
Prosper or Perish

Financing Local
Government Services
in Pennsylvania

Municipal Finance Task Force
City of Lancaster
J. Richard Gray, Mayor
June 2011



This report was produced and the policies recommendations set forth herein endorsed by the City of Lancaster's Municipal Finance Task Force. We thank members of the Task Force for their service to our community and their vision for a more stable and sustainable future.

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Like many local municipalities, the City of Lancaster is at a financial crossroads. Unless action is taken to reform the system used to finance City services, those services will go into sharp decline. It is truly a “prosper” or “perish” choice.

The City’s financial health is intertwined with that of Lancaster County and the School District of Lancaster. At the center of the County, the City’s ability to finance infrastructure, public safety and other services – and to sustain and expand its appeal as an arts and tourism destination – is vital to the entire County and the region.

Since 2002, the City has balanced its budget by drawing from reserve funds. The City’s General Fund year-end balance has shrunk from \$11.8 million in 2007 to an estimated balance of \$7.2 million at the end of 2010. Based on current projections, the City will have a *negative* balance of \$22.3 in 2016. The City is holding expenses in check, having implemented most of the 182 recommendations made by a consultant in 2007. Borrowing to alleviate the structural imbalance is expensive and unsustainable over time.

There are two root causes of this distress: state law that forces cities to rely on property taxes as the primary source of revenue, and mandated benefits for police and fire department employees. To illustrate, even without counting the cost of pensions and other benefits, the total of salaries for fire and police departments alone consume nearly 80% of all property tax revenues. The arbitration process for resolving contract disputes in collective bargaining has grown into a significant and costly mandate placed on local governments.

“... the ability of the City to sustain and expand its appeal as an arts and tourism destination will have a significant impact on the County’s economy.”

Six actions are needed to avert a financial crisis in Lancaster City and to help rescue those other cities which are now in crisis:

1. Local governments must be given a menu of options for generating revenue.
2. The public safety contract arbitration system must be reformed to establish clear and reasonable standards on which awards are based.
3. City management and bargaining units must engage in meaningful discussions of how health care and pension benefits can be adjusted to accommodate today’s financial realities.
4. Fragmented government at the local level must give way to inter-municipal shared services.
5. Revenue sharing with federal, state, county and tax-exempt property owners must be established so that all consumers of services assume a fair share of the cost of those services.
6. Barriers must be replaced with incentives for investing in community and economic development projects in older cities.

This “case” provides a road map for policy-makers, advocates, community leaders, elected officials, labor unions, and residents who are willing to acknowledge that Lancaster City is at a crossroads where only meaningful reform will determine whether the City prospers or perishes.

PROSPER OR PERISH?

To say that we face a “prosper” or “perish” choice is not an exaggeration. The City of Lancaster has the ingredients to truly become “a Red Rose blooming.” On the other hand, its financial crisis could erode so many of those ingredients, causing the City’s hopes and solid quality of life to perish.

What would happen in that scenario?

The City goes into a downward spiral of declining revenues, higher real estate tax rates and reduced services – principally in police protection and fire response time. This could lead to:

- An exodus from the City of businesses, homeowners, and responsible landlords;
 - A sharp reduction in the appeal of the City to new homeowners and to new and relocating businesses, especially professional services and merchants who depend on people coming to them;
 - A reduction in the appeal of the City to developers, restaurateurs and retailers who are considering where to risk their capital for medium- and long-term gain.
- As real estate taxes rise, so do rents. What was affordable housing for those at the lower end of the household income scale puts a severe strain on those residents. Many will move to lower-rent housing inside and outside the City. With lesser disposable incomes, some renters will find it financially difficult to keep up their end of their maintenance rental agreements.
 - Police coverage and response time will decline. Not only that, but the Lancaster City Police will not be able to do as much pro-active prevention of serious crime, especially those associated with the illegal drug trade. These factors will lead not only to rise in criminal incidents but also to a rise in the number of people with criminal intent.
 - This deterioration in affordable homes would accentuate not only a decay in the quality of life in the City, but also to a decline in the perception of the City as a safe place to live, work and visit.

Lancaster City boundaries encompass approximately four square miles. Combined with contiguous communities, the inter-municipal area is approximately 64 square miles. While a political boundary defines the city, an activity boundary does not exist. The City interior is linked quite efficiently to its surrounding region by radial routes, 13 “pikes” which aim at the heart of the City.

The significance of this is:

- Tens of thousands of people in vehicles – personal and commercial – move in and out of the City every day. If the core begins to rot – with attendant real and imagined concerns about safety and street conditions – it would affect these tens of thousands who do not live in the City and who have a choice of how to travel and where to go to eat, meet and do business.
- Regular and visiting travelers give no thought to the political boundaries as they move around; they don’t distinguish whether they are in the city or an area immediately adjacent to the city.

The same attitudes could well extend to choices of where to live. A stain of even a slight fear for both personal safety and denial of services would spread out to surrounding municipalities. In short, all of Lancaster County would be affected if the City were to fall into decline.

Lancaster City benefits greatly from the investment of time, talent, energy and money by community leaders who live outside the City. They invest because they see a reward, one that transcends their personal interests. Were the City to go into a severe decline, many of those same leaders would turn their attention and contributions away. Who wants to invest without prospect of returns? Who wants to be associated with a failing enterprise? Could this scenario play out? One need only examine the decline of many of Pennsylvania's Third Class cities that have been designated as "distressed."

On the other hands, what would this "prosper" scenario look like?

- City services are stabilized. City employees receive fair salaries, wages and benefits and need not fear the loss of their jobs.
- Instead of an exodus from the City of businesses, homeowners, and landlords, we see an increase in the influx of those who find the City an attractive place to live and do business.
- Developers, restaurateurs and retailers choose to risk their capital in new investments, in numbers which eclipse even the promising number of them doing just that now.
- The City enters a new era of tapping into and profiting from investment of time, talent, energy and money by community leaders who live outside the City.
- Suburban townships and boroughs and towns throughout the County can see tangible benefits of cooperating with a financially healthy Lancaster City.

So many encouraging developments are underway in Lancaster City now. New businesses are opening. Existing businesses are expanding their footprint. New residences have been created out of old disused buildings. The Amtrak station will once more be a classic beauty – serving 500,000 passengers each year. Millersville University has a new downtown presence. The arts community is thriving.

If structural reforms are implemented at the State level, the City of Lancaster can prosper as never before, Third-Class cities now in crisis will have hope for recovery, and smaller municipalities will be able to meet the growing demand for core services that only local government can provide.



THE CASE FOR REFORM

The nation's economic recession has provided an opportunity for elected officials to focus public attention on the long-term sustainability of basic services provided by local government: police, fire, water, sanitation, public health, streets, parks, traffic control and so on. For more than a decade, Mayors across the country have predicted a future with dwindling resources that would eventually leave local government unable to deliver those basic services needed to support economic vitality and quality of life for residents.

The revitalization and investment that Lancaster City has enjoyed over the past several years has not immunized the City from the impact of declining revenues, increasing expenses, and a stagnant tax base. Over the past five years, the City's police force has been reduced by 15%, from 171 to 145 sworn officers. In 2010, the Firefighters Union was faced with a choice of wage concessions or lay-offs. They chose the latter and four Firefighters were laid off. In all, the City's workforce has been reduced by 15% or 64 full-time employees over the past five years. Yet in spite of workforce reductions and extensive cost-cutting measures, City officials have been forced to increase property taxes by 47% since 2006. At the same time, for the past 9 years, the City has had to draw from reserve funds to balance its annual budget.

With reserves now nearly exhausted, bare-bones staffing levels across all departments of City government, and taxpayers who simply can no longer bear the burden of financing both public education and local government services, the day of reckoning is upon us. City taxpayers will soon be forced to choose what services they are willing to reduce or forego: public safety; street cleaning; parks maintenance; recreation programs; housing inspections; sanitation services; and traffic control to name a few.

Lancaster City residents and business owners need look no further than other Third Class cities to see where a downward spiral of declining revenues, higher real estate tax rates and reduced services have led to an exodus of businesses, homeowners and responsible landlords from once-thriving cities. Not long ago, neighboring Chester for example was similar in size to Lancaster City with an engaged business community and a stable tax base. Since 1990, Chester's population has declined by nearly one-third and for those who remain, poverty, crime, and unemployment rates have soared while property values have plummeted well below the state average. Pro-active crime prevention efforts have been replaced by repeated nighttime curfews imposed in response to violent gun crime and drug-related activity. Today's Chester provides a grim picture of a small city in distress, with other small cities not far behind.

The realities faced by these cities foretell the future of every municipality in Lancaster County and across the Commonwealth. The negative impact of outdated laws, burdensome regulations, and a fragmented local government structure, is beginning to be felt by municipalities of every size struggling with the same financial challenges that threaten the survival of their larger neighbors.

This report provides a road map for policy-makers, advocates, community leaders, elected officials, labor unions, and residents who are willing to acknowledge that Lancaster City is at a tipping point. Unless meaningful action is taken to replace or reduce reliance on property taxes as the sole means of financing City services, Lancaster City will join other Third Class cities in Pennsylvania that have lost their appeal and are falling into decay.

A Shared Destiny

In Pennsylvania, the high cost of maintaining too many local government entities has long been acknowledged as obvious yet well-entrenched. Pennsylvania is home to 67 County governments; more than 2500 local governments; and 501 School Districts – all with independent authority to levy local taxes.

Each of these cities and neighboring suburbs compete for the same housing, infrastructure, and investment dollars. Yet private sector business leaders recognize that the decline of one would constitute a loss for the other. In announcing a new funding initiative, Ford Foundation president Luis A. Ubinas noted that “Economic growth requires that cities and suburbs work together. The notion that suburbs can thrive while city centers atrophy has proved damaging to our nation. We now know that metropolitan areas share a common economic destiny. [Areas] that manage to interweave urban and suburban development attract more people, and more investment. We need [to] embrace a shared economic destiny.”

“The notion that suburbs can thrive while city centers atrophy has proved damaging to our nation.”

