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House of Representatives
COMMONWEALTH OF PENNSYLVANIA

HOUSE DEMOCRATIC POLICY COMMITTEE HEARING

Topic: Municipal Tax Burden

Hilton Scranton & Conference Center – Scranton, PA

February 18, 2020

AGENDA

2:00 p.m. Welcome and Opening Remarks

2:10 p.m. Panel from Pennsylvania Municipal League:

- Paige Cognetti, Mayor of Scranton
- Mike Lombardo, Mayor of Pittston
- Rick Schuettler, Executive Director
- Amy Sturges, Director of Government Affairs

2:40 p.m. Questions & Answers

3:00 p.m. Debi Domenick
Lackawanna County Commissioner

3:10 p.m. Questions & Answers

3:30 p.m. Gerald Cross
Executive Director
Pennsylvania Economy League Central Division

3:40 p.m. Questions & Answers

4:00 p.m. Closing Remarks

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PA Municipal League
Testimony Before the House Democratic Policy Committee
Regarding Municipal Tax Burden
February 18, 2020

Chairman Sturla, Representative Flynn, and members of the Committee, thank you for the invitation to provide testimony today. I am Amy Sturges, Director of Governmental Affairs, for the PA Municipal League. I am joined by the League's Executive Director, Rick Schuettler.

The PA Municipal League (the League) is a non-partisan association representing 116 municipalities from across the Commonwealth. Our membership is diverse. It consists of core communities – cities, boroughs and townships – of varying sizes. The common element among our members is the fact that they are full-service, core communities. As such, they provide a wide range of programs and services to their residents, businesses, tax-exempt entities, workers and visitors, as well as their regions.

The fiscal health of local governments in Pennsylvania is an on-going concern for the League and its members. Over the years we have provided testimony time and time again stressing the importance of addressing the root causes of municipal fiscal distress while also providing new tools to correct and prevent future distress. In 2009, in testimony before this Committee, we quoted a critical statement in the Pennsylvania Economy League's 2007 comprehensive analysis of municipal revenue shortfall, *Structuring Healthy Communities*. That statement was, "…fiscal distress is often inevitable under the existing state laws that govern municipalities. Current legislation and codes leave those who lead the Commonwealth's cities, boroughs and townships with revenue streams that are largely inelastic, capped, and out of sync with budget needs." This statement is equally true today. Regrettably, over a decade later, nothing has changed statutorily to improve the plight of the Commonwealth's core communities. As a result, local budgets are harder to balance, the tax burden is highest on those least able to afford it, and fiscal decline has worsened.

There are a number of factors working in tandem that make fiscal distress is inevitable. As municipalities "mature" in terms of providing a full range of services and becoming built-out, tax revenue begins to slow. Over-reliance on two primary local taxes causes the base to weaken. These municipalities find that they cannot generate adequate revenue to shore up the tax base, therefore finding it difficult to pay for all of the services they provide. Non-essential services are cut first, but as service and personnel costs continue, taxes need to increase and/or the next level of cuts undertaken. Taxpayers – residents and businesses – witness the decline in services while paying more in taxes. This initiates movement out of the municipality to escape the higher taxes and the visible signs of service cuts – blight, deterioration of parks, and inadequately maintained roads, for example. An un-kept and highly taxed community is not attractive to desperately needed new residents and businesses. This results in a cycle of falling property values and income levels that perpetuates more decline and more fiscal distress.

This scenario is further impacted by costs that local leaders have very little control over – tax-exempt properties, unfunded mandates, and personnel. Local leaders seeking to create attractive, clean and safe communities find themselves with no viable solutions to a systemically broken system governed by state laws that are outdated and inflexible. They also realize that only the General Assembly holds the key to new laws and new tools necessary to govern effectively in the 21st Century.

Like the Commonwealth, municipalities rely on tax revenue to pay for the services provided to residents and businesses. The laws governing our local tax structure were written in the 1960's and have remained largely unchanged. Furthermore, all local taxes are authorized by state statute, capped at certain rates, and are not flexible. Over the past 50 years, municipal services, on the other hand, and the costs to provide those services have changed significantly. This leaves us with one clear fact, outdated revenue sources are not meeting today's needs.

The majority of local tax revenue comes from two main sources, the Real Property Tax and the Earned Income Tax. As their names imply, these taxes rely on healthy property values and healthy income levels to produce adequate revenue to meet costs. If one examines the budgets of full-service communities, tax revenue is barely meeting public safety costs, which can top 50% or more of a municipal budget. When tax revenue is insufficient to meet costs, the choices are limited – taxes must be raised or services cut. These choices may seem simple on paper, but are very difficult in reality as local leaders look for a balance so as to not dig the fiscal hole deeper.

The decision to raise taxes does not come without a price. The capacity of taxpayers to absorb higher taxes must be weighed against the benefits. If the capacity to pay more is not there, a decision to raise taxes will result in the residents and businesses leaving for municipalities or even other states with lower taxes. The alternative, cutting services, has its own drawbacks and can only be utilized to a point. Once services, such as public safety, are in place and at a certain level, reductions to these fixed costs are very difficult to achieve. It's easier to delay road and infrastructure maintenance, reduce blight and code enforcement efforts, and scale back on quality of life programs and services. In the end, however, this only adds to the cycle of decline.

The League has long advocated for a more equitable tax local structure that allows local officials to decide the best mix of taxes for their municipality. Municipal officials should be able to pick among a number of different taxing options based on the particular needs and capacity of their municipality and its residents. This would include adding new taxing options, such as a Payroll Tax; but also allowing flexibility within the current system, such as the ability to raise the Local Services Tax beyond $52 dollars or the ability to increase the Earned Income Tax. These need to be local choices based on local needs.

