Commonwealth of Pennsylvania

October 19, 2004

Mr. William K. Lieberman, Chairman
Pittsburgh's Intergovernmental Cooperation Authority
US Steel Tower, Suite 5500
600 Grant Street
Pittsburgh, PA 15219

The Honorable James C. Roddey, ICA Board Member
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Pittsburgh, PA 15220

Dear Bill & Jim:

First, we would like to extend our sincere appreciation to you as a board member of the Intergovernmental Cooperation Authority (ICA). As residents of the Pittsburgh area, we care deeply about the successful financial recovery of the City of Pittsburgh. We have worked tirelessly on this issue for well over a year because we believe inherently that the City of Pittsburgh will emerge from this crisis a better and more competitive city and become a strong viable economic hub for Southwestern Pennsylvania. We hope that together we can charter a course to ensure that significant changes are made in the fiscal practices, operations and structure of the City of Pittsburgh including the Mayor's and Council's offices, and each department, Bureau and Authority.

Just as vital is the ability to achieve a consensus in the General Assembly to enable any statutory changes that may be necessary with regard to reductions, reforms and, if necessary, revenues. This is particularly true, given the limited amount of time available on the legislative calendar for the remainder of this session. To achieve a consensus, we believe that any legislation must necessarily be composed of three parts: (1) cost savings and reductions, (2) reform of the City's structures and practices to avoid similar crises in the future and (3) new revenues necessary to fill budget gaps remaining after cost cutting measures are taken.

Clearly, in addition to demographics and tax bases, the City's financial distress was directly caused by a combination of inappropriate City practices and decisions, including: (1) The failure to make the changes recommended by task forces over the last decade, which could have saved the City hundreds of millions of dollars over the last eight years alone; (2) The excessive incurring and delaying of debt, and (3) The failure to strategically plan and adjust the structures and services of the City to reflect changes in its demographics. It is the intent of the General Assembly to address these causes in any legislative solution.

I. *The Problems*

In your April 12, 2004 Preliminary Report, you note that the City of Pittsburgh has suffered major declines in the tax base and that the City has not offset these declines by corresponding reductions in City expenditures. You noted that "[i]nstead of long range strategic planning and realistic decisions, the City has pursued stop gap measures that have resulted in major fiscal distress."

We received the following information from the Executive Director of the ICA, which was accurate as of Friday, October 15, 2004. According to the Director, the budgeted expenditures for fiscal year 2004 were $388,800,000. However, the budget expenditures for fiscal year 2005, as proposed by the Mayor, are $433,000,000, an increase of $44,200,000. Presumably, although it is not clear, the proposed budget expenditures would have been $466 million but for projected Act 47 budget cuts in the amount of $33 million.

According to the Executive Director for the ICA, the proposed $433 million in 2005 expenditures includes a specific $7.5 million line item for capital improvements and approximately $5 million in additional capital improvements that seem to be buried in other line items.

Again, according to the Director, in 2003, the general fund revenues were $349,327,000. The general fund revenues for 2004 were budgeted at $388,800,000, which included a projected $17 million increase from the increased parking tax and $16.7 million from payments from the authorities. The proposed 2005 general fund revenues for the City of Pittsburgh show $433 million including $42 million from a property tax increase. Unlike the $16.7 million in 2004, the revenues only include $7.2 million in payments from authorities.

The City's projected gap -- without additional cost reductions -- for fiscal year 2005 is essentially represented by the total amount of the increase in the City's property tax which is $42 million. From the "get-go", it appears that approximately $22 million of that figure can be made up by receiving $9.5 million in additional payments from the authorities and removing, at a minimum, the $12.5 million in capital improvements.

It is true that the City's financial problems escalate with each new year 1) because of the exorbitant amount of debt it has undertaken, particularly in the last ten years, 2) because of its failure to adequately fund its three primary pensions over the last twenty years, and 3) because the City has maintained a bloated City workforce that is too large and inefficient for its size.

City leaders seek additional revenues in future years to cover the debt they foisted on future generations which is now coming due, to make up for the pension monies they did not contribute in the past, and to continue to maintain a large and inefficient workforce. City officials wish to continue without making the requisite tough decisions.

Ideally, of course, the City of Pittsburgh's goal should be to lower taxes to make it more attractive to live and work in the City. The City needs to pay down its debt, adequately fund its pensions and make its workforce leaner, more competitive and more efficient.

Ultimately, the goal is to lower taxes. This goal cannot be obtained without significant cost structure reductions. Bold changes are needed. We must take this opportunity to make real change for the City and region.

The following highlights just some of the City's problems that need to be addressed:

A. Debt

It is hard to believe but the City has amassed debt of more than $935,000,000 of bonded indebtedness. "The Pittsburgh debt per capita of $2800 is the highest for cities of comparable size." (Please see the ICA Preliminary Report) You noted in your Preliminary Report, that debt service is $90 million annually. You also noted that the challenge of reducing the City's annual debt payment of $90 million "has been made prohibitively difficult because the City refinanced its debt a number of times with non-callable bonds at a rate of interest at or above 6.5 percent." Almost 25% of the City's operating expenses are dedicated to paying debt service payments.