• Luis A. Ubinas
Ford Foundation

The notion that Lancaster County’s economic health is intertwined with that of the City is supported by a 2009 study by Franklin and Marshall’s Local Economy Center and Center for Opinion Research. In measuring the impact of the arts on economic development in the City and surrounding County, researchers found that economic flows associated with the arts in Lancaster City total nearly \$73 million and over one thousand jobs. Thus, the ability of the City to sustain and expand its appeal as an arts and tourism destination will have a significant impact on the County’s economy. Likewise, the City’s appeal is reliant upon its ability to finance the infrastructure, public safety, and other services that visitors, residents, and businesses demand.

The Root Causes

While significant attention has been given to the fiscal distress that many cities and smaller municipalities are experiencing, little discussion has focused on the root causes of this distress. In January 2008, the U.S. Government Accounting Office released its report, *State and Local Governments: Growing Fiscal Challenges Will Emerge during the Next 10 Years*. As the title suggests, the GAO study found that current fiscal policies will leave local governments across the nation with significant budget shortfalls and/or an increased need for borrowing within the next decade. Essentially, the GAO identified a structural imbalance between revenues and expenditures that has created a structural deficit into the future.

The GAO report concluded:

- Policy changes will be necessary in order for local governments to fill the gap between projected revenues and expenditures.
- Fiscal challenges are unlikely to be overcome solely by increasing revenue or by reducing expenses. Local government financing is hampered by structural problems that will require structural solutions.

Increasing Revenue, Reducing Expenses

Nearly four years ago, consultants worked with Lancaster City officials to develop a long-range financial plan; identify opportunities for increasing City revenues and reducing expenses; and analyze operations and programs with an eye towards improving service delivery while lowering costs. After an extensive audit of City operations and an analysis of financial trends affecting the City's budget, Management Partners, Inc. reported that "Revenues are growing slowly, if at all, while expenses increase due to higher labor cost and cost of goods purchased. The financial forecast [we developed], based on current revenue and expenditure trends, predicts Lancaster City will be unable to balance the 2009 budget and faces an accumulated shortfall of more than \$69 million by 2012."

TABLE 1: GENERAL FUND FINANCIAL PROJECTION 2007 – 2012

	2007	2008	2009	2010	2011	2012
Beginning Balance	\$15,221,475	\$11,755,104	\$5,984,842	(\$1,572,848)	(\$10,704,603)	(\$21,780,213)
Revenue	\$39,791,014	\$39,621,298	\$40,482,615	\$41,370,574	\$42,286,172	\$43,230,453
Expense	\$43,257,385	\$45,391,560	\$48,040,305	\$50,502,329	\$53,361,782	\$56,689,900
Surplus/(Deficit)	(\$3,466,371)	(\$5,770,262)	(\$7,557,690)	(\$9,131,755)	(\$11,075,610)	(\$13,459,447)
Ending Balance	\$11,755,104	\$5,984,842	(\$1,572,848)	(\$10,704,603)	(\$21,780,213)	(\$35,239,660)
Cumulative Deficit	NA	NA	(\$1,572,848)	(\$12,277,451)	(\$34,057,664)	(\$69,297,324)

<http://www.co.lancaster.pa.us/lancastercity/cwp/view.asp?A=670&Q=59757>

By 2010, most of the 182 Management Partners recommendations had either been implemented or were in the process of being implemented. Others had been rejected because of conflict with State law, or delayed because of an inability to reach agreement with bargaining units on recommended changes. In spite of actions taken to improve efficiencies, a reduction of 15% in the size of the City's workforce, and a series of property tax increases, Lancaster's financial stability continues to be undermined by flawed and archaic policies at the State level.

Indeed, Pennsylvania is operating in a 21st century economy while struggling to finance public services with policies, structures, and labor contracts conceived in the mid part of the 20th century. For most of Pennsylvania’s Third Class Cities, three factors that have the most detrimental impact on local government finances are:

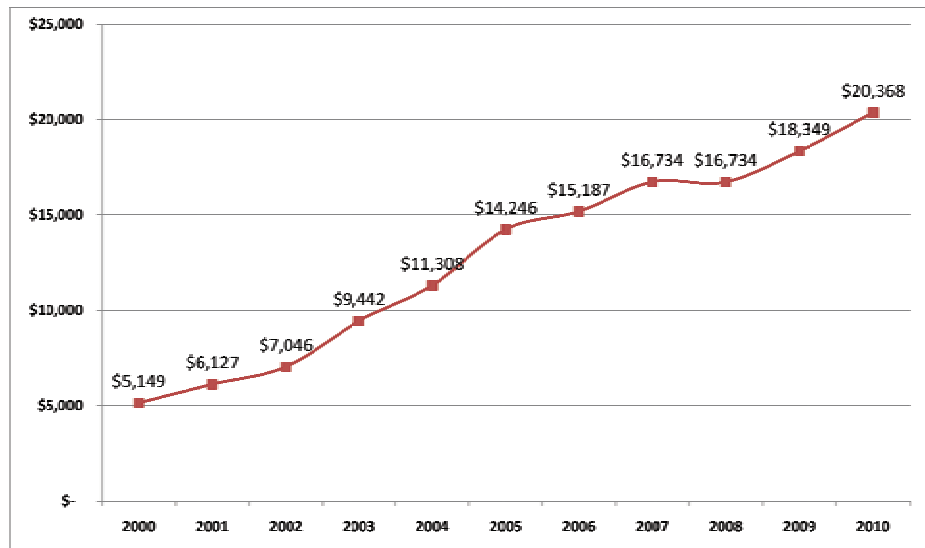
- Health insurance and mandated pension benefits;
- State restrictions that limit the ability to generate revenues by means other than the property tax.
- A fragmented local government structure with multiple neighboring municipalities duplicating core services.

Mandated Benefits

In a 2007 study, entitled *Structuring Health Communities*, the Pennsylvania Economy League found that “The fiscal distress of our municipalities is rarely due to mismanagement. Rather, this distress is more commonly due to the crushing burden of funding healthcare and pensions for their present and past employees.”

One-third of the City’s annual budget is consumed by benefit expenses for active and retired employees. Of that one-third, seventy-five percent is spent on health insurance and pension obligations. Health insurance costs have risen nearly 300% during the past decade – a pace that cannot be sustained. For the most part, current health benefit levels are established in labor contracts that were awarded more than two decades ago, when Health insurance was far less expensive than it is today.

Medical Insurance Premiums – Family Coverage
Annual Premiums: 2000-2010



Note: Above premiums for Fire and Police. Non-Uniformed coverage rates are approx. 4% lower

Labor contracts notwithstanding, the Pennsylvania Third Class City Code mandates that the City provide a defined benefit pension plan for its Police Officers and Firefighters. Yet, private sector businesses have almost entirely abandoned defined benefit pension plans because the risk of funding the plans is borne entirely by the employer. When pension fund investments don't provide sufficient return to cover the costs of these mandated benefits, City taxpayers are faced with covering shortfalls. This is not meant to suggest that City retirees are overpaid. What it does mean is that, with these legacy costs, today's taxpayer is paying for services long ago rendered while, at the same time, struggling to pay for current day services.

In Lancaster, even without counting the cost of pension or other fringe benefits, salaries alone for Fire and Police Departments consumes nearly 80% of all property tax revenues. Thus, property taxes do not generate enough revenue to pay for the anything beyond police and fire personnel – much less other critical services such as street cleaning, snow removal, parks maintenance, and housing code enforcement.

Limited Revenue Sources

State laws that force cities to rely on property taxes as the primary source of revenue fail to take into account the impact of a high concentration of non-profit entities that pay no property taxes. An estimated one-third of Lancaster City properties valued at nearly \$750 million dollars are tax-exempt. This includes County-owned properties such as the Courthouse, the County Prison and the Youth Intervention Center. Based on current values, County-owned properties alone represent \$1.2 million in lost property tax revenue. City taxpayers must fill this gap in revenues and are thus left with the highest property tax rate of all 60 municipalities in Lancaster County.

“County-owned property alone represents \$1.2 million in lost tax revenue.”

Cities like Lancaster, in which nearly all of the land has already been developed, also face the annual prospect of a stagnant or even falling real estate tax base. At the same time, suburban development can sometimes be at the expense of the City. For example, the City of Lancaster lacks the authority to levy a tap-in fee for new water utility service hook-ups for customers located outside the City's borders. This results in large up-front capital investment expenses to provide service to new housing developments without a dedicated source of revenue from the recipients of the new service for those capital expenses.

Continued failure to address the over-reliance on property taxes as a source of revenue undermines the financial stability of the City and will eventually result in fiscal distress for each and every one of the 60 municipalities that make up Lancaster County. Clearly, the success and economic health of the City as a vital core of the County is directly related to the future of the boroughs and townships that are home to hundreds of thousands of County residents.

This recession has placed a spotlight on the fiscal reality in which local governments operate. At the same time, it provides us with an opportunity to make long-term and long-overdue reforms in how we're financed and in how we're structured. Arcane and inequitable practices from a bygone day must be updated or discarded; local government structure should be remolded and streamlined, much as was done with the consolidation of school districts in the post-World War II era.

The time has come for Pennsylvania's legislature to change the rules by which communities finance their local services. Local governments are forced to operate with a fiscal system that is, at best, irrational and, at worst, dysfunctional; a system that effectively deprives locally elected officials and the people they serve of the ability to be the architects of their own communities and their own futures.

A "NEW DECK"

In Pennsylvania, the extent to which reform is needed and what steps should be taken, predictably varies depending on individual perspective. There are institutions and groups who either benefit from the status quo or who feel secure in its familiarity. Nonetheless, specific and immediate action must be taken to implement reforms that will stabilize the financial future of local governments across Lancaster County and the entire Commonwealth.

- ***The public safety contract arbitration system must be reformed to return balance and to establish reasonable standards upon which awards are based.***

"... the reality is, the numbers don't work for most of our cities, even when fiscal controls are in place and financial discipline is present. It's darn near impossible to succeed because the deck is stacked against cities in Pennsylvania."

