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ECKERT SEAMANS
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November 6, 2015

The Honorable William Peduto
Mayor, City of Pittsburgh
512 City County Building, 414 Grant Street
Pittsburgh, PA 15219

Dear Mayor Peduto:

Under last year's amendments to Pennsylvania's Municipalities Financial Recovery Act (i.e. Act 47 of 1987), we as Recovery Coordinators have new statutory responsibilities related to the City's budget process. According to the law as amended last year, we must review your budget for compliance with the Amended Recovery Plan adopted by the City in June 2014. We must then make any modifications necessary to the proposed budget to meet the Plan's objectives and return it to you with those modifications at least 45 days before the end of the year, or by November 17.

We are providing this letter to confirm that your budget as submitted to us on September 22, 2015 complies with the 2014 Amended Recovery Plan. The rest of the document following this cover letter describes our findings in support of that conclusion.

We understand that the next step in this process under Pittsburgh's Home Rule charter is your budget submission to City Council next week. Council may recommend its own set of changes to the budget during that process, culminating in Council's adoption of a budget in December. Please stay in communication with us regarding any changes that could have an impact on the City's compliance with the Amended Recovery Plan.

Once Council adopts the budget we will provide a letter to the Secretary of Pennsylvania's Department of Community and Economic Development, reporting whether the final version of the budget complies with the Amended Recovery Plan, as now required by law. As you know, the Pittsburgh's Intergovernmental Cooperation Authority has a separate budget review and approval process.

We appreciate your team's responsiveness to our questions during this process, especially the Finance Director, Budget Director and their staff. Please let us know if you would like to discuss our findings.

Sincerely,

Act 47 Coordinator
Dean Richardson, Eckert Seamans
Dean Kaplan, Public Financial Management
Gordon Mann, Public Financial Management
Vieen Leung, Public Financial Management

c: Fred Reddig, Pennsylvania Department of Community & Economic Development
Nicholas Varischetti, Chair, Intergovernmental Cooperation Authority
Henry Sciortino, Executive Director, Intergovernmental Cooperation Authority
Honorable Michael Lamb, Controller, City of Pittsburgh
Honorable Bruce Kraus, President, City Council, City of Pittsburgh
Paul Leger, Finance Director, City of Pittsburgh
Sam Ashbaugh, Director, Office of Management and Budget, City of Pittsburgh

City of Pittsburgh 2016 Budget Review for Recovery Plan Compliance

The 2014 Amended Recovery Plan sets five primary objectives that the City must achieve to exit Act 47 oversight.

- Eliminate the operating deficits in the Amended Recovery Plan baseline projection
- Keep the City's General Fund reserves at an appropriate level
- Gradually reduce annual debt service payments so the City can use more of its current year resources for daily operations
- Direct more funding to the City's capital budget with the priority to invest more in existing infrastructure (i.e. bridges, roads, City-owned facilities)
- Gradually increase the City's pension fund contributions to the actuarially recommended levels to improve the employee pension plan's funding status

These are not the only objectives that the City must meet to comply with the Amended Recovery Plan or exit Act 47 oversight, but they provide a useful measure of the City's overall progress in implementing the Amended Recovery Plan. The table below summarizes the City's intentions to achieve these objectives as described in the 2016 operating and capital budgets.

Goal	City progress
Eliminate projected deficits	The budget projects positive operating results through 2020, though the margin is small in 2018 before growing in 2019 and 2020
Maintain financial reserves	The budget projects fund balance will remain above the Recovery Plan's 10 percent minimum target through 2020
Reduce debt burden	Debt spending falls to 8.8 percent of total General Fund expenditures by 2020, even with new borrowing planned for 2016 and 2018
Fund capital improvements	The capital budget directs $44.1 million to infrastructure projects, plus additional amounts for recreation facilities
Increase pension contributions	The budget includes the Recovery Plan's required additional contributions to the employee pension plans

At the beginning of the 2014 Recovery Plan amendment process, we developed a baseline projection of the City's General Fund revenues and expenditures through 2018. We started with the five-year projection in the City's 2014 budget and made adjustments as described in the Recovery Plan introduction.[1]

[1] Please see Introduction, pages 10 – 16.

By definition that baseline showed the City's projected results absent any corrective action. In that scenario the City would have experienced annual operating deficits of $8.9 million to $14.6 million through 2018. Since adopting the Amended Recovery Plan in June 2014, the City has started to implement Plan initiatives and taken other corrective actions to avoid the projected deficits. The 2016 budget anticipates that total General Fund revenues will exceed total General Fund expenditures each year through 2020.

Recovery Plan compliance: Avoid baseline deficit projection ($ Millions)[2]

	2015	2016	2017	2018	2019	2020
Amended Recovery Plan baseline	($8.9)	($12.3)	($14.6)	($9.3)	N/A	N/A
2016 City budget	$19.3	$6.5	$4.8	$1.9	$18.3	$8.6

The $1.9 million positive result projected for 2018 is a very small margin relative to the City's $537.6 million budget, though comparable to the $1.2 million margin we projected in the Amended Recovery Plan with initiatives applied. The positive operating results should grow in 2019 when scheduled debt payments fall by almost $30 million.