The City's authorities have accumulated close to an additional $1 billion in debt. Some of this debt was foisted on the authorities controlled by the Mayor to prevent the City itself from having even more debt. By way of example, the City transferred the water treatment plant to the Pittsburgh Water and Sewer Authority in 1996. The City received $96 million in cash over three years from the Authority (which it used for operating expenses) but the Authority took on significant debt to do so.

B. Pensions

According to your Preliminary Report, the City pension plans recorded an unfunded pension liability of $375 million as of December 2003. It is our understanding that the ICA now believes the amount to be significantly higher and perhaps twice the amount. This pension problem is not merely a problem endemic to cities. This is a problem caused in great part by the City's irresponsible actions over the past 20 years, despite hiring paid special consultants to advise it on pension issues.

- Prior to 1984 the City of Pittsburgh underfunded its retirement system by operating on a "pay as you go" basis. Because the resulting low contributions were not sufficient to cover the accruing liabilities, the City accumulated unfunded accrued liabilities totaling $430 million in 1985.

- In 1984, the Municipal Pension Plan Funding Standard and Recovery Act (Act 205) established a uniform funding requirement for all municipal pension systems. Under the Act 205 Recovery Program, the City elected several options (40-year amortization, level percentage amortization, and funding phase-in) in 1985 that effectively lowered the City's contribution requirements. In part because of the funding referral that resulted, the unfunded accrued liabilities of the City's pension systems continued to grow and totaled $515 million in 1995.

- In 1989, when the "funding phase-in option" would have required the City to contribute more than the normally calculated funding requirement, the City elected to stop using the option and thereby lower the City's contribution requirements.

- In 1994, the City elected to modify the actuarial assumptions used to calculate the funding requirements of its retirement systems and the annual contributions to the City's retirement systems were reduced by approximately $3.7 million.

- The City provided an early retirement incentive program for police officers in 1994-95, which increased the unfunded accrued liabilities of the police pension fund by an estimated $50 million and achieved no complement reduction.

- In 1998, the City asked the State to pass legislation to amend the statewide actuarial funding standard under Act 205 permitting only the City to re-amortize its unfunded liabilities over a new 40-year period, which replaced the 26-year period remaining on the original amortization schedule. The amendment, which was signed into law, allowed the City to use an aggressive method for calculating the amortization payments that further lowered the City's amortization payments.

Representative Steven Nickol (R-Adams and York) made the following prescient comments on the House floor in 1998:

> Thirteen years into the plan and the payments are beginning to bite. Pittsburgh now wants a New Deal and level dollar payments look attractive. SB 284, in part, would allow Pittsburgh to switch payment methods and begin once again to pay off their unfunded pension liability over the next 40 years.
>
> Let us face it, Pittsburgh just lost 13 years in dealing with its pension debt.
>
> I have two concerns.
>
> First, there is special treatment given to Pittsburgh in this deal available to no one else. I will not go into detail on what I see as an overly aggressive interest rate assumption except to say that I fear other

> municipalities with distressed pension funds will now expect equal treatment...
>
> Second, I understand this New Deal is being heavily lobbied by Pittsburgh because without it the City is in serious financial difficulty.
>
> Water assets and accounts receivable like parking tickets and tax liens have already been sold off to generate money to balance the City's budget. These are strong indications that there may be an underlying structural deficit in Pittsburgh's budget. I also understand balloon payments are soon due on several significant old debts.
>
> If this is true, Pittsburgh could be on the same path that led Philadelphia to crisis in 1991. I certainly hope this is not the case.
>
> SB 284 certainly looks on the surface in the short term, to be the right deal for Pittsburgh because it lowers their pension costs. However, this is accomplished by pushing off payments to a future generation of taxpayers. And it is accompanied by greater degree to risk than any other previously approved deals for financially distressed municipalities under Act 205.
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> I certainly hope my concerns are without foundation. And I certainly hope this bill is not just being passed so Pittsburgh can pay its electric bills for the next year or two. If it is, we are about to lose an opportunity to force Pittsburgh to put its financial house in order, and taxpayers long term will be the losers.

C. Workforce Expenditures

According to the ICA Preliminary Report, the City had 327,898 residents, little more than half of the 604,332 in 1960. Nonetheless, the City's workforce has not been commensurately reduced. This is in part because of a pattern of entering into no-cut contracts. According to a May 29, 2003 Pittsburgh Post-Gazette article, almost 1/3 of the City's workforce is shielded from lay-offs due to no-cut contracts. According to the article a total of 1411 employees, or 32% of the City's workforce have "no-layoff clauses" in their contracts.