Additionally, expanding the local tax base to a regional level would share costs across a wider area while increasing revenue potential. A regional approach, such as a countywide sales tax, better matches the way we live today traveling in and out of several municipalities each day for work, meals, entertainment, and shopping. Revenue would be shared among the municipalities and the county and could be used for a variety of purposes such as offsetting county and municipal property taxes; alleviating the tax-exempt burden; and supporting regional services.

Compounding the impediments of an outdated and limited taxing structure, the Commonwealth's older core communities suffered a loss of population and tax base 50 years ago. In the 1970's, the attractive suburbs offered new single family homes, lower taxes, better schools, lower crime and job opportunities. Our new and improved transportation systems supported moving further from jobs and services. This out-migration set in motion a loss of tax base and, in turn, a loss of revenue to support established services. The Commonwealth's cities and urban boroughs still struggle to compete with the suburbs, the beneficiaries of the population and wealth shift. Today, many first-ring suburbs are facing the same crisis of cities and boroughs as their population and tax base move to the more far-reaching suburbs.

As population declines, the remaining residents and businesses shoulder an even greater burden of taxation to keep up with the cost of services. Oftentimes, this burden is falling on populations least able to afford the higher taxes – senior citizens and low-income workers. As the cycle continues, tax-burdened residents can no longer afford to maintain their homes leading to blight and abandonment and a further erosion of the already fragile tax base.

In order to reverse the loss of population, municipal officials must work to make their communities marketable and attractive to potential new homeowners and businesses. The housing stock and taxes must be competitive with neighboring municipalities, job opportunities must be available, infrastructure must support the population and crime must be under control. Recreation and cultural activities, good schools and reliable public safety services are also very important to potential new residents. What it takes to turn the tide – community investment and redevelopment; renewed attention to services; and enhanced quality of life factors all cost money, time and resources. A municipality with no tax base is going to be hard pressed to achieve these necessary but difficult goals.

The Commonwealth must become a partner investing in its core communities. The League is an advocate for a direct and comprehensive fiscal urban policy aimed not only at supporting those struggling to regain their footing and re-invent themselves, but also at *preventing* future fiscal distress. An urban policy would incorporate all of the items being laid out in our testimony today.

Regardless of new taxing options to meet local needs, the expense side of the equation cannot be ignored. Police, fire, emergency services, road maintenance, street lighting, blight remediation, water, sewer and garbage collection are in demand by citizens and are clearly necessary services, but the costs are overwhelming local budgets. As mentioned earlier, in many full-service municipalities, the cost of public safety services alone makes up half of the general fund budget and is barely covered by the tax revenue coming in. It's important to remember that personnel costs, such as contracted salary adjustments and pension obligations are fixed costs. Therefore, even if a municipality wants to reduce these costs, legally it cannot.

Aside from the operational costs, complying with unfunded state and federal mandates is a significant source of angst for local officials. Oftentimes these mandates are outdated, unclear, and expensive. A few examples of such mandates include: the laws governing municipal advertising; the requirement to pay prevailing wage on public projects costing $25,000 or more; and the requirement to reduce point-source storm water pollution. State government must alleviate municipalities of such outdated, ineffective mandates. Public notice can be achieved equally well by allowing local governments to place their notices on their websites rather than paying thousands of dollars each year to place public notices in physical newspapers that have lost readership in favor of electronic media sources. Prevailing wage should be a local option or at a threshold much higher than $25,000. Taxpayers have spent billions on storm water compliance measures that are changing, unclear and ineffective in the overall picture.

In addition to advocating for commonsense cost control measures, the League supports efforts to encourage service sharing among municipalities and regions. There are many examples of regional service provision across all levels of local government. We believe the Commonwealth should foster these types of service arrangements and assist as necessary to remove impediments. The more successes we have with shared services the more municipalities will consider working together.

Not only does tax revenue pay for municipal services, it also pays for the personnel to perform the services. Pennsylvania's full-service municipalities are up against staggering pension, healthcare and personnel costs and must attempt to balance these fixed costs with the capacity of the tax base to afford them. Public safety personnel mandates are significant cost drivers that must be included in any discussion of municipal tax burden.

In the area of public safety personnel, the balance tips in favor of the employee and against the taxpayer. Act 111 of 1968, an unfunded mandate, governs the collective bargaining process for police and fire fighters. If a municipality and labor union go to arbitration to have certain items of a labor contract settled, the arbitrators decide an award that is binding on both parties. In this case, the arbitrator has more decision making power and more of an impact on the municipality, than the local elected officials. Unfortunately, there is no consideration of whether a municipality, or its taxpayers, can afford an Act 111 award. Furthermore, benefits can be awarded that were never on the bargaining table. Act 111 must be reformed to level the playing field and give municipalities a fighting chance at controlling their future personnel obligations. Yet, for over a decade, we have not been able to make progress on achieving bi-partisan support for Act 111 reform.

Public safety pensions are another unfunded mandate that tie into Act 111. Municipal pension laws dictate the type of pensions and the benefits to be received. Current public safety pension costs are not predictable or sustainable. This is demonstrated by the number of under-funded plans. In addition to Act 111 reform, the League has been a long-time advocate for municipal pension reform. Among other reforms, new hires should be entering a defined contribution plan and retiring no earlier than age 55. Representative Greiner has again this session introduced a municipal pension reform bill – House Bill 2081. This bill is scaled back significantly from prior sessions and its positive impact would be years in the making, but it is a start and it deserves bi-partisan support.

