with taxes on income, revenue tends to fluctuate with economic cycle, so somewhat less reliable and stable than other (e.g., fixed fee) sources, but more “up-side” as the economy expands and payrolls increase
- **<u>Personal Income Tax (PIT)</u>** – Replace EIT with broader-based PIT, perhaps collected by the Commonwealth for the City

Revenue Options Under Evaluation (cont)

- At this stage, multiple other potential revenue sources, as well as tax reform ideas, remain "on the table" and are being actively analyzed, including:
  - Retail drink tax
  - Refuse fee
  - Updated fees, fines, and user charges
  - Payments-In-Lieu-Of-Taxes (PILOTs)
  - Tax collection improvements
  - Market-Based Revenue Opportunities (MBROs), such as private sector advertising and sponsorship opportunities
- Some of the alternatives being evaluated would require new State authorization. If any such options are ultimately recommended, alternatives within the City's direct control under the Act 47 process will also be incorporated within the Recovery Plan as contingencies

III. Conclusion

Balanced Mix of Corrective Actions

- Pittsburgh’s structural budget gap – projected to exceed $100 million annually within the next few years – cannot practicably be addressed using any one “magic bullet”
- A balanced mix of productivity, workforce, and revenue changes are needed to fill the gap and return long-term, sustainable fiscal balance
- Working in coordination with the ICA, the Act 47 team anticipates completion of its comprehensive Plan incorporating within approximately the next 45 days

Appendix A -
Criteria for Evaluating Revenue Options Definitions and Discussion

Criteria for Evaluating Revenue Options

The range of criteria by which to compare and evaluate options for raising revenue is almost limitless. Several of the most common and generally useful evaluation criteria are listed below:

- Revenue Generation Capacity
- Legal Process and/or Issues
- Distributional/Equity Impact
- Competitiveness/Practice in Other Jurisdictions
- Collection/Administrative Cost
- Reliability/Stability
- Economic Effects
- Externalities
- Stakeholder Acceptance and Feasibility

Each criterion is discussed below. The discussion provides both a general definition of the criterion, and an initial, qualitative method for categorizing and comparing how each revenue option "scores" on that particular criterion.

Revenue Generation Capacity

Definition: The amount of revenue the tax can generate when levied at a politically/economically acceptable rate. The formula for calculating the revenue production capacity for a particular tax is usually simple: Revenue = Tax Base * Tax Rate, with some allowance for non-collection.

Categorization/Comparison Options: One way to qualitatively categorize different revenue options along this variable is as "High", "Medium", or "Low". To place a tax in one of those categories, one can estimate the tax's potential revenue yield compared with existing revenue sources, or as a percentage of existing general fund revenues. Property and broad-based income taxes tend to be relatively "High" revenue generators. Selective sales taxes, often called excise taxes (e.g., a tax on theatre ticket purchases, parking taxes), tend to be "Low" or "Medium" revenue generators.

Criteria for Evaluating Revenue Options

Legal Process and/or Issues

Definition: The degree to which existing state and local laws pose a barrier to utilizing a revenue source. Would, for example, a state constitutional amendment be required to impose the tax? Would existing state statutes need to be modified?

Categorization/Comparison Options: Potential categories include: “State constitutional amendment required”, “Amendment to existing state law required”, “New state law required”, “Charter amendment required”, “Amendment to local ordinance required”, and/or “New local ordinance required”. Also, specific legal issues or questions may exist.

Distributional/Equity Issues

Definition: This refers to how, or on whom, the tax burden is distributed. “Fairness” is a synonym often used to describe this concept.

Categorization/Comparison Options: There is an almost endless list of dimensions used to evaluate the equity/distributional impacts of various taxes. At the most general level, two common equity standards are applied: 1) according to the taxpayer’s benefits from the usage/benefits of the public service being paid for (the “benefits received” criterion); and 2) according to the taxpayer’s capacity to bear the tax burden (the “ability to pay” criterion). This is the common “progressive” or “regressive” classification: progressive taxes impose a higher effective tax rate on those with higher incomes; regressive taxes impose a lower effective rate on those with higher incomes.