According to the ICA Preliminary Report, Pittsburgh per capita spending on public safety in 2002 was $541 compared to $349 for comparable cities. "Pittsburgh is spending $60 million more per year in public safety than smaller cities." This problem has, in large part, been created by irresponsible contracts entered into by the City. In particular, we focus on firefighter safety costs which have yet to be addressed despite warnings as early as 1996.

The 1996 O'Neill report noted that the City had "more firefighters and fire stations on a per capita and per square mile basis and a shorter work week than most comparable cities." It noted that the City's 24 firefighters per 10,000 residents far exceeded the average of 16 per 10,000 for comparably sized cities.

According to a May 9, 2001 Pittsburgh Post-Gazette article, the 1996 O'Neill report said "...the City could save money by closing fire stations and reducing the number of firefighters. It determined that Pittsburgh has at least 50 percent more stations and firefighters than other comparably sized cities."

According to a February 2004 Allegheny Institute report, "Pittsburgh spent $234 per resident on fire, more than $100 higher than the group average of $128." According to this report, Pittsburgh has actually headed in the wrong direction since 1996: it has 2.8 fire employees for every 1000 residents compared to an average of 1.6 per 1000 residents for peer cities. If Pittsburgh maintained just the average in comparison to peer cities across the United States, its total costs for fire safety would be approximately $35,000,000 less annually (the City's annual expense runs approximately $77,000,000 while the average annual expense runs approximately $42,000,000).

Keep in mind that, on the eve of primary election in 2001, the City entered into a no-cut contract with its firefighters. The contract is good through 2005 and guards 836 firefighters from any layoff, according to a January 3, 2004 Post-Gazette article. That contract included an 8.68 percent annual pay increase for senior officers, according to a Tribune Review article dated April 14, 2004.

Despite such a large workforce, the City firefighters incurred $7,000,000 in overtime costs for financial year 2003, according to the Executive Director for the ICA. This fact is difficult to comprehend.

D. Diversion of Regional Asset District (RAD) Tax Dollars

In 1993, the State Legislature passed the enactment of the Regional Asset District Tax pursuant to Act 77. As State Senator Jack Wagner has noted in speeches, the enactment of the Regional Asset District Tax created a new tax revenue for the primary benefit of the City of Pittsburgh. It is the only new tax in recent times that has been enacted on behalf of a city in Pennsylvania. No other municipality has requested such a tax or received one.

Act 77 provides for the enactment of a 1% county sales tax collected by the State Department of Revenue. Twenty-five percent of the funds go directly to the County while twenty-five percent goes to other municipal governments based on a formula.

In 2003, $19,377,786 was directly allocated to the City of Pittsburgh from the RAD Tax. Since 1994, the City has directly received $164,723,533. A substantial portion of the annual amount received by the City was diverted by the City to finance a Development Fund under the control of the Urban Redevelopment Authority.

The Pittsburgh Development Fund was created in 1994-1995 through the issuance of $61 million in bond debt to be retired by diversion of a portion of the City's RAD distribution. Since 1994, the City diverted 6.2 million of its annual RAD allotment to the Development Fund instead of using those monies for the City's own operating expenses. As of 2005, the diversion increases to $7.6

million annually. (The RAD's own website indicates that the proceeds of this portion of the RAD tax are to be "used to assist in shifting the tax burden away from property taxes.") To date, the City has diverted $62 million to pay off the Development Fund bonds. Another $76 million will be used to pay off the debt. All of these monies are being financed by the City's RAD taxes.

At the end of 2003, there were 31 outstanding loans with a book value of $55 million. According to URA officials, the loans have a market value of only $16 million reflecting exceedingly poor lending practices of the fund managers.

The most egregious loan was made to Lazarus to build a new department store. That store has closed, never having paid a cent toward the $18 million URA loan. And what's worse, that loan must be written off since the conditions of repayment requiring the store to pay back the loan based on a portion of sales in excess $40 million per year will never be met. This represents a direct loss to the City. And because the store was built with tax increment financing, the City, County, and school district are not receiving any new tax revenues from the $50 million structure.

Moreover, a large fraction of the still outstanding PDF loans have repayment conditions tied to the performance of the business or organization receiving the loans. As a result many of those loans will never be repaid in full. Then too, many of the loans are very low interest rate loans.

II. *Cost Savings and Sale of Assets*

Many times over the years, the City has come to the state for pension and debt assistance. The RAD tax, paid in large part by suburban residents, is only one example of the aid the City has been given over the years. Yet, the City has repeatedly failed to use that money wisely and to change the way it does business. On September 16, 2003, the *Pittsburgh Post Gazette* interviewed Paul O'Neill noting: O'Neill served on an 11-member task force that in 1996 offered a detailed plan for saving the City's finances, but he declined to comment yesterday about Pittsburgh's current financial crisis, beyond saying: "They should have done what I said."