▪ Secretary George Cornelius
PA Dept. of Community &
Economic Development
November 2009

Instituted in the late 1960s to counter low wages and poor working conditions, Pennsylvania's Act 111 established the arbitration process for resolving contract disputes between municipalities and public safety personnel (police and fire). Since that time, the Act 111 process has grown into the most significant and costly mandate placed upon local government. The municipality bears the full cost of the neutral arbitrator, with no cost to the bargaining unit; and "neutral" arbitrators are not chosen at random, resulting in a lack of neutrality. This provides little, if any, incentive for bargaining units to negotiate in good faith and work to resolve contract disputes without the need for costly arbitration. Finally, with no standards or guidelines as to what conditions must be met in order for arbitrators to arrive at specific contract awards, Act 111 has resulted in huge increases in a municipality's cost to provide mandated salary and benefits to active public safety employees, retirees, and their families.

Act 111 arbitration awards regularly impose collective bargaining agreements on local governments to provide: wage increases that outpace the rate of inflation; fully-funded health insurance with low-or-no employee contribution to premiums; lifetime health insurance benefits; defined benefit pension plan cost of living increases; and on-duty minimum staffing levels. For the City of Lancaster, the combined cost of these contract awards can represent as much as 65% of the City's entire budget.

Act 111 must be amended to establish standards by which arbitrators must award contracts. Rather than arbitrators being able to determine awards based on what will achieve the necessary majority vote of the arbitration panel, awards should be based upon a choice between the "last best offer" on each item in dispute. This would provide an incentive for both parties to negotiate an agreement on most issues prior to arbitration and, at the same time, ensure that demands and conflicting positions taken to arbitration are reasonable.

- ***Management and bargaining units must engage in meaningful discussions of how health care and pension benefit levels can be adjusted to accommodate today's financial realities.***

The Commonwealth should incentivize inter-municipal and inter-governmental health insurance purchasing cooperatives in order to take advantage of greater buying power in the insurance market place. The Commonwealth should remove mandates for defined benefit pension plans and provide incentives – or even mandates - for consolidation of municipal pension plans at the statewide level. Such consolidation would also provide for a reduction in the massive costs of administrative overhead associated with maintaining the more than 3,000 municipal pension plans in Pennsylvania.

- ***Fragmented government at the local level must give way to inter-municipal shared services.***

Pennsylvania cannot flourish or compete with fragmented government at the local level. To increase efficiency and reduce the costs of local government, inter-municipal delivery of services must be incentivized or mandated – and funded.

The 11 municipalities comprising the central core of Lancaster County are home to nearly 187,000 residents – about 40% of the County's total population. In spite of their proximity, eight of these municipalities each have their own Police Departments and Police Pension Plans; their own Public Works Departments; their own Planners, Code Officials, Solicitors, and so on.

If issues of politics, power, or parochialism prevent changes in municipal government structures that have been in place for hundreds of years, the Commonwealth should at least provide incentives that would lead to inter-municipal shared service agreements. Doing so would reduce the costs of infrastructure, service and equipment, eliminate operational redundancies, and allow the cost of necessary core services to be shared among a larger base of taxpayers.

- ***Property Tax reform must happen. Property owners cannot be burdened with disproportionate responsibility for funding public safety, public education, public works and County government services. Property taxes cannot sustain the cost of providing these services.***

Simply stated, reliance on property taxes to fund police, fire, public works, public education and county government places the entire burden on property owners who can no longer be expected to pay the cost of these services. Local governments must be given a menu of options for generating revenue so they can determine how best to finance municipal services, based on land development needs, population demographics, the cost of municipal services, and the demands and priorities of local residents and businesses.

- ***Revenue sharing must be established as a way for consumers of services to assume a fair share of the cost of those services.***

Nearly 30 percent of real estate in the City is exempt from taxation. Millersville Borough's percentage of tax exempt property is even higher at nearly 33 percent, primarily due to property owned by Millersville University. An additional 13 Lancaster County municipalities (7 boroughs and 6 townships) have tax-exempt property that makes up at least 10% of their community's total assessed property value.

Tax-exempt organizations play a significant and beneficial role in the lives of Lancaster County residents. Churches, schools, government offices, hospitals and social service organizations enhance our quality of life and, for an increasing number of County residents, a source of basic life necessities. The logical and most efficient location for many of these organizations is in the urbanized areas of the county – the City and boroughs. While the burden of the tax-exempt status of these organizations is borne only by the taxpayers in the host municipalities, these organizations serve populations from well beyond the municipal borders in which they are located. A State and/or County revenue sharing program should be created to offset the financial impact experienced by local municipalities that are host to high concentrations of tax-exempt properties.

In addition, some form of Federal revenue sharing must be re-instated to support the direct services that only local government can provide. First used by the Nixon Administration, from 1972 until 1987 Federal revenue sharing replaced a large number of federal grant programs with direct payments to States, Counties, and Municipal governments. During that time, Lancaster City received over \$1 million each year – about 8 percent of the City's total General Fund revenues. Funds were expended based on priorities and needs as determined by the local community.

Federal revenue sharing was also intended to help relieve the burden of costly federal mandates on state and local governments. Now, with such relief no longer available, one unfunded federal mandate alone, -- the Americans with Disabilities Act, -- is costing the City taxpayers millions of dollars to retrofit every intersection in the City with ADA-compliant curb ramps. A third goal of the program was to provide funding from a more progressive revenue source (the Federal income tax) to state and local governments whose revenue sources were typically more regressive (sales and property tax revenues).

Were it reinstated, the federal revenue sharing program would be of significant financial and operational benefit to the City of Lancaster. Federal revenue sharing would provide a new source of predictable, sustained revenues each year, with a flexibility that the City does not currently possess with the variety of program-specific grants it currently receives from the federal government.

➤ ***Replace barriers with incentives for investing in community and economic development projects in older cities.***

Economic development initiatives aimed at revitalizing the urban core of the City are undermined by state policies that make development more difficult. Implementation of the State Uniform Construction Code adds significant costs and poses excessive burden on revitalization projects in urban or historic locales; and the excessive cost and time needed to conduct environmental assessments and secure the clearances required to develop urban properties serves to undermine rather than encourage private investment in the City.

Lawmakers must establish policies that encourage investment in Pennsylvania's older cities. Historic structure tax credits and building codes that are more adequately applied to the adaptive reuse of existing structures have been successfully used by other states to boost economic development and revitalization of cities.

For additional information, contact: Mayor's Office, City of Lancaster
717.291.4701 www.cityoflancasterpa.com

APPENDIX

I. Policy Recommendations

- Act 111
- Act 511
- Pension
- Regulatory
- Revenues & Incentives
- Boundary Review

II. Third Class City White Paper: Chamber of Commerce

III. “Regulated to Death” – Business 2 Business Magazine, Oct. 2010

IV. Lancaster Newspapers

- **“Pa. Cities Left To Beg For Relief” –**
Sunday News, Sep 13, 2009
- **“A City and Its Mayor at a Crossroads” –**
Intelligencer Journal/Lancaster New Era, June 16, 2011
- **“SOS: State Needs to Make Radical Changes to Save Foundering Cities and Boroughs” –** Sunday News Editorial, June 19, 2011

**APPENDIX I:
POLICY RECOMMENDATIONS**

Pennsylvania ACT 111 Reform

The contract arbitration process established by Act 111 has grown into the most significant and costly mandate placed upon local government. Act 111 should be amended to:

- Establish standards by which arbitrators must award contracts. Currently, no standards or guidelines exist to define the conditions that must be met in order for arbitrators to arrive at specific contract awards.
- The “reasonableness” of contract awards, pursuant to specific standards, should be appealable by either party to a court of record. Currently, awards are generally not appealable. Such a procedure would encourage both sides to present more reasonable demands of the other during the negotiation process and encourage resolution without arbitration.
- Standards should include a finding regarding the municipality’s financial status. Arbitrators do not take into account the ability of a municipality to pay when awarding contract benefits and salaries, and do not differentiate between the ability of urban and suburban municipalities to afford the costs of contract awards. Police contracts in wealthy suburban municipalities are often used as “comparables” in City Act 111 arbitrations -- despite the structural financial problems cities have compared to most of their suburban neighbors.
- Allow arbitration rulings based on a choice between the “last best offer” submitted by each party for each item in dispute. The current method of determining awards relies on the subjective assessment of what will achieve the necessary majority vote of the arbitration panel.
- Neutral arbitrators should be chosen randomly by the Commonwealth and the cost of the neutral arbitrator should be shared equally between the municipality and the bargaining unit. Neutral arbitrators are currently chosen by agreement between the two parties, with the municipality bearing the full cost of the neutral arbitrator and at no cost to the bargaining unit.
- Arbitrators should be prohibited from awarding wage increases that exceed the rate of inflation. Note that this been implemented by New Jersey Governor Christie.

Pennsylvania Act 511 Reform

The Local Tax Enabling Act places Third Class cities at an economic disadvantage by limiting the ability of Third Class cities to generate revenues.

- Provide Third Class cities and other local governments with more flexibility with respect to taxing options.
- Enable Counties that are home to Third Class Cities to consider the establishment of Regional Asset Districts. .
- Provide counties and local governments with more options regarding how to deal with tax-exempt properties, particularly in those jurisdictions where such properties represent a significant percentage of the local property tax base.
- Allow cities with ownership of regional assets (i.e. water and sewer systems) to have more options for recovering operating costs.
- Enable the allocation of earned income tax payments based on location of employment rather than location of residency.

Establish Revenue Sharing and Efficiency Incentives:

Nationwide, states have established revenue sharing programs to provide local governments with a predictable source of revenue that would grow with the State's economy. Local governments continue to face growing fiscal stress and local tax rates are under increasing upward pressure as municipalities attempt to meet their responsibilities. Communities facing the most difficult economic conditions must be assured that the State will provide aid amounts which account for local fiscal capacity and need.