Also, some form of “geographic” category is commonly used when measuring distributional impact, especially at the local government level. This criterion refers to whether a particular jurisdiction’s citizens will pay all, some, or none of the tax. For example, a city hotel tax imposes the tax burden on those staying in hotels/motels, and this essentially exports much of the burden to non-resident visitors.

Criteria for Evaluating Revenue Options

Competitiveness/Practice in Other Jurisdictions

Definition: This refers to whether other jurisdictions – and in particular, whether "comparable" jurisdictions – utilize the tax under consideration and, if so, the rate at which the levy is imposed. Often the existence of a tax in a comparable jurisdiction, or the fact that another jurisdiction imposes the same tax at a higher rate, provides a rationale for imposing a new tax or increasing an existing tax.

Categorization/Comparison Options: Evaluation on the basis of this criterion is conducted by using tables that list the taxes imposed by jurisdictions deemed "comparable" in terms of population size, location, socio-economics, or other characteristics.

Collection/Administrative Cost

Definition: The total resources required to collect a tax. This often refers solely to the resource cost to the subject government of collecting the tax; in this case, the term "administrative cost" more accurately describes this criterion. Often, however, the definition of collection cost can be expanded to include the cost of collection for another level of government, as well as the cost of compliance to taxpayers.

Categorization/Comparison Options: Potential qualitative categories for this criterion include "Low", Medium", or "High". The answers to several questions can determine the category into which a particularly revenue raising options falls: Does an administrative structure for collecting the tax already exist? Can another level of government (e.g., County, State) administer the tax and remit the proceeds? What, if any, appeal/protest/enforcement mechanisms will have to be established?

Criteria for Evaluating Revenue Options

Stability/Reliability

Definition: The degree to which revenues generated from a particular source are stable and predictable. Certain revenue sources are highly sensitive to economic and market conditions, in some cases, within a narrow economic sector. All other things being equal, a steadier revenue source is preferable. Along similar lines, it can also be advantageous if a revenue source automatically self-adjusts (as income tax receipts grow with rising wages, and sales tax receipts may parallel inflation), rather than requiring governmental action that may trigger greater political resistance (as with certain flat-rate charges).

Categorization/Comparison Options: Different revenue options may also be qualitatively categorized along this variable as “High”, “Medium”, or “Low”. To place a tax in one of those categories, one can estimate the tax’s potential revenue yield under different economic and market conditions.

Economic Effects

Definition: The likely effect of the tax on economic activity within the jurisdiction where the tax is imposed. One of the big questions here is whether imposition of the tax will affect business, shopping, or residential location decisions, as well as other economic decisions made by businesses and individuals.

Categorization/Comparison Options: Potential categories are “Negligible”, “Potentially Moderate”, or “Potentially Significant”. It is very difficult to predict the economic effects of certain taxes. Particularly for local governments, the economic effects are always highly context-specific, depending on whether the revenue option under consideration would be a new tax, an increase to an existing tax (and if so, the rate of the existing tax), and the relative tax structure of surrounding jurisdictions.

Criteria for Evaluating Revenue Options

Externalities

Definition: Externalities are instances in which private actions create negative consequences for other persons or firms. Car driving and cigarette smoking are often citied as creating negative externalities, and these externalities sometimes provide a rationale for taxes on gasoline and cigarettes.

Categorization/Comparison Options: Potential categories could be "No Likely Externalities" or "Potential Externalities".

Stakeholder Acceptance and Feasibility

Definition: The degree to which the existing political climate poses a barrier to utilizing the revenue source. While this may be a highly subjective evaluation criterion, it can be the most important. It is also one of the most fluid categories – what is considered "acceptable" at one time may not be in another, and vice versa.

Categorization/Comparison Options: The likelihood of stakeholder acceptance can be categorized as "Low", "Moderate", or "Promising". When placing potential revenue sources in one of these categories, it is important to remember that the comparison is in a *relative* sense. No form of revenue raising initiative is ever popular, but some initiatives are likely to be less unpopular than others.