This cannot happen again. We are not convinced and have not seen a significant good faith effort on the part of the City to effectuate any cost reductions or change the way it does business. It appears certain City leaders hope to receive a commuter tax and carry on with business as usual. Unfortunately, business as usual has resulted in the City paying debt with debt (debt comprises 25% of expenses), increasing personnel costs far beyond revenue increases, and ignoring all calls for change.

One of the most striking indicators of the City's lack of desire to reform is the fact that the proposed budget seeks to spend approximately $40 million more, *purportedly including cost saving measures*, than it did last year. For a City in crisis, this is simply unacceptable, and cannot be completely explained away by contracts and benefits. Further, as reported on September 29th in the *Post Gazette*, City Council has put off a vote on the parts of the recovery plan, such as its calls to privatize the City garage and asphalt plant, eliminate the Engineering & Construction Department and increase fees for swimming pools and other services.

The expenditure reductions and recommendations suggested in your Preliminary Report were a good first step, as were some of those in the Act 47 plan. The Act 47 plan, however, does not go nearly far enough in making real changes to the City of Pittsburgh. It only requests $33,000,000 in needed cuts and ignores some excellent recommendations that have been on the table since at least 1996. We must insure those cost saving measures and more are accomplished. They must be a condition precedent to the receipt of additional revenues from any new sources.

In addition to those recommendations in Act 47, we suggest the implementation of the following changes which are, by no means, exhaustive:

A. Across the Board Cuts

A Pittsburgh Post Gazette article dated Sunday, October 10, 2004 entitled: "Pittsburgh Cutbacks Don't Cut Into City Council's Spending" stated: "The Act 47 plan recognized some of the issues in City Council's spending and called for 15 percent across-the board cuts in all elected offices, including the mayor and controller's offices.

"Under lobbying from council members, the Act 47 coordinators agreed to combine their spending with the city clerk's budget before making the cuts, giving them more budgeting flexibility."

"Their combined spending on miscellaneous services was $712,000 in 2003 and budgeted at $265,000 for all of 2004."

We believe that there needs to be 15% cuts across the Board in the Mayor's office, City Council and the comptroller's office. Furthermore, we believe there should be a freeze on the $10,500 discretionary funding that each council member receives. We would request the ICA to determine exactly how much in an additional savings would result from these cuts.

B. Privatization efforts

Privatization or marketization is an important tool available to the City of Pittsburgh and was first suggested in the 1996 O'Neill report. As Mayor Stephen Goldsmith wrote in his landmark book, The Twenty-First Century City:

> The idea is simple: just because government has a duty to ensure that citizens receive certain services does not necessarily dictate that government must produce those services itself. ...
>
> Privatization is an attempt to reverse much of the history of the twentieth century, during which the government took upon itself an astonishingly broad array of tasks – many of which it now attempts to provide almost exclusively, i.e., with as little competition from the private sector as possible. ...
>
> In retrospect, the importance of marketization seems simple. Why are most private sector companies more efficient, more customer-oriented, and are more innovative than government? Because private sector

companies are in competition and will go out of business if customers do not like the goods and services they offer.

The following City operations should be subjected to privatization/marketization:

- sanitation services should be completely privatized, which will save the City $8 million per year (according to the ICA executive director);

- the tow pound should be completely privatized, which will save the City $1 million per year (according to the ICA executive director); and

- EMS should be completely privatized, which will save approximately $6 million more per year (according to the ICA executive director).

Keep in mind that, unlike most other county residents, City residents pay no garbage collection fee. And, unlike every county municipality but one, the City has a public sector sanitation service force. According to one of our legislative colleagues, he determined, upon investigation, that as much as 25% of the sanitation service workforce has been on workers' compensation at any one time, as compared to 2 – 4% of a private sector sanitation services' workforce. A request for proposal to buy the sanitation service should be put on the table immediately and any private collector should be able to charge residents a fee.

C. Other Cost-cutting Measures

Should the state eliminate the City's business privilege, school mercantile taxes and mercantile taxes, the City's finance office workforce could be downsized to save another $1.5 to 2 million dollars per year, according to the Executive Director of the ICA.

The City school district, sitting on a reserve estimated to be at least $90,000,000 and a governmental entity which charges its residents a 2% wage tax, must undertake its responsibility to hire and pay school crossing guards. By eliminating this cost for the City, there would be an additional savings of $1.1 million per year.

D. Liquidation of Authorities and Sale of Assets

Assets of certain authorities and City properties must be liquidated -- e.g., the assets of the Stadium, Water, and Parking Authorities. These sales would put property back on the property tax rolls immediately. Furthermore, funds from these sales should be used to pay down the excessive debt of the City (even if the monies need to be placed in a sinking fund), which would enable it to then reduce taxes further in the future.