- Establish a formula for unrestricted State Per Capita Aid to cities based on objective measures of fiscal need, effort, and capacity.
- Establish an Incentive Aid Program that encourages localities to operate more effectively and efficiently and rewards consolidation and cooperation efforts

Third Class City Code: Pension Reform

Third Class City Code requires cities to fund a defined benefit pension plan for police and fire. Pennsylvania has more than 3,200 local government pension plans, about a quarter of all such plans in the nation, though two-thirds of the plans have 10 or fewer members.

- Incentivize the administration and management of local government plans by the Pennsylvania Municipal Retirement System (PMRS) and establish a statewide municipal employee pension plan.
- Prohibit benefit enhancements unless the system is 90 percent funded.
- Adopt new benefit levels/rules/contribution rates for all new hires.
- Prohibit including overtime and/or longevity in salary calculations.
- Replace mandated defined benefit plans with a hybrid plan that combines defined benefit with defined contributions. Given that police and fire personnel do not pay into and are not eligible to collect Social Security, this is necessary to provide a base benefit that is not dependent on market returns.
- Prohibit pension obligation bonds or other post-employment benefit (OPEB) bonds.
- Establish a maximum annual assumed investment return ceiling such as 6.0%
- Prohibit benefit enhancements if the result of such improvements causes the funded ratio to fall below 90%.

Regulatory, Grant and Fee-Related Reforms:

Various regulatory barriers must be replaced with incentives for private investment to stimulate community and economic development projects in older cities.

Cities must be provided with the opportunity to compete for existing state grant funds and; cities must be authorized to assess fees for utilities and services provided to non-resident consumers.

- Implementation of the State Uniform Construction Code adds significant additional costs and poses excessive burdens that hinder development projects in older cities. The UCC must be amended in a way that takes into account the special challenges and increased costs inherent in projects involving adaptive reuse of existing structures.
- Prevailing wage requirements should be abandoned and replaced with living wage requirements based on the local economy.
- The excessive costs and time required to conduct environmental assessments and secure clearances to allow development of City properties undermines investment in the older cities.
- Municipal Fire Bureaus staffed by paid professionals are not eligible to receive State grants. Instead, recipients of these State grants must be incorporated as a volunteer department.
- Only volunteer fire companies are eligible to receive low interest loans for fire apparatus; paid professionals Fire Bureaus most commonly found in older cities are ineligible.
- Cities must be provided with clear authorization to implement storm water utilities.
- Cities must be authorized to assess a tap-in fee for water and sewer services.
- Expand historic tax credits to stimulate neighborhood revitalization and homeownership in older cities.

Adopt Boundary Review Commission Legislation:

The State Planning Board has recommended changes to help municipalities adapt and thrive in the years ahead. Among them is a proposal to establish a Boundary Review Commission for the purpose of recommending municipal service and/or municipal government consolidations to the PA General Assembly.

- Boundary change recommendations should promote orderly development and encourage sound economic growth, conservation of resources, and effective delivery of government services.
- Boundary change recommendations should be developed for the purpose of creating and maintaining municipal corporations that have sufficient tax base and sound prospects for fiscal health.
- Set forth the Commission's powers & duties including authority to make studies (including cost benefit analyses) and recommendations to the General Assembly on "reorganizations" of local governments defined to include consolidation, merger, annexation of territory, shared services and functions, boundary changes, and creation of "area government" in accordance with Articles 6, 7 and 8 of the Pennsylvania Constitution.
- Give the Commission authority to receive and act on petitions for studies, from local governments, registered voters representing at least 5% of registered municipal voters, and upon notification by the Secretary of DCED that voluntary efforts for a non-viable or fiscally distressed municipality have failed and study and action by the commission is requested.
- Give the Commission authority to hire staff and/or to contract for services with DCED for administrative services.
- Authorize the Commission to make recommendations to the General Assembly for a plan or plans of reorganization applicable to affected counties and municipalities for boundary change. The plans may include municipalities in all classes of counties and municipalities except counties and cities of the first and second class unless such counties and cities seek to be included in a plan of reorganization.
- Require findings of three or more of seven indicia of non-viability and fiscal distress as grounds for recommending a plan of reorganization. Require consideration of the comprehensive plans of the affected counties and municipalities.
- Require publication of a plan or plan of reorganization within 30 days of the Commission's approval, a 60 day public comment period.
- Require the Legislature to vote by resolution of the plan of reorganization within six months.

**APPENDIX II:
Chamber of Commerce
Third Class City White Paper**



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Third Class Cities White Paper Outline:

Pensions:

- Authorize municipalities to offer an optional defined contribution plan and encourage municipalities to place all new hires into such a plan.
- Adopt/ensure appropriate actuarial principles.
- Incentivize/encourage the administration and management of plans by the Pennsylvania Municipal Retirement System (PMRS).
- Prohibit benefit enhancements unless the system is 90 percent funded.
- Adopt new benefit levels/rules/contributions/rates for all new hires.
- Prohibit including overtime and/or longevity in salary calculations (anti-spiking).

Binding Arbitration:

- Consider a municipality's "ability to pay."
- Redefine an "impasse."
- Instill "last/best" offer as part of the arbitration process.
- Ensure neutrality of arbitrators.
- Institute a legitimate appeals process.
- Share the cost of arbitration.

Economic Development:

- Create "Urban Redevelopment Areas."
- Expand the Local Economic Revitalization Tax Assistance (LERTA) program to non-profit properties.
- Create a "Strategic Communities Partnership."
- Remove impediments to and support shared services.

Revenue Enhancement:

- Recognize revenue sources and challenges as a real issue.
- *Address revenues after other reforms are in place.*

Metro Chambers for Sustainable Cities

Cities like Reading, York, Lancaster, Harrisburg, Wilkes-Barre, Allentown, Bethlehem and Easton share a similar history, charm and sense of community. But they also share less idyllic characteristics with concentrated poverty, deteriorating property values and red ink seeping into the city balance sheets as tax revenues fails to keep pace with the cost of providing basic services.

The extent of the fiscal predicament was validated by research conducted by the Pennsylvania Economy League (PEL) of five of the cities concluding that financial stability is on very shaky ground due to “systemic problems, not political or personality based problems.”

Municipalities expend their largest share of resources maintaining the most fundamental and much needed services of police and fire protection. Each of the municipal governments in the PEL study has been engaged in using – to varying degrees – operational supplements in order to bring total revenues in balance with total expenditures.” Municipalities have been creatively plugging an existing hole for some time now in order to meet basic needs. The cities have transferred funds from Water and Sewer and the Parking Authorities, sold off assets, and refinanced debt. The plugs ran out for Reading since the report was published and the City filed Act 47 in the hopes of developing a sustainable financial plan with the state’s help. Harrisburg appears poised for the same fate and the others likely a year or two behind.

Ironically, Act 47 provides relief for municipalities from some of the constraints they face due to the systemic or structural problems. So why not address the constraints directly?

On the revenue side of the equation, municipalities only have the authority to tax in areas specifically granted by the state. Act 511 gives Third Class Cities the authority to tax income and property of its residents. Concentrated poverty and deteriorating property values have eroded the base of taxation while City Councils have contributed to the declining revenue stream in their reluctance to increase the rates on the taxes. Cities also host a large proportion of non-taxable property including schools, colleges, hospitals, churches, charitable organizations and government buildings.

Expenditures haven’t been contained very well either. The PEL report pins the blame on contract arbitration awards, skyrocketing healthcare costs and the costs of maintaining fully funded pension plans.

The bottom line: The PEL study concluded that in each of the cities, taxes and non-tax revenue simply do not and cannot support the expected level of essential services that the cities provide on an annual basis. Due to state mandated and demographic constraints, City elected officials will be unlikely able to solve this structural dilemma alone. It will require a regional perspective and modifications of the state legislated framework in which cities operate, including Act 511 (tax authority), Assessment law, Act 111 (binding arbitration), Act 205 (pension requirements), and Act 47.

The revenue side of the equation should be addressed after the expense side of the equation is addressed or the problems our Cities face will only be further fueled.

Pensions

Background

Municipalities, and Third Class Cities in particular, expend their largest share of resources maintaining the most fundamental and much needed services of police and fire protection [Note: Most municipalities have very low fire protection costs because they rely on volunteer departments. Cities, in contrast to boroughs and townships, are different in that they mostly have paid or paid/volunteer departments. Of the 53 third class cities, only eight do not have any type of paid fire protection while 46 do]. The costs however have reached a point where they now exceed the total tax revenues coming into the cities. Using Reading as the example, public safety personnel expenditures grew by \$12 million from 2003 through 2007, while personnel headcount remained fairly constant. Salaries increased 28%, employee benefits rose 81% and pension costs were up 176%.

Obviously, a ranking problem for the Cities on the expenditure side is escalating pension costs. Pennsylvania has over 3000 separate local government pension plans, which is 25% of all such plans in the nation! And two-thirds of the plans have 10 or fewer active members.

While the efficiency of administering 3000 plans is an obvious issue, it is the funding of the benefits that is the bigger problem. During the 90s, healthy investment returns led to decreased employer contributions to Defined Benefit (DB) plans and expansion of benefits. Practices did not change with changing economic realities and a combination of underfunding, investment losses, benefit increases and inappropriate funding assumptions have led to a tipping point. By 2007, there was an estimated \$5.2 billion in unfunded liabilities.

The private sector shift to DC plans actually began in the 1980s and is an international trend. The movement has been due to a confluence of factors including the decline in long term interest rates, the move to market based accounting, increased regulatory burden all of which mean uncertainty in long term costs, which is unacceptable as a business practice. DC costs are actual and final where DB costs are simply estimated deposits based upon actuarial assumptions.

The private sector has by and large shifted away from defined benefit plans to defined contribution (DC) plans; government has not. In fact, our cities are required by state law to offer defined benefit pension plans.

Recommendations

We believe there is a need to pursue comprehensive and sustainable long-term pension reform for our cities to be financially sustainable. Pension Reform should be guided by a responsible set of principles and standards, which do not contribute to passing today's cost to future taxpayers.