A final mandate that must be mentioned in any discussion of tax burden is the designation of tax-exempt which is made at the state level, but the impact is a local one. Core communities that host a high percentage of tax-exempt entities face an additional hurdle in maintaining the tax base and staving off fiscal distress. Government buildings, hospitals, universities and cultural centers provide services to the region, but they do not pay property taxes to their host for the services provided. On a volunteer basis some tax-exempt entities make in-kind contributions or payments in lieu of taxes to their host municipality, but these cannot be relied upon and do not come close to the amount of tax revenue lost. This means their share of taxes is paid by the property owners who already shoulder a large burden as demonstrated throughout this testimony.

We recognize that these institutions contribute to the community; they are often the largest employers. They also serve the region with healthcare, education, cultural and entertainment programming. Possible solutions to the help alleviate the impact of tax-exempt entities are: spreading the cost of services over the entity's service area; establishing a required payment in lieu of taxes system that includes government owned facilities; authorizing municipal services fees; establishing a fund for state reimbursement to municipalities as put forth in Representative Freeman's House Bill 1677.

To some, this testimony may be an oversimplification of the fiscal issues impacting the tax burden on residents and businesses in our core communities. Each municipality and its individual circumstances are different, but they are all operating under the same broken system. Purposely, we have left the data and real life examples to the experts – the PA Economy League and the elected officials testifying today. Unfortunately, Mayor Sorace of Lancaster was unable to attend this hearing. She has been sounding the alarm on behalf of for her own city's fiscal health and we highly recommend the Committee invite her to testify at a future date.

Briefly, Lancaster, a city often held up as thriving, is facing a $20 million budget deficit in just 5 short years. Property Taxes bring in 50% of the city's revenue while public safety expenses makeup 65% of the budget. Lancaster has increased Property Taxes 8 times in the last 14 years. It has also increased fees, reduced spending, and relied on reserves to balance recent budgets. Its reserves will soon be depleted and extreme tax increases are on the horizon if reform measures at the state level are not implemented. Those in local government see Lancaster's fiscal situation as a perfect example of the result of a systemically broken system.

In conclusion, elected and appointed municipal officials work tirelessly to make our core communities attractive places to live and work. They put their best foot forward no matter the severity of the circumstances. They work to keep employment opportunities available; to make housing choices attractive and affordable; to provide services and amenities that are competitive with neighboring communities; to keep crime at bay and to provide the necessary infrastructure to support citizens, businesses and visitors. This is a tall order given the fact that they are working with an outdated local tax system, laws that work against good government, and ever-rising service and personnel costs.

The fiscal crisis facing Pennsylvania's local governments presents all of us, as policymakers, with the unique opportunity to make real, significant change before it is too late. The League and its member communities are prepared to continue this discussion and ready to help find the answers and support the hard choices necessary to see our local governments gain and sustain fiscal health. After all, the prosperity of the Commonwealth is directly reflected in the prosperity of its local governments.

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House Democratic Policy Committee Testimony
The Pennsylvania Economy League
February 18, 2020

Presented by PEL Executive Director Gerald Cross and Communications Director Lynne Shedlock

Good afternoon to Rep. Marty Flynn and the other committee members. On behalf of the Pennsylvania Economy League, we would like to thank the House Democratic Policy Committee for inviting us to speak on the important topic of municipal tax burden. We will start with a little background on our organization, and then we will address what we see on the ground and the findings in our research.

The Pennsylvania Economy League was founded over 80 years ago during the Great Depression as a good government organization. We are a non-profit, non-partisan public policy think tank with offices in Wilkes-Barre, Harrisburg, Philadelphia and Pittsburgh. We represent the PEL Central division, which has provided technical assistance to almost three dozen financially challenged cities, boroughs and townships – including Scranton – in the last eight years.

We have performed local government work in every corner of the state, including what is considered the more prosperous Southeast. Our towns range in size from tiny 700 person boroughs to the largest second-class township in the state at over 55,000 people. We have found that no region is immune to distress.

Here is one nearby example of distress that is ***NOT*** Scranton:

A small city has lost significant population and seen its public works department drop from a high of over 30 to seven despite the fact that the same miles of infrastructure exist and if anything are now in worse shape. Most of the city's administration wears more than one hat so there is no fat to cut. Because of an outdated county assessment, the city receives only $36,000 per mill to help fund a $5 million budget. From 2001 to 2017, the city's STEB market value grew by 65 percent, while assessed value calculated by the county actually declined by 2.7 percent. The city's demographics show residents are poorer than both the surrounding county and the state, and housing values are also lower.

We are currently in Lackawanna County, which has not conducted a complete property reassessment since 1968. Like the small city described above, Scranton is a home rule community not subject to the state's 30-mill city tax limit. But if Scranton was subject to those limits, it would collect only $11.6 million with its current county assessment value compared to the $33 million that it collects now. Scranton also has enhanced earned income and local services tax rates. If those two taxes were reduced to the statutory maximums, the city would lose another $24 million in revenue. Scranton's operating revenues are approximately $96 million. The enhanced tax revenue Scranton receives is $45 million or 47 percent of operating revenues. Now deduct the fixed obligations of pension, retiree health care and debt together with the enhanced revenues. The city is left with $16.8 million to operate. For perspective, public safety alone costs the city $50 million annually. Remember also that pension and retiree health care are costs for work done decades ago.