E. Sale of URA Assets

Also, the holding of large numbers of parcels of properties by the URA is not good public policy. It deprives governments of property taxes and prevents the private sector market place from developing the property. Sales of URA assets should be carried out expeditiously and to the maximum extent possible with all resulting net proceeds set aside in an ICA account. Those funds will be used solely for the purpose of paying down Pittsburgh's debt.

We would hope that the ICA board would provide some guidelines for selecting properties to be sold, such as:

- Any and all land owned by the URA that is leased to the owners of a building situated on the land.
- Any property owned by the URA that is not under active redevelopment.
- Any property whose sale is not explicitly restricted by law or contractual arrangement.
- Any property owned by the URA for more than ten years.

Numerous studies over the last 10 years have pointed out these and other meaningful remedies. Yet the Mayor and City Council have not implemented any of these measures to solve the city's financial problems.

III. *Better Use of an Existing Revenue Source – the Regional Asset District 1% Sales Tax.*

We believe that the problems with the City's usage of Regional Asset District (RAD) tax revenues should be corrected, which would free up $11.5 million in revenues annually for the City. The original purposes of the RAD should be complied with. In the future, those revenues should be used for recreational, cultural, and tax relief purposes. We would hope that you would recommend strengthening the law to prevent the long-term obliging of RAD revenues to the bonds of an authority. Legislation has been drafted on this issue.

A. Return RAD Tax Revenue from School to City

We believe that an outdated reimbursement from the RAD tax to the school district should be eliminated, which will immediately make $4 million per year in revenues available to the City.

B. Liquidate the URA Development Fund

The Development Fund should be defeased immediately if possible by the sale of other URA assets. 7.6 million dollars per year would be available to the City if the Development Fund were defeased. (These monies can be placed in a sinking fund to make annual payments to the Fund in lieu of the RAD tax dollars if necessary.)

If the ICA believes it prudent (although reasons must be set forth as to why), it can suggest waiting for gaming tax monies from the Gaming and Economic Development Fund to defease the URA Development Fund. Act 71 of 2004 provides that 5% of the daily gross revenues go into a Gaming Economic and Development Fund which will spend money on a list of authorized projects in counties of the second class (section 1407, subparagraphs (4)-(10) of Act 71), including a project to defease the URA Development Fund. However, the law does not mandate that these gaming taxes for economic development be used to defease the URA Development Fund – it merely provides the discretion to do so.

IV. *New Revenues*

The ultimate goal is to lower taxes. This can only be done if the City's costs are reduced. The expense reductions, including marketization efforts, the sale of assets, the shift of RAD tax dollars back to the operating budget and the new gambling revenue should all significantly address the City's fiscal problems. These items need to be taken into account going forward.

As an initial matter, a commuter tax is not warranted. As noted by the Act 47 coordinators in its report, a commuter tax will "erode the City's already weakened economic competitiveness, but it would also be based on a higher EIT that would evaporate once Act 47 distressed status is eventually lifted. Moreover, this tax requires annual reauthorization by the County's Court of Common Pleas, and home rule suburban jurisdictions can effectively capture the revenue themselves by raising their EIT to match Pittsburgh's non-resident rate."

The burden to assist the City should be more fairly shared. However, the goal should be to ultimately lower taxes, not increase them. Broadening the bases of business taxes and keeping the rates lower will enable the City to be more competitive. Mayor Goldsmith states: "Taxpayers will tolerate some level of inefficiency and unresponsiveness from government. But as taxes continue to rise, their patience wears thin."

No one can fully know what, if any, new revenue amounts are needed until there is a comprehensive calculation as to the cuts and changes set forth above. We request that the ICA conduct that analysis before any new revenue analysis.

A. New Taxes Already Implemented or Soon to be Implemented

1. Parking Tax Increase

The Pittsburgh City government approved a parking tax hike in January 2004. The tax was raised from 31 percent to 50 percent effective February 1, 2004.

The City's 2004 budget estimated the tax would bring in $47,313,292, up from $30, 879,444 in 2003. In June, the Act 47 coordinator Recovery Plan estimated the 2004 collections would be $43,500,000 and 2005 collections would rise to $44,487,794, in part because of a month of additional collections at the 50 percent rate. In September, the Mayor's budget estimated 2005 parking tax revenue will be $43,750,000.

In short, the 50 percent tax rate is bringing in approximately $13-14 million annually more than the 31 percent rate rather than the $16.5 million originally estimated by Pittsburgh officials. Thus so, beginning this year, the City is already receiving $13 million more in new revenue on an annual basis than it did in 2003, when it announced a pending fiscal crisis. Keep in mind that a November 22, 2002

Allegheny Institute of Public Policy report calculated that 75% of the parking taxes are being paid by non-residents of the City.