Steps lawmakers should take to address the pension crisis are:

1. Establish a unified Defined Contribution plan for new members like a 401(k) style plan to curtail open-ended liabilities for taxpayers. Allow by law Third Class Cities to establish such plans as well. While this does not solve the underfunding of the current system, it better manages future risk.
2. Funding of public sector defined benefit plans should be kept current. Benefits should be funded as they are accrued. Require a set of valuation and funding standards (assumptions) consistent

with sound actuarial and accounting principles for public sector defined benefit plans. Such reforms are now required of private sector defined benefit plans in The Pension Protection Act of 2006 which requires lower interest rate assumptions, market valuation of assets and shorter amortization periods. Public sector defined benefit assumptions are currently at roughly 8% [I agree with the basic point, but be careful how you state this. Not all are at 8% – some are higher and many are lower.] which is not practical (Private sector closer to 6%). Amortization periods should conform to the remaining working duration of the active members of the plan. Asset values need to conform to market related values and be compliant with Government Accounting Standards Board (GASB) accounting requirements

3. Modifying existing defined benefits plans including:

Prohibit benefit enhancements if the fund is below 90% funded

Anti-spiking – prohibit overtime in calculation

Allow municipalities to offer optional defined contribution plans to all employees.

eliminate COLAs and Deferred Retirement Option Programs (DROPs).

Binding Arbitration

Act 111:

Act 111 states how Commonwealth employed police and fire personnel can resolve contract disputes and grievances. In accordance with the law, they cannot strike and therefore have the right of binding arbitration which allows unresolved disputes to be handled by a panel of arbitrators who then make a decision on the dispute. Act 111 authorizes three specific measures: (1) collective bargaining between police/fire and their employers, (2) for arbitration in order to settle disputes, (3) and it requires compliance with collective bargaining agreements and the finds of arbitrators. The overall law is vague on the specifics of the arbitration process and fact-finding provisions.

The Arbitration Process at a Glance:

Collective bargaining becomes binding arbitration when the two parties involved reach an impasse, which then ushers in the need for an arbitration panel. The arbitration panel is composed of three individuals in which one is chosen by the union (the employees), one by the employer (municipality etc.), and the third is a neutrally agreed upon person chosen by the union and employer. It is also very important to note that the decision made by the arbitration panel is final and binding on both parties.

The Need for Reform:

Many studies have concluded that although Act 111 is a safeguard to prevent strikes and contract disputes by police and fire professional employed by the State, there are several reforms that are needed in light of the overall process, as well as, the increasing numbers of municipalities facing Act 47 and possible bankruptcy.

Recommendations

1. *Consideration of Ability to Pay*

Several studies and criticisms of the Act 111 arbitration process focus on municipality considerations and arbitration awards that lead to strong financial stress on a city or municipality. Studies have shown several criteria that focus primarily on market forces to combat this problem: comparison with economically and demographically similar cities to see what their police and fire personnel earn and the benefit package they receive; staffing levels; productivity level changes; hours worked per-week; inflation since the approval of the last contract and projected for the term of the contract; average income growth in the municipality; and financial ability of the municipality. A municipality's ability to pay should strongly be considered as a reform to the system due to the exponentially growing number of distressed cities in Pennsylvania.

2. *Redefine definition An Impasse*

Act 111 states that an impasse exists when the parties don't reach a written agreement within thirty days after collective bargaining proceedings have begun. This raises the question of whether an actual impasse exists between the two parties and the necessity of binding arbitration. Clarification of the law would aid in establishing when a true impasse exists. For instance, under Ohio law the Bureau of Mediation must determine that the following conditions have been met prior to issuing a conciliation order: fact-finding report was rejected timely by at least one party by a three-fifths majority of the individuals who were eligible to vote, the vote of the fact-finding report was served timely upon the State Employee Relations Board (SERB) and the other party, publication of the fact-finding report did occur in which the effective date of publication is stated on the board-issued notice of rejection of the fact-finding report, at least

seven days have passed since the effective date of publication of the fact-finding report and the parties have not reached a settlement. Eliminating 'false' impasses may lead to proactive negotiations between the parties and eliminate costs associated with the binding arbitration process.

3. *Last-Best Offer Arbitration*

This type of arbitration is used in baseball arbitration and requires each party to give their 'best and final' offer. The arbitration panel would then choose one of the last-best offers as the arbitration award. This is a clear cut arbitration style that inhibits an arbitration panel from making additional awards; their choice is only offer A or offer B. This also forces the two parties to make legitimate offers and levels the playing field allowing for an offer that is likely to be acceptable to both parties in the end.

4. *Neutrality of Arbitrators*

These suggestions are examples of how arbitrators could be selected and how they could make a judgment:

- **State Oversight:** A pool of arbitrators would be housed in the Department of Labor and Industry and would be classified as civil servants, free of political pressure. Panels of arbitrators would be appointed from the pool to hear cases around the state.
- **Neutrality:** Arbitrators would have no interest or connection to the dispute. No arbitrator could participate in a case in the county where he or she resides.
- **Professionalism:** Arbitrators would be certified by a professional organization/association and would be qualified to hear cases involving workplace matters for police and fire personnel and their employers.
- **Accountability:** A review panel made up of disinterested senior arbitrators should oversee the arbitrators' decisions and have the final approval on awards.

5. *Institute a Legitimate Appeals or Review Process*

As it stands now, there is no formalized appeals process once the arbitration panel makes an award-both parties are bound by the decision. In all other facets of our judicial system, an appeals process is permitted in order to review decisions and possibility eliminate excessive judgments. Currently courts will only review an award made by the arbitration panel if it is outwardly excessive, however clarification on what 'excessive' means is needed as well as a trigger that municipalities could use if they view the award as excessive in terms of their ability to pay. Amending the law to include the right of appeal and judicial review may handicap the use of excessive awards and further level the playing field during arbitration.

6. *Shared Cost of Arbitration Process*

The Pennsylvania League of Cities & Municipalities (PLCM) notes that in addition to the issues of cost, the Pennsylvania State Association of Township Commissioners (PSATC) supports amending Act 11 to place the cost of the third arbitrator and all other expenses on the party requesting the arbitration and this would therefore make the process more efficient and more fair in terms of cost. As it currently stands, the municipality is required to pay for their appointee arbitrator as well as the third neutrally appointed arbitrator.

Third Class City Alliance – Emphasis on Economic Development

No City can "out-build" the regressive governance and tax structures established for Cities in Pennsylvania Law. Our Cities must be given a new set of development tools designed to encourage commercial investment and residential growth.

- **Create Urban Redevelopment Areas/Development Tax Credit:**
 - Areas are designated by the Cities in planning with DCED and final approval of DCED
 - Areas must have a local 10 LERTA in place provide at least 5 years at 100%, then graduated to 20% in last year.
 - Program goals include development of mixed use, walkable communities with good access to public transportation
 - Expansion or program similar to the Enterprise Zone Tax Credit program that would apply a broader base of tax credits for businesses and residential development.
 - Raise participation rate to 40% (current rate is 20%) Tax credits could be sold for a percentage of value in order to generate capital, or applied directly to tax liability.
 - 20% tax credit would be available to property owners donating property for redevelopment in these areas
 - Add Historic Tax Credit of 20% for both commercial and residential with the ability to capitalize through sale of credits
- **Expand LERTA (Local Economic Revitalization Tax Assistance)** to include previously tax exempt properties (schools, churches, city, county, state, federal buildings, and buildings that paid under PURTA taxes.) to address problem of when an exempt property is purchased by the private sector, it immediately becomes fully taxable based on the assessed valuation when the property is sold, removing valuable capital from a renovation project that could be used for renovations.
- Through a reenergized Main & Elm Street program in partnership with the PA Downtown Center incentivize and financial support for the human capital required to enable a **Strategic Communities Partnership Program** – designed to bring cities, neighboring municipalities, city/county planners, economic development corporations and active urban not for profits together in 3rd Class Cities to work on strategies for redevelopment of major corridors and adjacent residential neighborhoods in 3rd Class Cities and larger Boroughs (over 20,000 population)
- **Neighborhood and small trade area support mechanism** to provide assistance to the "non-downtown" commercial sections of PA core communities. Most cities have their core downtowns, but also have smaller, neighborhood commercial districts as well, some of which may be just a few buildings. These areas serve as cores for residential areas with small groceries, restaurants and other services. They also inspire adjacent residential and other commercial investment. PA's program offerings have for the most part forced communities participating in other programs to "choose" their primary business district at the expense of these very small areas that require substantially less capital, but perhaps more technical assistance and organizing support. The Main Street/Elm Street programs should include a neighborhood commercial component.
- **Remove impediments to /encourage Shared Services**

The efficiency of service delivery could be enhanced if local governments addressed the delivery of services from a regional perspective. Economies of scale would show bottom line benefit and hard investments could be spread over a larger base.