Clearly, the city could not function without these enhanced revenues. Scranton is not alone. A recommendation we now give almost all municipalities is to consider home rule, which provides flexibility in terms of the tax mix. That approach is now jeopardized by the Act 511 tax lawsuit that was filed in Scranton and which the city is now appealing. The lawsuit challenges not only Scranton but 14 other municipalities across the state that our research indicates might be in the same position. In addition, there are another nine municipalities that appear to be at 90 percent or more of the Act 511 threshold. Many of these 24 municipalities operate under home rule and, like Scranton, cannot function without the additional revenue. The list includes Pittsburgh and nine Act 47 communities. The enhanced revenue sources used by these municipalities were authorized by the General Assembly; therefore, it is incumbent on the General Assembly to ensure that these enhanced revenue sources remain available to these municipalities.

Here are two more examples of municipal distress:

A small borough of less than 700 people not far from here had its public works department of one person quit last April. The truck was broken and the independent contractor that used to plow the streets was no longer available. We met with them in August and hoped to have them contract public works from a neighbor. But the neighbor refused and the borough, which is fighting significant blight issues, is worried it will not be able to afford both public works and its lone part-time police officer. This is the third borough of this size in the last two years we have worked with that has found it difficult if not impossible to provide basic public works and public safety services on its own.

Another small city, this time on the western side of the state, has lost significant population and has major blight issues. People are moving out of the city into the surrounding townships into bigger, newer houses where taxes are half the cost. But those townships are also relying on responses from the city's fire department, which they don't pay for. This situation is not unusual. We have multiple municipalities across the state with costly public safety services that provide free mutual aid and thus are subsidizing their neighbors that do not pay for their own police or fire. Subsidizing their neighbors not only further drains the resources of these already fiscally precarious municipalities, it raises the question of what will happen to the entire region if the municipality providing all the services is no longer financially able to do so and tells the nearby towns that they are on their own.

How do these municipalities survive? They cut services and employees. They rely more on part-time local police or eliminate local police completely. They use lease backs of facilities to borrow money. They roll over tax anticipation notes that are supposed to be paid off in one year. They raid authority funds. They impose fees that may or may not be directly connected to the cost of the service. They scramble for one-time revenue sources. One thing they are loath to do is raise property taxes. Even when they do raise taxes, assessments might be so low that it generates little additional revenue, as we discussed previously, not to mention that property tax collection rates often fall when taxes are hiked. The general pattern we see is flat to minimal annual tax revenue growth with expenditures increasing roughly 3 percent annually for payroll, which is often driven by union contracts, and 6 percent annually for health care. That's not to mention other expenses, like legacy costs.

In 2017, we released Communities in Crisis in response to calls from community leaders in Scranton, Reading, York, Harrisburg, Pittsburgh and more who were concerned about what would happen to Act 47 municipalities after the 2015 reform mandated an exit from that program. This handful of municipalities survived only because they were taken out of the broken local government system and given revenue enhancements like those under threat by the Act 511 lawsuit, as well as expenditure controls and technical assistance.

Communities in Crisis was an effort to educate on the extent of municipal distress in the hope that the General Assembly would act. We reviewed the health of over 2,300 PA municipalities from 1970 to 2014 and ranked them against each other on a scale of 1 to 5. We found that all but a few Pennsylvania cities ranked dead last on our scale. During those years, tax base by our measure fell or stagnated in cities but the amount of money pulled out of the tax base for services grew. On the flip side, tax base increased in all other municipal classes but the biggest gains were for second-class townships. By 2014, second-class townships on average moved into the healthy range of our scale while boroughs and first-class townships dropped into the distressed range. This is because boroughs and first-class townships were also pulling more wealth out of their tax base to pay for services. Second-class townships tend to have less services, particularly in terms of local police, and their main source of revenue is generally earned income taxes, reflective of the wealth and population that moved to these towns. But we find that as these towns are built out and demands for services increase, second-class townships end up in the same financially challenged position as more urban municipalities with revenues that fail to cover expenditures. Our Communities in Crisis research also found that municipalities that employ their own local police take twice the amount of wealth out of their tax base and are much more likely to score low on our health scale.

Communities in Crisis is a story of wealth and population leaving the more densely populated urban municipalities for more rural areas. The problem is that Pennsylvania's current full-service municipal tax system assumes most of the wealth is in urban areas. These urban areas require more services, particularly cities that serve as regional hubs for health care, education, courts and more. But the wealth is no longer there to pay for these services and municipalities have no way to tap into the wealth and population that left except through the woefully inadequate $52 local services tax. Unless a municipality is home rule, generally the only tax that they can increase is on property; school districts and counties heavily rely on the same tax and the county assessment system that undergirds property taxes is often neither fair nor adequate. Moreover, as we discussed, the tax flexibility provided by home rule is now jeopardized.

Pennsylvania's current local government system is extremely complex with certain municipalities provided band aids that are often still inadequate to the task while others are simply left out in the cold. Municipalities need greater tax flexibility that reflects life today, not some past where all the wealth was in the city and everyone else was a farmer. Municipalities need better tools to pursue shared services and intergovernmental agreements – and a new mindset that sharing might not reduce costs but will save the service. None of this is possible without the General Assembly making changes. It is up to you.

2017 REPORT

COMMUNITIES IN CRISIS

THE TRUTH AND CONSEQUENCES OF MUNICIPAL FISCAL DISTRESS IN PENNSYLVANIA, 1970-2014

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ACKNOWLEDGMENTS

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- Berks County Community Foundation
- Central Pennsylvania Community Foundation
- Central Susquehanna Community Foundation
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- The Foundation for Enhancing Communities
- Lancaster County Community Foundation
- The Luzerne Foundation
- The Philadelphia Foundation
- The Pittsburgh Foundation
- Scranton Area Community Foundation
- York County Community Foundation

EXECUTIVE SUMMARY

Fiscal decay has accelerated in Commonwealth municipalities over the last 24 years, according to a new Pennsylvania Economy League analysis. The negative trend jeopardizes cities the most but also endangers boroughs, first class townships and even second class townships, whose explosion in wealth and population since the 1970s does not make them immune to the consequences of Pennsylvania's broken local government system.