The Amended Recovery Plan requires the City to maintain an "unassigned General Fund balance of at least 10 percent of annual General Fund revenues."[3] That financial reserve helps the City pay its obligations early in the year before tax revenues arrive without borrowing money for cash flow purposes. It also provides a contingency against unanticipated shortfalls and bolsters the City's credit rating. The City's projects it will meet that 10 percent minimum threshold through 2020.

Recovery Plan Compliance: Maintain fund balance ($ Millions)

	2015	2016	2017	2018	2019	2020
General Fund Revenues	$524.9	$524.1	$531.0	$539.5	$543.6	$552.4
Ending Fund Balance	$63.0	$59.5	$61.4	$60.2	$63.5	$62.1
Fund Balance as a % of Revenue	12.0%	11.4%	11.6%	11.2%	11.7%	11.2%
Meet or exceed 10%?	Yes	Yes	Yes	Yes	Yes	Yes

Reducing the City's debt burden while increasing its investment in existing infrastructure has been an important, but elusive, objective for years.

[2] When we developed the 2014 Amended Recovery Plan, Act 47 required at least three years of revenue and expenditure projections. The 2014 Plan provides four years of projected results to match the five-year planning horizon used by the City and the Pittsburgh Intergovernmental Cooperation Authority (ICA).

[3] Initiative FM01, pages 90-91. The City's budget shows fund balance as a percentage of total expenditures, instead of revenues, and the percentage results are similar.

On the one side of that balancing act, the City has been steadily paying down the debt it carried into oversight in 2004, with total principal and interest payments of $80 million to $90 million each year. The Amended Recovery Plan depicts a “debt cliff” where scheduled debt payments would have dropped by almost $50 million from 2017 to 2019.[4] In anticipation of reaching that cliff, the City adopted a debt policy in 2011 that limits the use of long-term debt to capital projects in the adopted capital improvement program and sets a 12 percent target for future total debt service as a share of General Fund expenditures.

While the City has been steadily paying down its debt, it has had to subsist on pay-as-you-go and grant funding for capital projects, like road paving, bridge repair and facility renovations. Last year the City was able to issue $49.6 million in new debt to fund these infrastructure improvements as required in the Amended Recovery Plan.[5] Those proceeds should carry the City through 2016 when the City plans to issue another $50 million in debt in compliance with the Amended Recovery Plan. The City’s budget anticipates another $50 million issuance to fund projects in 2019 and 2020. Even with these new bonds, debt spending will drop from $74.4 million in 2018 to $47.7 million in 2020.

In addition to these bonds, the Amended Recovery Plan required continued pay-as-you-go contributions to capital projects in 2015 and 2016. The 2016 budget exceeds those required contributions and carries them beyond the Amended Recovery Plan period.[6]

To date the City has made less progress on the Amended Recovery Plan’s third strategy for funding capital improvements. The Amended Recovery Plan calls for larger annual contributions from Pittsburgh’s major non-profit organizations and directs at least half of any new contributions to capital projects.[7] We have repeatedly acknowledged the critical role that these institutions have played in stabilizing the City’s economy. Because of their size, number of employees and the amount of land they own, they also rely on the City’s roads, bridges and other infrastructure that their employees, students, patients and visitors use every day.

Given the critical need to invest in these shared assets, we urge the City’s non-profit organizations to increase their contributions above the levels in the 2016 budget. It shows a very modest contribution of $400,000 from all non-profit institutions and, to our knowledge, there has been minimal progress on a new agreement between the City and the major non-profit institutions.

In addition to the Amended Recovery Plan provisions related to how the City funds capital projects, there are others related to *what* the City funds. We recommended that the City remove operating items from its capital budget, add useful life to the criteria for determining whether a project belongs in the capital budget and establish separate funds for expenditures that traditionally reside in the capital budget but are actually grant-funded operating items. The main thrust of these recommendations is to ensure that the City commits an adequate amount – or as much as its limited

[4] Please see Debt chapter, page 47.

[5] Please see initiative DS01, pages 51-52.

[6] Please see initiative CP02, pages 37-38.

[7] Please see initiative CP03, pages 38-40.

resources will allow – to addressing the existing capital needs. The City is making progress in this regard and should continue to do so in subsequent budgets.

The final primary objective in the Amended Recovery Plan is for the City to increase its annual employee pension plan contributions to the levels recommended by its actuary in the most recent valuation reports. As described in the Recovery Plan, a provision in Commonwealth law gives the City legal authority to contribute less money to the pensions than the actuary recommends. The practical impact is that the City will not make sufficient progress toward improving its very low funding levels unless it contributes more than its Minimum Municipal Obligation (MMO).[8]

According to the estimates available when we wrote the Amended Recovery Plan, the City would have to contribute $55.3 million in 2016, plus the $13.4 million in parking tax revenue previously committed and the $10.7 million in estimated employee contributions, or $79.4 million total, to reach the actuary's recommended level of contributions. The Amended Recovery Plan requires the City to gradually increase its contribution to these higher levels and the 2016 budget complies with that requirement.

