

**GENERAL OBLIGATION BOND DEBT
OF THE
TOP 75 U. S. CITIES BY POPULATION**

*REPORT BY THE
OFFICE OF THE CITY CONTROLLER
PERFORMANCE AUDIT SECTION*

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To the Honorables, Mayor Tom Murphy
and Members of Pittsburgh City Council:

The Office of the City Controller is pleased to present this Survey of Municipal Bonded Debt. The purpose of this survey is to present a true picture of the City's current debt situation. The study compares the general obligation bonded debt of the seventy-five most populous cities in the United States as well as that of cities with similar population and economic history to Pittsburgh. The City's debt situation was not created by the current Administration. The roots of the problem extend back to the time of David Lawrence. This report is offered as a starting point for discussion on how to manage the City's bonded debt.

Executive Summary

The findings of the study show that Pittsburgh has a daunting debt burden. Apart from New York City, which is an anomaly in terms of its size and governmental complexity, Pittsburgh has the highest debt per capita among the seventy-five most populous cities, of which Pittsburgh is the forty-ninth largest. The City's total bonded debt as well as debt service as a percentage of revenue is among the worst. The following statistics further highlight Pittsburgh's dismal debt position.

- Pittsburgh has the 8th largest total net bonded debt in the United States (U.S.) As of 1999, the City had incurred total general obligation bonded debt of \$898,935,000.
- Pittsburgh has the largest general obligation net bonded debt per capita in the U. S. with \$2,430. This burden is roughly 50% larger than the city of Rochester, New York, which has the second largest debt per capita.
- As of 1999, Pittsburgh's net bonded debt exceeded its gross revenue by \$485,017,416. No other city that is similar in population or economic history to Pittsburgh had bonded debt that exceeded gross revenue.

- Analysis of the ten cities with similar population shows that Pittsburgh has the fourth-largest debt service as a percentage of revenue with 17.67%. Minneapolis ranks first with 22.83%.
- Analysis of the cities with similar economic history as Pittsburgh reveals that Rochester and Pittsburgh have the largest debt service as a percentage of expenditure. Debt service accounts for 29.29% and 15.80% of expenditure for Pittsburgh and Rochester, respectively.
- During the years 1990-1998, Pittsburgh's population declined by 29.35%. This translates into a lower tax base and a higher debt burden per capita.

The results of the study prove that Pittsburgh has a heavy debt burden. The problem continues because the Commonwealth will not give the City the revenue tools it needs to operate as a metropolitan hub. Internal revenue increases, i.e tax increases and refuse pickup fees, will only cause more residents to leave the City which will facilitate greater debt burden on those remaining. Unless this situation is arrested through additional external revenue sources such as revenue sharing from the State, the City's debt crisis will continue to inexorably worsen.

Sincerely,



Tom Flaherty

Introduction

The City of Pittsburgh's Controller requested a survey of the bonded indebtedness of the largest cities in the United States. This request was the result of the Controller's concern about the City's growing bonded debt. This report is offered as a starting point for discussion of how to manage the City's bonded debt. The basis of the survey is comparative; however, some analysis of how the cities contrast will be offered. The elements under review will be both bonded debt in relation to city population and the debt service of the bonded obligation.¹

The survey findings are offered in three sections. The first section compares the net bonded debt and debt per capita of all 75 cities in the study. The second section is a comparative presentation of data with cities similar in population to Pittsburgh. (By population, Pittsburgh is the 49th largest city in the United States.) The third section analyzes cities similar to the City of Pittsburgh in having been major industrial manufacturing centers of the 19th and 20th centuries. This comparison is not one of population, but one of shared and similar histories.

Results demonstrate that there are some very wide separations between Pittsburgh and the cities under comparison. The debt of the City of Pittsburgh needs critical evaluation and this report is meant as a resource for additional study. It is hoped that this document can be of assistance in the public debate that needs to follow.

¹ Some areas of comparison are net bonded debt per capita and debt service as percentage of revenue.

Bonds: A Brief Explanation

In the operation of any business there is the need to raise capital. Though cities are not businesses they too must raise capital. Bonds are a primary method used to raise capital. The issuance of bonds is an important financial tool for a city. How a city manages this debt from the sale of its bonds is key to a well-run city government. The implications of bonded indebtedness for cities are explained below.