2. New Gambling Tax

Under Act 71 of 2004, the new gaming act, one *Category 2* license will be issued to a stand alone non-racetrack facility in Pittsburgh. From this facility, per the governor's plan, there will be a 4% local share assessment—2% for the county and 2% or $10 million, whichever is *greater*, for a second class City. [Section 1403]. Thus so, the City will be receiving an additional $10 million – at a minimum – in annual revenues beginning in 2006. This new revenue must be taken into account and cannot be readily dismissed.

B. Proposals for New Revenues.

1. Payroll Tax and Other Proposed Business Taxes

There has been much discussion about implementing a "payroll" tax in the City of Pittsburgh. Keep in mind that the Pittsburgh 21 Report called for a payroll tax on top of the existing City business privilege and mercantile taxes and the Hillman-Roderick report called for a per-head business employee tax on top of the existing City business privilege and mercantile taxes. Neither plan called for the elimination of the business privilege and mercantile tax. Other legislators have proposed to eliminate existing exemptions to the business privilege tax while keeping the tax still in place. All of these proposals, each supported by the Mayor, would maintain an onerous business tax environment that would discourage further growth in the City.

Only recently has there been discussion of replacing the current business privilege and mercantile tax with a "payroll" tax. Although taxing employers on the basis of employing people may not be the most desirable form of taxation, there is a benefit to employers for the use of their workforce, in addition to the government services they receive. Further, there appears to be no other viable alternative that has received interest in the legislature.

Senator Wagner proposed two bills, 991 and 1051, which would provide for a payroll tax. Under Senate Bill 991, the payroll tax would be adopted by ordinance at a rate not to exceed .75% or the rate which would cause the city to realize $15 million more than the BPT/mercantile taxes, which ever is lower. Under Senate Bill 1051, the city is provided three options: eliminate the BPT and mercantile tax with a payroll tax of .75%, or phase out those taxes over time with an eventual payroll tax of .75%, or eliminate the mercantile tax and reduce the BPT to 3 mills and impose a payroll tax of .51%.

On page 197 of its June 11 final report, the Act 47 team proposes two business tax plans. The first calls for a reduction in the BPT to 4.0 mills of gross receipts, a reduction in the mercantile tax to 0.67 mills of gross receipts for wholesale vendors and dealers and a reduction in the mercantile tax to 1.33 mills of gross receipts for retail vendors but keeps each tax in existence. The first plan then imposes two business taxes including a $5.25 per month charge for each employee and a 0.3% charge on total payroll. The second Act 47 option on business taxes is to eliminate the business privilege tax and the mercantile tax and replace them with a gross payroll tax at .85%

These proposals estimate that the total for profit payroll in the City is slightly over $7 billion. It appears that both Act 47 and Senator Wagner relied on the City Finance Department to determine the estimate of the City's for profit payroll amount. Unfortunately, the calculations underlying this base payroll figure, and the original source of the data, have not been disclosed. And, the U.S. Census, which actually records business payroll data, indicates that the figure is significantly higher.

We contacted the City Finance Department and the City Controller's office regarding this estimate. Neither office provided support for the base payroll figures.

We have had staff analyze earned income and prior census data to determine the source of the City's base payroll figure, but they could not duplicate the calculations.

Clearly, any base for new tax revenues must be calculated using data and methodology that can be replicated. We have run two calculations, both of which indicate that the City has underestimated both the base and the amount of revenue that could be generated from a payroll tax.

First, using Department of Labor, Bureau of Statistics figures, the number of business employed in the City of Pittsburgh for 2003 was 320,000 (Business employees does not include non-profits and does not include government workers). The average weekly wage for the City of Pittsburgh obtained from the Pennsylvania Department of Labor and Industry was $644.25. This number, multiplied by 52 to obtain the average yearly wage, equals $33,501. The average yearly wage was multiplied by the number of business employed to obtain a tax base of $10,720,320,000.

This number, multiplied by the tax rate of .55 percent provides an estimate of revenue from the payroll tax of $58,961,760. This is $9.4 million over the current business privilege and mercantile taxes, which would be repealed. If the payroll tax was .75%, as proposed under Sen. Wagner's bills, the estimated revenue would be approximately $80.4 million, which is at least $30 million higher than the amount brought in by the combined business and privilege tax and the mercantile tax ("BPTM taxes"). If the payroll tax was .85% as proposed by Act 47, the estimated revenue would be $91.1 million, which is at least $40 million higher than the amount brought in by the BPTM taxes.

In a second calculation using actual census payroll data for the zip codes located primarily in the City's borders, minus medical, educational, and religious organizations (many of which are for-profit, we have calculated the base to be $10.9 billion, which would yield $60 million dollars from a payroll tax of .55%. Keep in mind that Senator Wagner's proposals would permit up to .75% and Act 47's proposal calls for a .85%. If the payroll tax was .75%, as proposed under Sen. Wagner's bills, the estimated revenue would be $82.2 million. If the payroll tax was .85% as proposed by Act 47, the estimated revenue would be $93.2 million.