**APPENDIX III:
“Regulated to Death”
Business 2 Business Magazine, October 2010**

The business solution to PA's city crisis

Regulated to Death

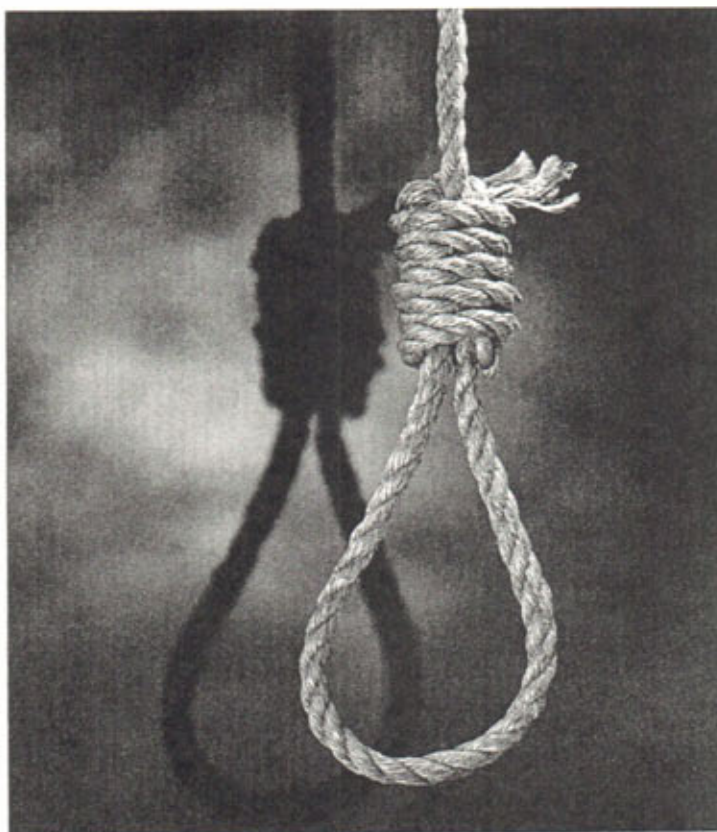
By Ted Byrne

In the past months, Pennsylvania's city fiscal woes were splashed across America's media. Reading has entered Chapter 47, Harrisburg has received emergency state relief to make a normal payment on a general revenue bond, and Lancaster has discovered that its entire property tax revenues fail to cover just the cost of its public safety employees. There is not one city in Pennsylvania that is totally solvent. And each of them is terrified of next year's impact of an enormous spike in their cost of public pensions. Late last month, we put these problems to four presidents of influential chambers of commerce. We wanted to know how they see the impact of these urban problems upon business. We wondered about a common business solution to the worst of the fiscal mess that has caused city financial management to break down.

Here's the discussion among David Black, president of the Harrisburg Regional Chamber & CREDC; Ellen Horan, president of the Greater Reading Chamber of Commerce & Industry; Tom Baldrige, president of The Lancaster Chamber of Commerce & Industry; and Nancy Keefer, president of the Chester County Chamber of Business & Industry.

David: Cities are in trouble in Pennsylvania. They are making headlines in financial publications read by millions of people worldwide. This adversely affects the business climate by perception. Unfortunately, perception becomes reality. The perception of our city problems, among people around the world, is that Pennsylvania is a failing state. Our cities make headlines. Reading has sought creditor protection under Act 47, Coatesville's struggling, Lancaster's on the brink, Harrisburg's in the can. Those truths and associated bad perception hurt in attracting and retaining both business and workforce.

Ellen: You cannot contain the problems within the city borders. It affects your region as a whole, making it less desirable as a place



to want to live and work. And that affects your talent base.

Tom: *If we treat this as a city problem, we will not solve it.* This is a countywide, regionwide, and statewide problem that speaks to the prosperity of our entire Commonwealth. While the cities might be feeling it most acutely, it is a problem in which we all have some skin in the game.

Nancy: Pennsylvania is ranked as having the highest effective corporate net income tax rate, putting us second in the world behind Japan. And a rank of 50 out of 52 in having a positive legal environment in which to do business puts all of us at a disadvantage.

Ellen: City governments are on the front line. Businesses are in a better position to help resolve some of the

problems simply because they are not political. A political solution isn't going to be sufficient.

David: I think the solution has to start with governments respecting business. As goes the state, so follow the cities and counties. We need the state and Washington to provide assistance to our businesses to grow, to provide an environment that is competitive and profitable. They do not need to tell them how to run their businesses by mandating them. The market has gotten so much bigger with global competition. It's no longer just about the state next door; it's much bigger than that.

David: The problem of the cities has transcended local government and also impacted public education. Fiscal problems and failing schools seem

FOODS

to go hand in hand in Pennsylvania cities. There is also evidence of the same types of *administrative distress* and signs of incompetence.

Tom: My initial take on both is that schools are on the front lines of feeling the impact, along with city governments, most specifically with respect to public safety and general public services, which are on the front lines as well. It all lends itself to an overall economic climate that will be impacted concurrently.

Why is PA first with respect to prominent city distress? Why when California, Illinois, Michigan, and New Jersey are so far ahead in terms of overall fiscal distress?

David: Structure. We have 2,562 municipalities, there are 53 Third Class cities in PA, 958 boroughs, our cities are smaller, more restrictive, they've never had the ability to grow and capture some of the suburban growth for their tax base. The boundaries of Coatesville, Lancaster, Reading, and Harrisburg are the same as they were when they were founded. The tax base can't grow, so redevelopment and reinvestment are key.

Tom: I also believe that while I don't know how it relates to other states, our cities have been more prone to practice a one-size-fits-all mind-set that may benefit the unions with respect to mandates here more than in other states.

Is this more a political than an economic problem?

Tom: Every expert and analyst agrees that there is a problem. And the problem is not just on the revenue side. In fact, revenue could be part of the problem by feeding other things (revenue as an enabler). There are structural issues that need to be addressed within city governments for them to sustain themselves. However, in the same breath, those experts say that change will never happen.

A lot of that is because you will be dealing with such things as police and fire, which are well organized and represented on a statewide basis from a lobbying perspective. Plus, the Republican and Democrat politics of the whole matter often get in the way of what many would conclude are common-sense solutions.

Nancy: The most common challenge our businesses discuss is the uncertainty of tax policy at the federal and state levels. In addition, continuous mandates on businesses for things such as health care and energy, lawsuit abuse reform, to name a few, ties the hands of businesses to be competitive in the

market. So in my opinion, politics plays a significant role in the economy, with both good and bad outcomes.

Are the revenue constraints on the city a political problem?

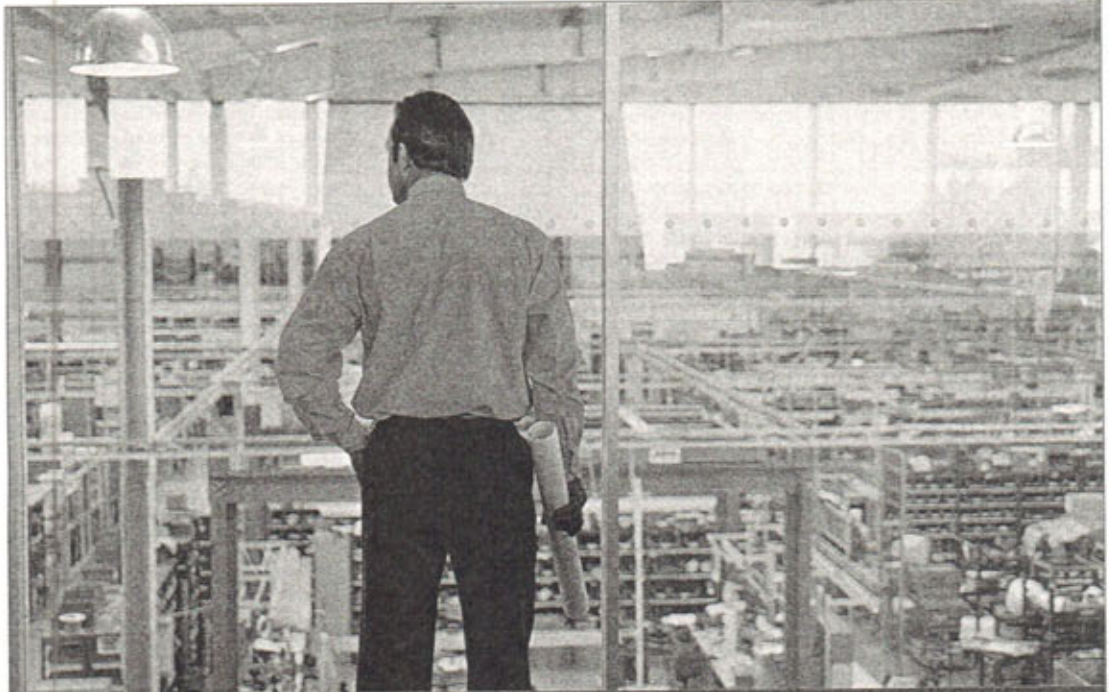
Ellen: The problem is really pretty simple—their expenses exceed their revenue capacity. They are not willing,

for political reasons, to address the *expense side* of the equation.

Nancy: Let's face it. If government ran like business, we would be better off. Specifically in the area of revenues and expenses. When businesses' revenues are reduced, they cut expenses. It's that simple. Unfortunately, in government,

we have all become accustomed to entitlement programs making expense reductions very difficult for political officials.

So many fish in the same pond: Except for some fees and minor income taxes, the largest revenue source is from real estate
More Regulated pg 8



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The Tale of Two Cities

Reading and Harrisburg have drawn national attention. Each faces fiscal problems that have forced upon it extraordinary tactics. Each has failed to meet a creditor obligation. Each is struggling with debt burdens that have caused them to choose between their contractual current obligations and their contracted debt.

Reading is a city of some 85,000, while Harrisburg's population is about half that. Each is characterized by a disproportionately large percentage of households with incomes not far above the poverty level. Each is surrounded by prosperous suburbs whose residents earn a large percentage of their incomes from direct or indirect employment in the cities.

Reading's difficulty with debt maintenance has already forced it to seek protection under Act 47, which, while not a formal bankruptcy haven, does provide the city with certain protections while it creates a financial recovery plan that is suitable to both the creditors and the courts.

Harrisburg failed to make a \$3.5 million payment on its general revenue bonds last month. However, the Commonwealth has, through a combination of facilitated speed-up of expected state revenues and an additional combination of loans and grants, promised the city sufficient funds to make that payment with about a million dollars left. But among the facilitated dollars were large payments toward the city's pension funds and public safety that will have to be made at some future point. Thus this state "relief", many argue, has left the city in marginally worse shape than it was before the monies were freed. Harrisburg faces the next payment on this note in March and a multi-million dollar payment on a controversial incinerator project early next year.

Both cities have discovered additional financial obligations as they have worked to cobble together a recovery plan. Neither city has yet dealt with the continuing obligations imposed by collective bargaining contracts with its workers. Reading has sold significant hard assets to make certain of its payments. Harrisburg is inventorying its assets in hopes of renegotiating its credit burden.