When money is borrowed interest must be paid. The bond's interest rate is determined by market conditions and is based on the borrower's ability to provide cash flow to pay principal and interest. An additional element in the determination of a bond's interest rate is risk, i.e., how sure is the bondholder that repayment will be made. The greater the likelihood of repayment, the lower the rate of interest.

Corporations, governments, and individuals can issue bonds, providing there is a forecasted cash flow to service the debt. Corporate cash flow is dependent on market conditions and there is no guaranteed cash flow to repay the bondholders. Unlike corporations, a government's taxing power is not affected by market conditions. Therefore, at least in theory, the taxing authority of a government guarantees a cash flow sufficient to pay the debt service on the bonds. Bonds issued by local governments are exempt from Federal tax and, in most situations, State and local taxes. These tax exemptions make them attractive to investors.

Bonds can be of varying maturity. Cities normally issue bonds to finance long term capital projects. A bond that is issued by a city is referred to as a municipal or 'muni' bond. There are varying types of municipal bonds such as the special revenue bond. This type of bond has its own specific purpose and tax or fee revenue source. General obligation bonds are the types of bonds discussed in this report. The general obligation bond is a special bond that is guaranteed by the full faith and taxing power of

the city that issues it. All city taxes are pledged to these bonds. This makes the general obligation bond the most secure type of bond that a city can issue for the bondholder. Conversely, the debt created by a general obligation bond is the most crucial to a city.

The way a city manages and controls its debt is subject to judgement. A bond rating is that verdict of the city's debt position and management. There are companies whose primary purpose is to evaluate bond issuers. Standard and Poors Ratings Group and Moody's Investors Service, Inc. are two such companies. The city of Pittsburgh has a current bond rating of "Aaa" from Moody's and "AAA" from Standard and Poors. These are among the top ratings a bond issuer can receive. A lower rating would fall into the 'B' and 'C' ratings group. It must be noted that the City's bonds are insured. This raises the bond rating and thus lowers the interest rate on the bonds.² The proper management of Pittsburgh's debt is extremely important for maintaining a low debt service which, in turn, will free more money for current budget needs.

² Without this insurance, the ratings from Standard & Poor's are BBB and Baa1 from Moody's. The additional expense of bond insurance could possibly be avoided if the City 's financial situation were to improve.

the non-GFOA conforming cities' presentation of data did not lend themselves to a similar evaluation.⁵

⁵ *The GFOA standards require the inclusion of a statistical section in each CAFR. Non GFOA conforming cities do not always produce a statistical section. When a statistical section was unavailable the city was omitted from the study.*

Analysis of the top Seventy-five Cities by Population

This section analyzes the debt situation of the top seventy-five cities in the United States. A number of these cities were excluded from the analysis for varying reasons. Long Beach, Omaha and Jersey City were exempted because their reports are not in compliance with the standards of the Government Finance Officers Association (GFAO), a requirement of this study. Washington D.C. was also excluded because of its special relationship with the federal government. Because of this relationship, its governmental structure is an anomaly compared to the other cities in the survey. New York City was not included in the sample because of the unique nature of the city. It can be viewed as a city/state, thereby making a comparison with other cities unbalanced.

Analyzing of the remaining 70 cities' CAFR's, from 1998 and 1999, reveals that Chicago, IL has the largest total net bonded debt in the United States (see Appendix 1). By December 1998, Chicago had amassed a total net bonded debt of \$2,356,826,000. Philadelphia ranks second with a total net bonded debt of \$2,081,153,798.

Pittsburgh, too, is among the highest indebted cities in the United States; ranking eighth in the nation for total net bonded debt. As of December 1999, the City has incurred a total net bonded debt of \$898,935,000.⁶ An analysis of Pittsburgh's CAFR reveals the City's total debt has risen steadily over the last twenty years. (See Appendix 2). The sharpest peak was in 1997-1998. The growth rate of Pittsburgh's total debt is further demonstrated in Appendix 3. During the years 1981-1999 the debt growth rate had two significant peaks, one in 1986 and the other in 1998. In these years, the debt growth rate surged to 30% and 40%, respectively.

⁶ Source: City of Pittsburgh, Pennsylvania. Comprehensive Annual Financial Report for the year ended December 31, 1999. Statistical Section. Table 8. Page 210.

Meanwhile, San Jose, Santa Ana, Tampa, Riverside, and Stockton reported zero as their total net bonded debt. Sacramento, as of June 1999, had the next lowest total bonded debt at \$571,000.