We believe calls for a payroll tax of .75% and .85% are absolutely too high and should be lowered significantly while still eliminating the BPTM taxes. The more cost reductions and reforms are implemented, the lower the taxes. The less reductions and reforms are implemented, the higher the tax. Bold changes to the cost structure are needed.

The projected payroll tax could be reduced even further if it were more broadly applied. Some have suggested that the payroll tax be broad enough to cover the for-profit aspects of nonprofits that maintain for-profit entities. We call upon the ICA Board to determine whether any new payroll tax should be applied more broadly and, if so, to whom. We would request a detailed analysis by the ICA Board as to whether the tax should be applied more broadly so that the rate can be lowered. Nothing should interfere with the City's ability to contract for services or in lieu of payments with regard to non-profits.

While it is possible that a payroll tax alone could provide ample revenues while being fairer to businesses across the board, other options have been put forth to achieve these goals, and we would be willing to consider some or all of them as part of a comprehensive package.

2. <u>Occupational Privilege Tax</u>

Certain City officials have long contended that commuters and visitors do not pay enough to the City and that they are a drain to the City. Furthermore, they contend that the only money that the City extracts from the commuting workforce is the $10 occupational privilege tax. (Keep in mind that the occupational privilege tax is the same for every community – excluding Philadelphia – in the state and that it has not been increased for any other municipality as it is regarded by many to be a nuisance tax). Proponents of this argument prefer to foster an "us versus them" mentality.

In a November 22, 2002 report, the Allegheny Institute dismisses the contention that non-residents – because 270,000 of them commute into the City for work – do not pay their fair share for City services. First, the Institute contends that it is not commuters who are by and large using City services. "It would be interesting to look at the share of Police and Fire department resources that are devoted to dealing with crimes and fires attributable to commuters." Second, the argument completely fails to take into account the vibrancy and economic activity non-resident workers and visitors add to City life and attractions. "[T]he City would be in far worse shape without the contributions of the visitors and commuters to the City." Finally, non-residents do pay significant taxes to the City already.

At the outset, the fact of the matter is that non-residents pay a sizeable amount of many other taxes collected by the City including the amusement tax, parking tax and the 1% sales RAD tax. According to the November 22, 2002 report, using conservative estimates, non-residents pay approximately 75% of the parking taxes and 70% of the amusement taxes. The projected revenues for the parking tax in 2004 at the 50% rate are $43,500,000. 75% of that amount is equal to $32,625,000. The projected revenues for the amusement tax in 2004 are $9,407,945. 70% of that amount is equal to $6,585,561.

In addition, the City received approximately $19,300,000 in direct RAD tax payments in 2003. According to the Institute, non-residents pay approximately 75% of the 1% RAD sales tax. 75% of $19,300,000 is equal to $14,475,000.

Keep in mind that the 1% RAD sales tax generated $143.6 million in taxes in 2003. Non-residents paid at least 75% of that tax, generating at least $107.7 million in tax revenues. These monies were used to pay for many facilities located in the City -- as part of non-residents "fair" contribution to the assets of this region. For instance, 22% of the RAD tax annual revenue is used to pay the annual debt service costs of the tax-exempt stadiums and arena. Since non-residents contribute 75% of the tax, non-residents contributed $23,694,000 in 2003 alone to the debt payment on the stadiums by virtue of their payment of the 1% RAD sales tax.

Significant amounts of RAD tax monies appropriately went to City assets like the National Aviary, Phipps Conservatory, the Pittsburgh Zoo, City of Pittsburgh's four regional parks, the Children's Museum and the Historical Society of Western Pennsylvania.

The Institute goes on to argue that non-residents, in fact, help to generate a significant portion of the business privilege tax, the mercantile tax and real estate taxes. That argument remains open but tenable.

Finally, the Occupational Privilege Tax is projected to bring in approximately $3,250,000 for 2004. Non-residents pay approximately 60% of the Occupational Privilege Tax collected. 60% of the $3,250,000 is equal to $ 1,950,000.

We recognize that many City officials demand that the occupational privilege tax be increased as part of any comprehensive solution. As many of our fellow legislators have said to us – both Democrats and Republicans – the City of Pittsburgh keeps coming back for help every few years. We do not want to increase taxes to just throw good money after bad. We will certainly look at any suggested increases provided that significant reforms are undertaken by the City.

With regard to the occupational privilege tax, we believe that an increase in the OPT, if any is warranted, should be far less than that recommended by Act 47, which appears to have made a recommendation with politically punitive motives. The Act 47 team has called for an increase in the OPT to $145 per person (with some minor changes), resulting in annual revenues to the City of approximately $43,500,000, an approximate annual increase of $40,000,000.

Combining the Act 47 increase in the OPT with the Act 47 suggested payroll tax increase (over the BPTM taxes), the City is looking at a potential windfall of over approximately $80,000,000 in new revenues. These are in addition to the new gambling taxes and the increased parking taxes. Taking those two taxes into account as well, the City is looking at a windfall of approximately $103,000,000 in new revenues annually. This proposition is absolutely untenable.