Recovery Plan compliance: 2016 additional pension contribution ($ Millions)

	Actuary Recommendation	Recovery Plan Requirement	City Budget
Minimum municipal obligation	$55.3	$43.7	$44.6[9]
Parking tax commitment	$13.4	$13.4	$13.4
Estimated employee contribution (Not budgeted in General Fund)	$10.7	$10.7	$10.7
Recovery Plan supplemental contribution	N/A	$6.9	$6.9
Total contribution	**$79.4**	**$74.7**	**$75.6**

The City's 2016 budget shows the planned contributions to the pension plan through 2020 and they also comply with the 2014 Amended Recovery Plan. The Amended Recovery Plan projections run through 2018 while the City's contributions remain at the higher level through 2020.

[8] Please see the Workforce chapter, pages 65-66.

[9] The City notes that its MMO for 2016 is $43.0 million, but they will voluntarily contribute $44.6 million instead.

Recovery Plan compliance: 2016 - 2018 General Fund pension contribution[10]

	2016	2017	2018	2019	2020
Recovery Plan Projection	64,051,428	67,715,121	83,406,412	N/A	N/A
2016 City Budget	64,884,272	67,715,121	83,406,895	90,495,483	87,001,483
Meets Plan requirement?	Yes	Yes	Yes	N/A	N/A

The City's ability to achieve these primary objectives depends in part on successfully implementing other Amended Recovery Plan initiatives that are more directly related to increasing revenue and controlling expenditure growth. Those initiatives include the following:

- **Restore real estate tax revenue:** The Amended Recovery Plan required the City to increase its real estate tax rate in 2015 to replace the revenue lost when the City reduced the tax rate after the county wide reassessment.[11] The City increased its tax rate this year and the projected real estate tax revenues in the 2016 budget meet the Recovery Plan targets.

- **Increase parking related revenue:** The Amended Recovery Plan required the City to meet with the Pittsburgh Parking Authority to discuss rate increases at Authority controlled parking facilities to generate additional revenue for the City. The Recovery Plan set a target of $1.5 million in additional revenues (or 3 percent of projected parking tax revenues) for 2016.[12] The City achieved this objective through an alternate approach. The Authority agreed to transfer a larger portion of the daily parking meter revenues to the City.

- **Adjust service fees and charges:** The Amended Recovery Plan requires the City to periodically review its fees and service charges to ensure they cover the cost of services delivered to specific organizations or individuals. The Plan does not require any particular fee increase, but sets a target of $550,000 in additional revenue across all licenses, permits, service fees and similar charges.[13] The City increased its building permit and zoning fees in 2015 and the revenue associated with that increase meets the Recovery Plan target.

- **Negotiate collective bargaining agreements that comply with the Amended Recovery Plan's maximum allocations for employee compensation:** The majority of the City's General Fund expenditures are for different forms of employee compensation – salaries, overtime or "premium pay," other forms of cash compensation, employee health insurance, the City's pension contributions, etc. So any meaningful effort to control growth in total expenditures has to control growth in total employee compensation.

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[10] The $64.9 million shown here for 2016 differs from the $75.6 million contribution in the previous table because that table included the employee contributions recorded outside the General Fund.

[11] Please see initiative RV01, pages 149-150.

[12] Please see initiative RV02, page 151.

[13] Please see initiative RV03, page 152.

In accordance with the provisions in Act 47, the Amended Recovery Plan provides cost control by setting maximum annual allocations for total employee compensation for each bargaining unit and non-represented employees. Those allocations are based on a recommended pattern of wage increases and higher employee contributions to the cost of their health insurance. The City and each bargaining unit have flexibility to negotiate different terms of compensation so long as the total projected compensation stays within the Amended Recovery Plan's limits.[14]

To date, the City has completed negotiations with two bargaining units on new collective bargaining agreements that comply with the Amended Recovery Plan – the International Association of Firefighters, Local No. 1 and Service Employees International Union, Local 192-B.[15] There is a tentative agreement between the City and the American Federation of State, County and Municipal Employees, Local 2719 that complies with the Amended Recovery Plan and awaits final action by the City and union. The City and the Fraternal Order of Police, Lodge 1 are engaged in interest arbitration and the City has reported progress on its negotiations with other bargaining units.

The next step in this budget process is the Mayor's budget submission to City Council during the week of November 9. We understand that Council may recommend its own set of changes to the budget during that process, culminating in Council's adoption of a budget in December. We also note that the Intergovernmental Cooperation Authority has a separate process for reviewing and approving the City's budget. We will continue to monitor the City's progress and provide a letter to the Pennsylvania Secretary of Community and Economic Development on whether the final version of the budget complies with the Amended Recovery Plan.

[14] Please see initiative WF01, pages 71-74.

[15] The IAFF agreement covers cash compensation since health insurance is governed by a separate arbitration award that expires at the end of 2016. The SEIU 192-B agreement covers cash compensation and health insurance.