In terms of net bonded debt per capita, Pittsburgh and Anchorage rank the highest among the cities that were analyzed (see Appendix 4). Their bonded debt per capita as of 1999 was \$2,430 and \$1,907, respectively. Conversely, Sacramento and Jacksonville boast the lowest debt per capita. Their figures are \$1.44 and \$2.94 respectively. It should be noted that although Chicago has the highest total debt, its debt per capita is only \$846.64, which shows it has a greater ability than Pittsburgh to service its debt.

Analysis of the Ten Cities with Similar Population to Pittsburgh

In this section Pittsburgh's debt position is compared to cities that have similar population. In light of this, an analysis of the debt burden for the ten closest cities to Pittsburgh in terms of population was done. The five cities whose population exceeds Pittsburgh's are Tulsa, Miami, Oakland, Mesa, and Minneapolis, while the five cities with smaller population are Colorado Springs, St. Louis, Cincinnati, Wichita and Toledo.

In view of the analysis, Pittsburgh's debt per capita greatly exceeds all ten cities (see Appendix 5). Its debt per capita by 1999 was \$2,430. In fact, the difference between Pittsburgh and St. Louis, which has the lowest per capita debt (among the ten cities), is \$2,412. This figure is alarming in light of the fact that St. Louis has only 1,200 fewer residents than Pittsburgh according to the 1998 census estimates. In addition, Minneapolis and Colorado Springs, which are closest to Pittsburgh in population size, have a per capita burden of only \$190.00 and \$123.00, respectively.

Pittsburgh's net bonded debt per capita has also been worsening over the years. This is due to a rising total debt coupled with a declining or stagnant population. Although the debt per capita grew steadily between 1981 and 1999, the greatest surge was recorded in 1997-1998 (see Appendix 6). In fact, the growth rate for net bonded debt had two significant peaks over these years. These peaks were experienced around 1986 and 1998 (see Appendix 7).

In addition, a comparison was done between the cities' total net debt and their gross revenues. It must be noted that Pittsburgh is the only City whose net bonded debt has exceeded gross revenue (see Appendix 8). Moreover, its debt more than doubled its gross revenue.

Pittsburgh's debt situation was further revealed in a comparative analysis of the ten cities' debt service as a percentage of revenue (see Appendix 9). Among the ten cities that were analyzed, Minneapolis had the highest debt service as a percentage of total revenue. Pittsburgh was fourth with 17.67%.

A comparative analysis was also conducted of the cities' debt service as a percentage of expenditure (see Appendix 10). To maintain the integrity of this analysis some adjustments were made to the data. This is because each city measured its debt service as a percentage of revenue differently. Some used only the general fund as a measure of expenditure; others used the general and debt service fund, while others used the total government expenditure in all funds. Pittsburgh used the sum of all governmental type funds (general fund, special project fund, debt services fund and capital project fund) to compute this ratio. In light of this, to maintain a constant comparison, the sum of all governmental type funds for each city was used for the analysis. These figures were computed only for this comparison and are not part of the officially audited CAFR.

The analysis shows that Pittsburgh is above the average in terms of its debt service as a percentage of expenditure. Debt service accounts for approximately 15.80% of the city's total expenditure. This represents a substantial portion of any city's expenditure.

Analysis of Cities with Similar Economic History as Pittsburgh

To further evaluate Pittsburgh's debt situation, a comparative analysis was done of six cities with similar economic history as Pittsburgh. The cities chosen for comparison include Cincinnati, Cleveland, Rochester, Akron, St. Louis, Birmingham and Pittsburgh. They were selected by virtue of that fact that they were all major industrial centers of the 19th and 20th centuries. Furthermore, these cities have all suffered a decrease in their population over the last ten years (see Table 1).

Table 1. Numerical Population Change for five Pre-Industrial Cities 1990-1998

City	Population Change
Cincinnati, OH	-27.71
Cleveland, OH	-9.79
Rochester, NY	-13.46
Akron, OH	-7.30
Birmingham, AL	-12.35
St. Louis, MO	-57.36
Pittsburgh, PA	-29.35

Population Estimates Program, Population Division, U.S. Census Bureau, 1999

The decrease in population is largely attributed to the impact of globalization, among other factors. Globalization has specifically led to the demise of the manufacturing industries, which had been the 'backbone' of these economies for years. Consequently, these regions have experienced massive exportation of jobs.