Neither city has a sufficient revenue stream to support both its employee contracts and its current debt burden. In fact, some question whether their revenue streams can support just their current budget requirements. Either current contracts or the credit contracts or each of these will have to be dealt with rapidly. Each has come close to the limits upon its ability to raise real estate or income taxes, which compose the maximum of available revenue opportunities. In fact, each of these sources is contracting as a result of the present business cycle and as a result of structural challenges that have frustrated fiscal management.

Regulated continued from pg 7
taxes. Municipalities, the schools, and the counties all trawl there. Without some other pond, isn't there a clear constraint on the revenue side?

David: The nice thing about property taxes is that they are somewhat resistant to swings in the economy. However, unless there are changes in the tax bases or cities, other municipalities, counties, and school districts will not be able to draw from the same source. Sales and income tax receipts mirror the economy but are perhaps fairer ways of funding education. Property tax for municipal services does make sense to me. Still, while property taxes are somewhat more resilient in the short term, there is no growth built into property taxes, beyond tax increases and reassessment.

Ellen: The demographic makeup also means you are taxing the incomes of poor people and the property owned of lower income people, which erects an additional ceiling on the potential effectiveness of property taxes to cities.

David: The changes we are supporting are tweaking around the

edges, but it's a good place to start. They include such things as altering Act 111, which enforces binding arbitration upon cities negotiating with their public safety unions. That proposal's already failed once in a recent attempt to alter binding arbitration in Second Class cities, in the case of Pittsburgh.

An additional problem I see is that talented people are not running for office. We lack candidates with a lot of business or government management experience. There is a desire to avoid getting involved with politics, which is all the more reason that the business community needs to step up in a sense of civic duty to identify people to run for office or to run themselves.

Ellen: That's where business involvement can make a difference. Since they are not seeking career involvement, they are not looking to get reelected and can look at challenges more objectively. Businesses can become involved both as consultants and as participants.

What can business do to protect itself from symptoms?

More Regulated pg 10



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Regulated continued from pg 8

Tom: I'm compelled to make a point: In 10 years, we have looked for opportunities to work more regionally with other chambers. But parochial problems have often caused that collaboration to fall apart. What's unique about this issue is that it is working in the reverse. We're finding more opportunities for collaboration ... for mobilization of a broader business community. We recognize that we can't fix this in Lancaster by ourselves. So we are committed to being part of a greater effort that's mobilizing through chambers across the state, led by Ellen, to create a louder voice to include private job creators in the solution, not just in the public sector—a public sector that is often alone at the table saying, "This is what I need."

We are now in a position to say, "This is what the business sector needs." And while some of this may be long-term, the short term is just making sure we are at the table, because we believe that our respective markets will not prosper and thrive without a strong core city.

How do we convince people that the common good is greater than the parochial good?

Ellen: Well, first we educated ourselves on the issue so that we better understood the root cause of the problem. This led us to conclude that there are a lot of statutory constraints on the cities that are obstacles to their addressing their problems themselves. Revenue constraints, for example, that limit them only to authority dictated by the state. And more critically, we looked at the personnel costs, which are the biggest expense of any city, and how they are constrained with how they can deal with costs. For example, while they are required to offer defined benefit plans, they cannot offer defined contribution pension programs if they want to. Also, they are bound by the binding arbitration process. *These two components in particular are driving personnel costs through the roof.*

As businesspeople, we understand how to advocate, we understand the state legislature, we have the contacts, and we don't have to worry about the upcoming elections, so altering those

two components will be one huge fight we can help them make.

Is there resistance, even hostility to the cities in the suburban and rural areas?

Tom: It is getting better, not worse.

David: I'd disagree with that. There is a lot of concern outside of the cities. There is concern for bond ratings over guilt by association with Harrisburg's problems. Before this current era in Harrisburg, it was understood that it was healthy for the region to have a healthy city of Harrisburg with good public safety. If the city should gather bad press for its, say, failure in public safety or public works, it sends a bad message for market stability to those considering moving to or staying in the greater region. The city needs to be successful for the region to be successful.

Ellen: Reading's downtown has the highest concentration of poverty in the state. But the region as a whole does not take ownership of that—it is considered to be the city's problem.

Tom: I recall when Harrisburg's ex-mayor Reed said that cities are the 21st century Indian reservations. Society puts all its problems inside

and then blames cities for being the way they are.

Nancy: Chester County is in a little different situation. We do have businesses that are suffering, so I don't want to have anyone think we are immune. We absolutely have seen a reduction in revenues and an increase in responsibility and expenses to our county based on actions at the state level. I believe that because of progressive leadership at the county level, both in elected positions and administration, we have been able to weather the economic and political storm fairly well. Our county government does run with simple business practices. It has a strategic plan, it holds all departments accountable from a financial standpoint, and it is very engaged with the business community. We continue to rank as one of the most affluent counties, have a Triple A bond rating, and have a fairly stable unemployment rate ... typically staying in the top three lowest unemployment rates in the state.

If cities need to depend upon the kindness of strangers, what sort of
More Regulated pg 20

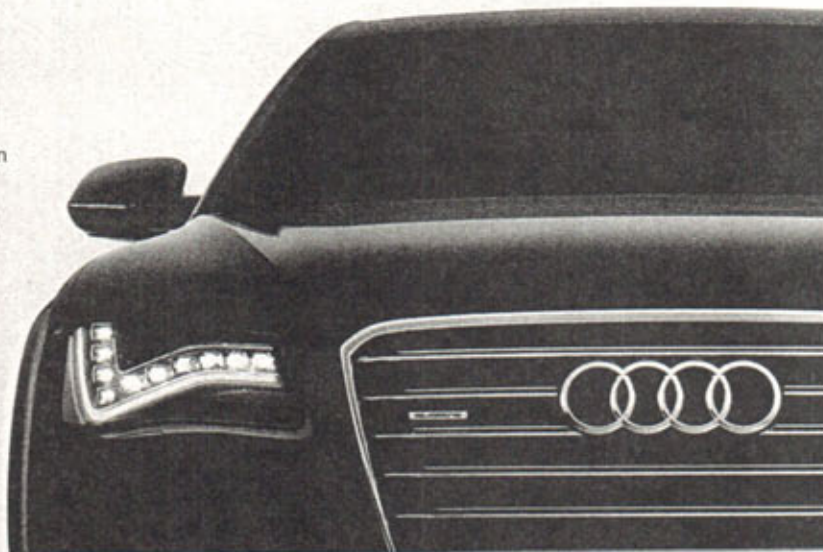
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Regulated continued from pg 10
 communication campaign will make the case that cities are the linchpins of their regional market? How do we convince people that at least some of their tax should be at the point of origin as opposed to point of residence?

David: People don't understand how they are taxed locally. Dollars are withheld out of paychecks, and people simply aren't aware that those dollars are going to places other than where they work.

Tom: We don't think this is a revenue issue. It is not so much that the city needs more of your money, but that the city needs freedom to manage the resources it has. The city is held hostage by certain state laws that make it almost impossible to fix the problem itself. Those problems simply will not be fixed simply by providing more revenue. In fact, some might say that more revenue will exacerbate the problem in the short term.

Ellen: That would just feed the beast.

Is it correct, then, that there are essentially two major fiscal restraints: Act 111 regarding compulsory

arbitration and proscriptions on alternative pension options?

Tom: There may be some state constraints upon regionalization of municipal health care plans. But there is more opportunity there to find local solutions.

Nancy: The pension issue is not unique to Pennsylvania; many states are dealing with this as well. Many believe that the only way to avert this crisis is for a broad-based tax increase. The biggest issue here is that everyone is looking for short-term solutions to an issue that has been building for years. There is an assumption that someone is going to figure this out, so we keep putting off decisions now. We keep transferring this debt to future generations by borrowing more and taxing more instead of looking at new programs now for anyone entering the pension program.

Ellen: Essentially, though, that is the area of key difference: cities can largely address their health care themselves.

What's the plan from here?

Ellen: At September's end, we will have our own boards sign off on the agenda. Then we will reach out to other Third Class cities to expand the network and to look for building some legislative coalitions. We are poised for more significant action in 2011. Through this year, we'll shore up the business support behind this so that we are positioned in 2011 to seek the legislative changes.

David: This is a very small step, but that's how it has to start.

Nancy: While we are not part of the initiative with the others represented in this dialogue, it sends a good message for others to collaborate and to find common ground on issues that can be addressed by communication and cooperation.

Ellen: While cities may eventually need modifications in their revenue alternatives, we can't do that first. You will never get to the other reforms if you do the revenue first. Politics will just gobble it up.

Nancy: Restructuring starts with trust. It's important to continue the dialogue in a respectful way. My guess

is that the discussion will become a necessity sooner rather than later.

David: Times are different, cities are being challenged now, and townships are beginning to feel some pain with pensions. If city government were a business, we would have restructured it 30 years ago. From that perspective, it's up to the business community to push the General Assembly and elected leaders in city governments to understand that change is necessary. We need to look at the way we govern ourselves at the local level before there is an enormous fiscal crisis throughout Pennsylvania. This takes us back to our general discussion at the beginning of this regarding what it does for the perception of our cities and Pennsylvania. It will paint us with an incredibly bad brush that we will have a horrible time shaking as more Harrisburgs pop up on the map.

It's not a Republican/Democrat thing—it's an efficient government thing. Business has to step out of its comfort zone on this issue.

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**APPENDIX IV:
Lancaster Newspapers Editorials, Columns**

Pa. Cities Left To Beg For Relief: [Sunday News; Lancaster, Pa., Sep 13, 2009](#) | by [Gil Smart](#)

It's an urban jungle out there.

Last week the mayor of Reading announced that he'd asked the state to declare Reading a "distressed city." With a \$15 million budget gap, Mayor Tom McMahon has said as many as 45 police officers and 35 firefighters could be laid off.