The disturbing drift threatens the ability of all types of municipalities to provide even basic services that keep the communities where we live, work, shop and go to school safe, well-maintained, and free from crime and blight. It means core municipalities, whose fiscal health has a direct influence on the financial well-being of the surrounding region as centers of commerce, health care, courts, education and more, are increasingly distressed.

Among the key findings:

- Tax burden as measured in this report (See Appendix A for formulas) has grown for all types of municipalities since 1990. Calculations for tax burden and tax base in this report were determined using well-established formulas that consider municipal market value, tax revenue, aggregated household income, and the number of households.

- Tax base has on average fallen in cities since 1970, although tax base increased on average in boroughs and townships during that same time period.

- Of the 14 cities and boroughs that have been in the state's Act 47 distressed municipalities program for at least five years, only one had a 2014 tax base that was at least on par with the average for those that had never been in Act 47. This finding occurs despite the extensive state assistance that has been given to these municipalities, in some cases for decades.

- Most Act 47 municipalities increased their tax burden during the report's review period, generally at a rate higher than non-Act 47 municipal averages.

- The six municipalities that exited Act 47 from 1990 to 2007 (all boroughs) had tax bases that were significantly below the non-Act 47 borough average for 2014. This indicates that Act 47 was not successful in restoring tax base value to the boroughs that exited the program.

- Municipalities with their own local police force have twice the tax burden of communities with only Pennsylvania State Police coverage, which municipalities are able to get for free under state law as the default provider of police services. Slightly more than half of municipalities completely rely on state police.

- Seventy percent of municipalities that have their own police department ranked in the bottom statewide on the report's measurement of tax base and tax burden. In contrast, 75 percent of municipalities that rely on state police coverage were in the top tier in terms of having a higher tax base and lower tax burden.

The alarming trend should come as no surprise. Ten years ago, a Pennsylvania Economy League analysis warned that a growing number of municipalities throughout the Commonwealth were falling into fiscal distress as a consequence of state laws that mandate out-of-date and often expensive rules-of-the-road, fail to offer compelling incentives for municipalities to work together as a way to increase efficiency and save money, and provide local governments with revenue streams that are largely inelastic, capped and out of sync with budget needs.

PEL urged the Commonwealth to fix the system or face continued fiscal decline that is often inevitable given the rules under which municipalities with even the best financial management system must operate.

Little has been done by the state since that call for systemic change. The result: the latest PEL analysis shows further erosion of certain key measures of fiscal health that signal a community's ability to pay for critical services at a level that citizens can afford.

Why should we care? Because quality of life is one of the most important factors in decisions ranging from where to locate a business to whether our children choose to remain in Pennsylvania as adults. Quality of life is based on what people see in their communities — whether the streets are well-maintained and not full of potholes, whether neighboring homes are well kept or victims of blight, whether people feel safe in their towns or are wary of burgeoning crime, whether public services are sufficient and reasonably priced.

Therefore, the ability of municipalities to deliver the basic functions that result in a good quality of life is crucial to the economic sustainability and vitality of the Commonwealth as a whole. The growing incidence of municipal financial distress, with its resulting decline in the ability of local government to deliver services necessary for a good quality of life, has a chilling effect on the ability of the state to present itself as a healthy community that can attract and keep businesses and residents.

Adding to the seriousness and immediacy of the current findings are recent amendments to the state's Act 47 legislation that include a strict timetable for how long municipalities can remain in the distressed municipality program. The deadline was imposed because many of these communities have lingered in the program for years. Act 47's provisions have kept these municipalities afloat but not fixed their situation to the point that they have been able to exit the program.

Clearly, municipalities of all types — even relatively healthy ones — struggle under the current local government system. What will happen to Act 47 municipalities when they are returned to the system that apparently failed them in the first place? What will happen to the public perception and financial picture of Pennsylvania as a whole should significant population and commerce centers go into receivership?

Key Findings at a Glance: 1990-2014

Cities: Overall Negative

- *Negative Trend:* Tax base on average remained flat.
- *Negative Trend:* Tax burden on average increased.
- *Negative Trend:* All but three cities were in the fifth quintile by 2014.
- *Finding:* The fiscal situation in cities on average has deteriorated and many are likely experiencing distress regardless of whether they are in the state's Act 47 program.

Boroughs: Largely Negative

- *Positive Trend:* Tax base on average increased.
- *Negative Trend:* Tax burden on average increased.
- *Negative Trend:* The number of boroughs in the first and second quintile fell and the amount in the fourth and fifth quintiles rose.
- *Finding:* Despite gaining wealth overall, more boroughs were likely experiencing distress.

Act 47 gives municipalities revenue enhancements, expenditure controls, technical assistance and similar measures that keep communities afloat but does little to fix the underlying causes of distress — a lack of available tax base that forces municipalities to dig so deep into those resources in the form of tax burden that it can become confiscatory; a large need and/or demand for public services; and underfunded or unfunded state rules and mandates.

As a result of the state's failure to repair core issues that result in distress, municipalities tend to stay in Act 47 for years. The program throws them a life line by allowing them to remain outside the limits of the normal taxation and expenditure system.