The table above shows that St. Louis suffered the greatest decline in population. During the years under review this city's population fell by 57.36%. Pittsburgh, too, has been severely affected. Its population declined by 29.35% compared to its 'next door neighbor', Cleveland, which only had a 9.79% decrease in population. Cincinnati was the third city under review that experienced a drastic decline of 27.71% in its population.

An analysis was done of the cities' net bonded debt per capita (see Appendix 11). The graph clearly depicts that Pittsburgh has the most daunting debt burden per capita among these post-industrial cities. It should also be noted that St. Louis, which experienced the greatest population loss, has the smallest debt per capita among the cities in this comparison.

Another analysis of the cities' gross revenue relative to their total net bonded debt also shows that Pittsburgh is in the worst position (see Appendix 12). For the year 1999, the gross revenue for Akron, Cincinnati, Cleveland and Rochester all impressively exceeded their total debt. Birmingham's gross revenue, however, fell slightly below its total debt. Pittsburgh on the other hand represents a different scenario. This City's total debt has more than doubled its gross revenue. Its gross revenue was \$413,917,584 compared to \$898,935,000 of net bonded debt.

This situation is not only characteristic of the year under review, but has been the trend for the past thirteen years (see Appendix 13). The graph shows that prior to 1985, the gross revenue had exceeded total debt, though marginally. However, from 1986 to present, total debt over-took the gross revenue and has continued to grow at an increasing rate. Meanwhile, the gross revenue has only shown gradual increase since 1983. In fact,

starting from 1983 to present, gross revenue has not doubled. On the contrary, there has been approximately a four-fold increase in total debt starting from 1983 to present.

This situation could have serious implications for Pittsburgh. First, it could affect the city's bond rating. Second, it could hinder Pittsburgh's ability to pay principal and interest on its debt. Third, a high total debt could lead to a cutting back of spending in crucial areas.

A further evaluation of these cities' debt service as a percentage of revenue was also initiated. Appendix 14 shows that Pittsburgh followed by Cincinnati have the highest debt obligation as percentage of their revenue.

In addition, an evaluation of these cities' debt service as a percentage of expenditure was initiated (see Appendix 15). Among these post-industrial cities, Rochester and Pittsburgh recorded the highest debt service burden as a percentage of expenditure. Roughly, 15.8% of Pittsburgh's expenditure goes towards servicing its net bonded debt.

In addition to the above analyses, a closer evaluation of Cincinnati, St. Louis and Pittsburgh, which all have similar population size as well as similar historical economic background, shows that Pittsburgh is in the worst position. The City's total debt and debt per capita greatly exceeds that of the other cities. However, in terms of debt service as a percentage of expenditure, Cincinnati is in the least favorable position with 21.19%. It is followed by Pittsburgh and St. Louis with 9.77% and 0.90%, respectively.

Conclusion

The above analyses of Pittsburgh's debt situation in relation to the top 70 cities and peer cities in terms of population and economic background show that Pittsburgh has a daunting debt burden. In comparison with the top seventy cities that were analyzed, Pittsburgh ranks high in terms of total net bonded debt. It shows similar trend for debt per capita. Apart from New York City, which can be viewed as a City/State, Pittsburgh has the highest bonded debt per capita.

A comparative analysis of Pittsburgh with ten other cities further demonstrates the city's dismal debt situation. Pittsburgh has the highest total debt and debt per capita among the ten cities which similar population to Pittsburgh. In addition, the City's total debt greatly exceeds its gross revenue. Such a situation is non-existent among the other cities analyzed. Furthermore, although Pittsburgh does not have the worst case of debt service as a percentage of total revenue and expenditure, its figures are still above average.

A second comparative analysis of Pittsburgh with cities that are historically similar further demonstrates Pittsburgh's weak debt condition. The City's net bonded debt as well as net per capita exceeds that of those post-industrial cities that were evaluated. This is also true of the City's gross revenue compared to total debt, as well as its debt service as a percentage of expenditure and revenue.

Pittsburgh's debt condition is compounded by the fact that, over the years, the total debt and, consequently, the debt per capita has been growing steadily. Meanwhile, the gross revenue continues to fall below the debt. Unless a concerted effort is made to arrest this situation, Pittsburgh would continue to face a daunting debt situation for many years.