Harrisburg is debating bankruptcy. Pittsburgh faces a state takeover of its pension system. Philadelphia officials are waiting for the state Legislature to approve a plan permitting the city to hike its sales tax by 1 percent. Without it, Mayor Michael Nutter has said a "doomsday" budget could result in 3,000 layoffs, including 1,000 cops, and other major cuts.

Stung by a faltering economy and facing structural economic challenges, cities across the commonwealth are struggling. Lancaster, say local officials, is in better shape than many. But if long-term problems aren't addressed, it too could plummet into the abyss.

"It's a struggle to stay away from it," said Lancaster Mayor Rick Gray, who notes that Pennsylvania's 53 third-class cities are in particular peril. "Reading is going, York is teetering, Easton is teetering. We're not that close and Bethlehem's not that close, but that's because [Bethlehem has] a casino that's saved them. But that's a short-term fix; it's an uphill battle for all of us."

Lancaster is seeing revenues drop even as demand for services increases. In his message to Lancaster City Council last week, Gray said the city has lost \$300,000 because of property tax reassessments. Revenue from the real estate transfer tax is also down because sales have fallen substantially from previous years. Building permit revenue has dropped, as has interest on investments. City officials also said the possibility that Lancaster Township will seek police protection from Manheim Township rather than the city will put yet another dent in the budget.

"Overall, the city's budget outlook continues to be extremely difficult," Gray reported to council. "As is the case in every city in Pennsylvania, we are strapped with ever increasing salary and benefit costs, retiree pensions, and unfunded state and federal mandates." City budget negotiations will begin in the coming weeks.

At a press conference in Reading last week, several Pennsylvania mayors charged the state Legislature with ignoring the plight of cities. At the event, York Mayor John Brenner said his city was on the brink of filing for Act 47 help, the municipal equivalent of bankruptcy. "The bottom line is, York and Easton and Bethlehem and Lancaster are facing exactly the same challenges," said Brenner. "This is not about Reading."

In an interview last week, Brenner said he doesn't think most suburban and rural residents and legislators realize just how dire the plight of Pennsylvania's third-class cities is. "Those urban cores like York and Lancaster are at the forefront of the entire county," Brenner said; as they go, so go the counties themselves.

Gray, Brenner and other mayors have backed a local option sales tax as one way out. A bill permitting counties to levy a 1 percent sales tax was proposed by Democratic state Rep. Mike Sturla, of Lancaster, earlier this summer. Half of the revenue raised would have gone to the county; 40 percent would have been split among municipalities with another 10 percent going to the Municipal Collaborative Efforts Fund within each county. According to information posted on the County Commissioners Association of Pennsylvania Web site, the levy could have generated \$66.6 million statewide, with \$7.2 million going to the City of Lancaster.

"We could balance our budget" with that, said Lancaster Mayor Gray.

An amendment to the proposed legislation divides the tax revenues differently - half for school districts, and 25 percent each for counties and municipalities, with the money for school districts used for tax relief.

Sturla said he doesn't oppose the amendment, though the goal of the legislation is both to provide property tax relief and generate new sources of revenue for cities and counties. "Whether you reduce county, city or school taxes, it's irrelevant to voters so long as they do get tax relief," he said.

Sturla said some 50 municipalities in the state are close to bankruptcy, "and that's not scare tactics. ... In cities, where 25 percent of the property is owned by non-profits and exempt from taxes and 70 percent of tax revenue goes for fire and police protection, where's the waste you're going to cut?" Twenty-three Pennsylvania municipalities have gone into Act 47 since 1987. None have emerged.

The measure allows cities to restructure debt and gives them access to emergency loans, among other measures. The municipality must meet at least one of 11 criteria, such as missing payrolls, running deficits or defaulting on loan payments.

Gray said Act 111, the Pennsylvania Police and Firefighter Collective Bargaining Law, handcuffs cities. "We can't control the costs of health care under Act 111," said Brenner. Said Gray, "About 81 percent of [Lancaster's] expenses are personnel; of that, over half pays for police and fire protection. We spend 13 percent on operating expenses, 6 percent on debt service.

"We don't have an expenditure problem, we have a revenue problem," said Gray. "And somebody in Harrisburg is going to have to get the chutzpah to say, 'If we're going to have these services, we have to pay for them.'

"Something's got to give."

###

Intelligencer Journal/Lancaster New Era

A city and its mayor at a crossroads – 6/16/2011

Let the record show that on the 521st day of Mayor Rick Gray's second term, he took a mighty swing at the status quo. It came not a day too soon.

Joining eight business leaders who comprise the city's municipal finance task force, Gray last Thursday warned that "arcane and inequitable" state mandates are strangling Lancaster and that failure on the part of lawmakers to change the rules will be the city's undoing.

The mayor's task force lays out the sobering details in a 19-page report titled "Prosper or Perish." It's an important read, yet for anyone who's been paying attention to the city's plight for the past decade, the paper contains not a single surprise.

It's not news that property taxes are a tired source of revenue for built-out older communities. And it's not news that ever-rising public safety costs consume an ever-larger portion of what the city has to give.

Gray so far has managed the squeeze by conventional means: raising taxes, dipping into reserves, reducing services and cutting staff. Any one of those steps, though, makes the city a less desirable place to be.

And then things will get really dire when the reserves are drained, a crash-and-burn scenario that could hit as early as 2014 if steps aren't taken to forestall it.

"We did some very difficult things" to stay financially viable, Gray told me, "and continue to," unlike other cities that are officially labeled distressed. But Lancaster's options are running out. To stay afloat, Lancaster and other cities, boroughs and first-ring suburbs need what the report calls "a new deck" that only the Legislature can deal.

The report calls for six reasonable reforms that will let urban centers tap fairer sources of revenue, better manage the demand for services and be the masters of their destiny. The changes include pension reform, the fostering of shared intermunicipal services and fairer arbitration in setting wages and benefits for police officers and firefighters.

Sounds simple, but moving bills through the 253-member Legislature can make Middle Eastern diplomacy look easy. And the structural changes in municipal management that the task force proposes would impinge upon unions, redraw municipal boundaries and shift tax burdens. Expect special interests to employ every trick to ensure these reforms never see the light of day.

How to outwork the opposition and shepherd reform to passage? Gray has buy-in from 14 regional chambers of commerce, the Pennsylvania Economy League, the League of Cities and a growing number of boroughs and townships.

State Sen. Lloyd Smucker, a Republican whose district includes Lancaster city, supports the reform movement and said "there's a chance some of these can get done." He's starting with a bill offering tax credits for development in historic districts.

State Rep. Mike Sturla, Lancaster's Democratic representative, also is on board, noting that it's going to be a fight every step of the way.

So can the rest of Lancaster County's delegation unite behind saving the city? And can a genuine statewide movement push reform over the goal line? This is the challenge that will likely define the rest of Gray's tenure. If we achieve reform, the mayor leaves office having helped the city gain a new lease on life.

And if reform goes nowhere? I feel sorry for the next mayor.

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Sunday News – June 19, 2011

SOS: State needs to make radical changes in laws to save its foundering cities and boroughs. Municipalities need to work together or sink together.

editorials

I am the master of my fate; I am the captain of my soul.

--William Ernest Henley

"Invictus"

Not the city of Lancaster.

Far from being in control of its destiny, Lancaster finds itself buffeted by financial forces that it can't navigate. If a task force appointed by Mayor Rick Gray is right, unless the real captains of the ship of state make a course correction, Lancaster is sailing into a fiscal maelstrom.

That's the picture emerging from a 43-page report issued earlier this month by the mayor's Municipal Finance Task Force. Ominously titled "Prosper or Perish: Financing Local Government Services in Pennsylvania," the paper predicts a grim future for Lancaster and other third-class cities and boroughs unless key reforms are enacted. Unfortunately for Lancaster, virtually all of the reforms are beyond the city's control.

The task force, composed of business leaders, says small cities need a menu of tax options to reduce overreliance on property tax revenue. Only the state Legislature can do that. And, the report says, the contract arbitration system for police and fire unions has to be rewritten. Again, a job for the Legislature.

The report calls for revenue sharing with federal, state, county and tax-exempt property owners, meaning, among other things, that other government offices would contribute a fair share toward the cost of services provided by the city. Lancaster can't force any level of government -- or any nonprofit agency -- to cough up the cash.

"Prosper or Perish" also proposes that local governments should share more services. Unless the Legislature radically changes the state's crazy-quilt municipal government system, that requires the voluntary cooperation of the city's neighbors.

How about the recommendation that the city and its public safety unions engage in serious talks about the budget pressures of their pension and health care benefits? If union negotiators aren't willing to budge, nothing will happen. Lancaster, in short, faces a future that city leaders can't do much to change.

The finance task force, recognizing that reality, tries to build a case in the report that if Lancaster fails to prosper -- if it perishes -- the ripple effects will spill over onto the rest of Lancaster County. And, of course, other small cities and many boroughs, including those in the county, face the same kinds of financial problems. But the case is bound to be a hard sell.

Take revenue sharing. Suburban townships don't see how their fate is intertwined with the city's. The county is pinched for money. The state has a \$4.2 billion deficit. Washington? Forget it.

Possibly the easiest way to help Lancaster avoid the fiscal rocks is for the Legislature to change the laws establishing what taxes may be levied by third-class cities. Sales tax. Income tax. But lawmakers have been ignoring the plight of small cities and boroughs for years. Consumed by the state's own deficit, they're not likely to have a sudden change of heart.

Lancaster faces the ongoing prospect of dwindling revenue, spending 80 percent of its property tax income on police and firefighter salaries and watching its budget reserve swing from \$7.2 million in the black this year to a predicted \$22.3 million in the red by 2016. And that will mean continuing reductions in services, even though Lancaster City Council has already cut 64 full-time employees in the last five years.

And that will lead to even faster-dwindling revenue, higher deficits and deeper cuts in vital services like police and fire protection. It's a downward spiral from which Lancaster can't extract itself -- without help. The Titanic can be turned, but it requires immediate intervention.

So consider "Prosper or Perish" an SOS. If the distress signal goes unanswered, the next step might be shipwreck.