But the fact that less than half of municipalities have emerged from Act 47 shows that the program, while necessary, is insufficient, and the real, solvable problems can only be fixed by repairing the broken local government system. The Commonwealth attempted to legislate away the inadequacy of Act 47 by compelling municipalities to leave the program through establishment of an arbitrary deadline. The legislation was passed despite the fact that it is questionable to assume real change could be made in only five years when the problems inherent in the local government system itself have not been addressed.

To meet the deadline, a municipality may be forced to take draconian actions that will extract large amounts of wealth from its small purse. Those measures could include forced asset sales, required privatization of municipal services, deep service cuts and/or stiff tax increases. The municipalities will then return to the local government system without the Act 47 safety net – and potentially with an even smaller purse.

It's anticipated that even the measures described above will not be enough for some Act 47 municipalities, whose final option for recovery is a state-appointed receiver.

For Pennsylvania at large, having municipalities in receivership could undermine the faith of the credit markets, costing substantial amounts of money in higher interest rates on borrowing for the state and other municipalities – or even make it impossible for them to borrow at all. The reputation of the state would also suffer, potentially for years, with national media stories focusing on the devastation reminiscent of when Detroit sank into financial ruin. It is hard to imagine that people would want to move here or that businesses would want to relocate here to what would be perceived as a failing state.

In the meantime, the Commonwealth will still have to spend precious resources to "fix" these communities – not to mention the political implications of forcing a receiver's will on sovereign local governments.

First-Class Townships: Largely Negative

- *Positive Trend:* Tax base on average increased.
- *Negative Trend:* Tax burden on average increased.
- *Negative Trend:* The number of first class townships in the first and second quintile fell and the amount in the fourth and fifth quintiles rose.
- *Finding:* Despite gaining wealth overall, more first class townships were likely experiencing distress.

Second-Class Townships: Mixed Positive

- *Positive Trend:* Tax base on average increased.
- *Negative Trend:* Tax burden on average increased.
- *Positive Trend:* The number of second class townships in the first and second quintile rose and the amount in the fourth and fifth quintiles fell.
- *Finding:* In general, second class townships were in a better fiscal position by 2014 due to the gains in wealth. But even second class townships increased their tax burden from 1990 to 2014 as population grew. Unlike the other municipal classes, second class townships were in a better position to afford it.

Act 47 Impact

Entrance into the Act 47 program is dependent on factors including deficits; a drop in municipal service levels caused by reaching the general purpose millage limit; inability to meet payments including payroll, debt, pension, and employee tax withholdings; and/or a bankruptcy filing. Municipalities are able to exit the program once the Act 47 coordinator and the state agree that the factors have been corrected.

The tax base/tax burden calculations used for this report's stress index do not measure those specific elements relative to the Act 47 program. Instead, the stress index measures factors that are basic to municipal health and thus contribute to a municipality's ability to raise revenue and pay its bills.

Despite these concerns, the state has taken no action as of the time this report was being written to mitigate the situation they created when the timetable was approved in 2015. Nor has there been any public discussion within state government on the potential ramifications.

Meanwhile, coordinators that write and oversee implementation of Act 47 recovery plans worry the mandatory exit will have devastating consequences on at least some of the communities they are trying to dig out of distress.

While there is cautious optimism that some Act 47 municipalities will be able to leave as sustainable communities on sound financial footing, along with a sense that some municipalities have lingered too long in the program and need a push, there is great uncertainty about the fate of others. The concern is focused particularly on the poorest places that still require a high level of services for their citizens and businesses yet have no real assets to sell or base of wealth to tax. Some serve as hubs of commerce, providing the surrounding area with hospitals, courts, universities and more.

"The needs outstrip the abilities," said one Act 47 coordinator, noting that a potential three-year extension or even a receivership is "not a bridge to anywhere" because of the limited options inherent in the current Commonwealth local government system that confines public service provision and revenue collection to municipal borders.

"The tax base just doesn't grow," he said of the more worrisome municipalities that are so steeped in poverty and blight that people don't want to move there and businesses don't want to relocate there.

While Act 47 municipalities are only a fraction of the Commonwealth's local governments, the data demonstrates that many municipalities of all sizes and types are struggling to meet public service expenses like police and public works with currently available revenue.

The Broken Local Government System

In order to enact true reforms, it's essential to understand why the system is so inadequate to meet 21st Century needs. That discussion starts with the state.

The Commonwealth's 2,561 municipalities are creatures of the state. They are formed, structured and governed by a myriad of state statutes that date back as far as 1803. These laws decide everything from what type and how high taxes can be levied to the type of pensions that are offered to municipal employees and how collective bargaining is conducted with public safety personnel.

The Local Government Commission of the Pennsylvania General Assembly has identified over 6,000 mandated state statutory provisions — more than half of which are required as opposed to discretionary. Many of these laws, particularly those centering on taxation, were last visited over half a century ago when the demographic and economic realities of the state were very different.

At the time, most townships were truly rural, and the low population meant not much was needed in the way of public services other than some level of public works. Wealth and population were more concentrated in cities, which developed a higher level of services to care for both the resident population and those who traveled daily to these centers of commerce.

The reality today is that a considerable amount of wealth and population has shifted from cities to townships. Cities, because of their socio-economics, density and status as hubs for business, health care, courts and more still require a large amount of costly services, particularly in terms of public safety. But in the last 50 years the wealth and population that used to contribute the revenue necessary to sustain those services has shifted to the townships. That trend has not abated. Townships continue to grow while cities and boroughs shrink.

Reductions in the residential population are not the only problem. For instance, loss of economic activity in western Pennsylvania following the collapse of steel and related industries led to tax base reduction and extensive municipal distress, resulting in the creation of the state's Act 47 program. It's no accident that communities in Allegheny, Mercer, Beaver and Cambria counties were among the first municipalities to enter Act 47.

Meanwhile, the movement of wealth and population might not be as much of a problem if services were routinely provided, and paid for, on a regional basis as is the situation in most states. That way the wealth and population migration would not have such a profound impact on service levels and ability to pay for them. But that is not the case.

Inadequate Revenues and Rising Expenditures

Municipalities have an array of taxes available to them including real estate, earned income, local services and more. As a result, residents logically believe their municipal taxes are sufficient to pay for whatever the community deems is an appropriate level of services and municipal management. But those taxes are largely subject to restrictions set by state law that make them inadequate.

Property taxes, for example, are often the main revenue source for municipalities. State municipal codes cap the amount of real estate millage that can be levied based on the municipal class. Unfortunately, the system also depends to a large extent on having an accurate, reliable method of property assessment to ensure fairness and adequate revenue generation. Pennsylvania's system for conducting property assessments, which determines the value of a mill in each municipality as well as how much individual property owners must pay, is frequently neither fair nor adequate.

A feature of Act 47 is so-called revenue enhancements — the ability to levy tax rates above state imposed limits. To a large degree, it is these revenue enhancements that keep Act 47 municipalities viable. And all of those revenue enhancements, with the exception of the payroll preparation tax, are lost as soon as a municipality leaves Act 47. There is a reason communities stay in Act 47 so long: they cannot function without the additional revenue.

Just as they are hubs for commercial activity, cities are often home to a substantial number of nonprofits like hospitals and universities that contribute economically to the community but further erode the tax base because of their exempt status. Municipalities are forced to rely on an ever shrinking tax base for more and more revenue creating a downward spiral.

In many cases, expenditures are literally out of a municipality's control because of state laws. This is particularly true in terms of statutes such as Act 111, which trades the right to strike by public safety personnel like police officers and firefighters for binding arbitration. Under binding arbitration, a neutral arbitrator decides the contract provisions, including wages and benefits, which are then binding on the municipality with no ability to appeal. However, the arbitrator does not have to take into account the municipality's ability to pay the contract award, and many communities argue they are saddled with awards that they cannot afford.

Many municipalities are also facing skyrocketing costs to shore up underfunded pension systems. Like much else in local government, pension plans are established by each individual municipality under state law. Forty-six percent of the 1,223 local governments in the Commonwealth that administer pension plans have plans that are distressed, according to the most recent state auditor general's report on the issue. These pension plans were unfunded by $7.7 billion as of 2013, an increase of approximately $1 billion in two years. The problem hits all sizes and classes of municipalities. For example, nine of the ten communities with the largest percentage of unfunded pension liabilities are boroughs and townships.

As higher costs begin to overwhelm largely stagnate revenues, and after expenditures are cut to the bone, municipalities often turn to "non-traditional" avenues to meet payroll and pay the bills. Actually, one of these questionable methods is to simply stop paying bills. PEL calls this the "cigar box syndrome," where bills are put in the proverbial cigar box and largely forgotten.

Municipalities might also turn to various forms of borrowing. Asset sales, or even the anticipation of asset sales, are another popular method to balance a municipal budget. Asset sales and similar one-time revenues get the municipality through an individual year but do not solve the need for an ongoing revenue source to fill a structural budget hole.

These nontraditional, often one-time revenue sources can paper over the problem of an ever growing structural deficit that occurs as expenditures grow and revenues fail to keep pace. But at some point the municipality will likely no longer be able to squeak through and distress takes hold.

The Burden of Local Police Costs

Municipalities that have their own municipal police force have twice the tax burden of those that rely on Pennsylvania State Police for coverage. They are also much more likely to be ranked in quintile five than those communities that only use state police.

The findings should come as no surprise. Local police are generally one of the largest, if not the largest, expense for those municipalities that have them. The provision of police services is yet another example of why the Commonwealth's patchwork quilt system of local government laws is broken, and in this case, results in creating financial inequity between those with local police and those without.

Municipalities that have local police spent over $2 billion on those services in 2014 or an average of $230 per person, according to an Associated Press analysis. That money primarily came from local taxes, although municipalities do receive some state aid to defray pension costs. Approximately 10 million residents are served by local police.

In contrast, the Pennsylvania State Police estimated in 2017 that it costs $600 million to provide state police services to the 2.5 million residents in municipalities without local police. That figure is about half of the state police annual budget of approximately $1.2 billion, or roughly the same per capita cost as locally-funded police protection. A large amount of state police funding now comes from fees and taxes that were supposed to fund construction and repair of roads and bridges.

There are some densely populated communities that depend on free state police coverage regardless of their wealth. Forty percent of communities among the top 20 ranked municipalities in the first quintile receive coverage for free from the state police. Most are in the so-called collar counties around Philadelphia.

Police protection in a community is not really optional. There must be some level of police protection to secure the health, safety and welfare of citizens regardless of who provides it. The question in Pennsylvania is not whether there are police services in a municipality but rather who foots the bill.

The point is not that all 2,500 plus municipalities in Pennsylvania should be mandated to have and pay for their own local police departments. Instead, policy makers need to modernize the unfair, antiquated system for providing police in the Commonwealth.

The Truth and Consequences of Act 47 and Municipal Distress

The truth is that the Commonwealth can change the optics of distress by claiming to have "fixed" Act 47 municipalities by forcing them out of the program but that action has done nothing to repair the broken system these municipalities must operate in. Given the findings of the most recent stress index, the consequences of failing to truly reform the rules under which local governments function likely will result in increased municipal distress throughout the state.

Scranton School District Fact Sheet

February 14th, 2020

Background:

The School District of the City of Scranton (the "District") encompasses an area of approximately 25 square mile and is coterminous with the City of Scranton, Lackawanna County, Pennsylvania. The City serves as the county seat of Lackawanna County. The City lies approximately 130 miles north of Philadelphia and approximately 125 miles west of New York City.

The District has a student population (inclusive of Pre K) of 9,921 as of February 14th, 2020. This consists of 4,886 elementary and 5,035 secondary. This includes a Special Ed population of 2,062 or 20.78% and the ELL population of 972 or 9.78% Enrollment has remained steady from prior years. 2016-2017 = 9,990, 2017-2018 = 10,134, 2018-2019 = 10,051.

The District operates a total of 18 buildings, consisting of twelve (12) elementary schools, three (3) intermediate schools, two (2) high schools, one (1) alternative school consisting of two(2) programs and one (1) Administration Building.

Labor / Labor Relations

The District has budgeted for 2020 Calendar year full time staff of 1,179. This consists of the following:

Employee Classification	# of Employees
Teachers	731
Para Professionals	140
Maintenance	101
Clerical / Other 32 BJ**	108
Principals / Vice Principals	26
Central Administration	18
Tax Office	11 (2 full and 18 ½ share)
Other Employees ****	44

**Building clerks/secretaries, LPN, Behavioral Techs, Attendance Officer, Hall Monitors

*** This section contains employees who are not covered by CBA or Professional Agreements e.g. IT staff, Confidential Secretary's

****Other Full time employees – Misc Admin, IT/Computer techs, confidential secretaries

Note: District also budgets for non full time employees. These include temporary maintenance, sub clerks / sub aides, crossing guards etc not included in the above.

The District and local SFT 1147 representing the Professional and Para Professional employees continue to work under an expired contract as of August 31, 2017. Negotiations sessions have been held and as of this date no resolution has been settled between the District and the SFT.

The District and Local 1201 / 32 BJ that represents the custodian, maintenance, clerical employees as working under an agreement until December 31, 2020.

The Districts Act 93 agreement, with the School Administrators has also been expired since December 31st, 2017.

Budgets / Finances

The District is one of two (Pittsburgh) Districts in the state of Pennsylvania that operates on a calendar year budget.

Over a 10 year period the District's budget has increased from $116,534,118 in 2011 to $166,141,185 in 2020. The represents an increase of over 42%.

Areas of significant increases are as follows:

Expenditure Type	2010 Audited Expenditure	2020 Budgeted Expenditure	$ Increase	% of Change
Healthcare	$11,153,220	$23,123,100	$11,969,880	107%
Pension – Employer Share only	$1,146,613	$5,798,486	$4,651,873	405%
Charter Cyber	$1,520,556	$7,200,000	$5,679,444	373%
All Other Expenditures	$104,553,604	$113,420,229	$8,866,625	8.4%

In an effort to balance budgets the District had to issue debt and raise local property taxes and reduce staff.

Outstanding Long Term Debt	Amount	Annual Debt Service	% of Total Budget
12/31/10 (audited)	$139,815,000	$9,324,000	8%
12/31/19 (estimated)	$194,610,000	$16,989,485	10.2%
Increase	$54,795,000	$7,665,485	

Property Taxes / Assessed Values

Budget Year	Millage	Increase	% Change
2011	109.24		
2020	137.62	28.38	26.25%
Average		2.8 mill per year	2.625%

Since 2011 the District has raised local real estate taxes in 7 out of the 10 budget years. The District also exceeded the Act 1 Index amount in 2015. The District has also raised taxes to the allowable Act 1 Index in the past 3 years.

The Districts Recovery Plan requires the District to raise taxes to the Act 1 Index and also apply for exceptions to Act 1 on an annual basis.

According to reports from the State Tax Equalization Board the Districts assessed values have declined from **2014 = $397,321,682** to **2018 = $388,299,190**. For Budget year 2020 the District used a taxable assessed value **of $385,839,193** that was provided by the Lackawanna County Assessor's Office. The same report list non taxable properties of $220,292,155 or 36% of the total assessed in Scranton.

In addition to Property Taxes the District also levy's the following ACT 511 Taxes

Tax	Levy	Budget
Earned Income Tax	1%	$11,300,000
Mercantile Tax	.000452 (wholesale) and .000679 (retail)	$1,100,000
Business Privilege Tax	.00513	$6,150,000
Occupation Tax	$5.00	$180,000
Realty Transfer	½ of 1%	$600,000

Staff Reductions Brief Summary

	2017	2020 Budget	Reduction
Professional (SFT)	770	731	39
Maintenance / Clerical (32 BJ)	234	209	25
Admin / Act 93 (Principals)	44 (2019 budget)	42	2

By reducing staffing the District has lowered its salaries from **2010 audited actual $67,099,200 to 2020 budget of $66,986,280.** As noted above the District's teachers have been without a contract for 3 years, Maintenance contract includes no salary increases and the ACT 93 agreement expired in 2017.

Also annually the District has had to reduced building level budgets therefore reducing the educational resources that are in the classroom. For example for the past 3 years the District has had to cut a ELA resources from the middle school due to the funding not be available.

Buildings / Operations:

A 2018 Report on School Facilities and Operations conducted by PFM, the Districts state appointed Technical Assistance has identified short term (critical 1-3 yr) capital needs in the amount **of $7.3M** and an estimated **$55.5M** needed in the next 7 years. These needs **were prior** to the environmental related repairs and abatements that will be necessary that recently were discovered.

The District through the Recovery Process has established a Building Reconfiguration Advisory committee to explore options for District buildings.