Ideally, if it is determined to be necessary to increase the OPT, we would consider an option to increase this tax for all municipalities or at least for all municipalities that are distressed. Senator Ferlo has two bills regarding the OPT, Senate Bill 1015 (Pittsburgh) and Senate Bill 1016 (statewide). A few other legislators have said that they would be willing to increase the OPT on a statewide basis. These legislators have not yet introduced such a bill for consideration and we are not aware of any plans for any of them to do so. To date, the Governor has not called for a statewide increase and has not asked for one. Without his endorsement of such an increase and his leadership, we do not believe that a statewide OPT tax increase can occur.

3. Public Facility Wage Fee

Another revenue option includes allowing the City to collect the 2% wage tax that visiting athletes and performers are not subject to from the school district, by virtue of their residence, but which other athletes and employers who are residents must pay. This could be done through a public facility usage fee. This would allow for a total of 3% on earned income on visiting athletes and performers attributable to their use of publicly funded stadiums and arenas, the same as residents. Payors of this fee would then be exempt from those other taxes. In addition to augmenting the City's tax revenues, this tax could be used to substitute for an elimination of the amusement tax on non-profit cultural institutions.

V. *Elimination or Reduction of Taxes*

A. Amusement Tax on Non-profit Cultural Institutions

To support the arts and culture, we would ask that you also consider recommending the removal of the amusement tax from those non-profit cultural institutions. If the ICA Board did not find the public facility wage fee acceptable, it should consider increasing the amusement tax on for-profits in a percentage amount necessary to offset the decrease in revenues from the elimination of the tax for cultural institutions.

B. Parking Tax

There clearly needs to be a reduction in the City parking tax. At present, the parking tax increase to 50% has raised an additional $13-14 million annually for the City of Pittsburgh. The board needs to address to what extent, if any, parking rates will drop if the parking tax is, in fact, forced to be reduced. The Parking Authority actually "raised rates at most of its downtown garages much more than necessary to cover the higher tax. For example, the $11 rate at the Mellon Square garage should have risen to $12.60 to cover the tax. However, the Authority raised the rate to $14.00." Please see the October 7, 2004 Allegheny Institute policy brief.

VI. *Debt Reduction*

Since a very large part of the City's financial problem lies within its debt and debt service, we believe that it is imperative that your recommendations be forceful on debt reduction. You cannot ignore this issue. Neither the Hillman-Roderick nor the Pittsburgh 21 reports addressed the City's debt issues. No recovery plan can be of any value without the debt service issue being addressed. We cannot hide from the past City mistakes and act as if they did not occur.

In that regard, we believe that half of any increase in any new revenues over 2004 must be dedicated or earmarked to debt reduction. We recommend that certain new revenue streams be used to specifically pay down debt either by pre-paying any callable debt or being put in a sinking fund to account for the future payment of non-callable debt. Ideally debt service payments should be reduced from 25% of the operating budget to 10% of the operating budget.

Again we reiterate that selling assets from the Parking, Stadium, Urban Redevelopment Authority and Water Authorities should be designated for debt payment

Once these debts have been significantly reduced, the ICA should determine if the new taxes are still necessary and if they can be eliminated to create a more competitive Pittsburgh and region. As debt is retired, these new revenues will be reviewed to see if they are still necessary or if they should remain part of the general operating funds of the City.

VII. *Sunset Provisions*

Clearly, there must be a sunset provision enacted with respect to any new revenues (other than the new gaming tax revenues) to allow for a review of the tax structure and tax revenues. We recommend a 2 year sunset provision. The taxes can be re-enacted, reduced or eliminated depending on a future review and analysis. The goal is not to provide the City with a windfall but to get it through its crisis by helping to pay down debt and fund its liabilities. The goal is to make the City of Pittsburgh more competitive.

VIII. *Fiscal Reforms*

As we contemplate expenditure reductions, sale of assets and potential new revenues for the City, we believe we must also continue to keep in mind the need for reforms to the financial practices of the City and its authorities, so that situations like the present can be avoided in the future. The fiscal matters extend from the operations of the Mayor's and Council's offices, to each Department, Bureau, *and* Authority connected to the City. The authorities hold tax exempt property, lend money, borrow money, and spend money.

Therefore, it is imperative that the board use the funds recently received from the state to audit these authorities, as well as recommend increasing the accountability of the City's authorities by subjecting them to open meeting and open records provisions, by strengthening conflict of interest provisions, and by providing for competitive bidding. Senator Orie has prepared and is ready to proceed with legislation on this topic.

Furthermore, the City cannot continue to allow the use of unrecorded interdepartmental transfers, which essentially permit the City Finance Department to play "shell games" with revenues and expenses. Also, we believe that the City (as should Act 47) be required to use bookkeeping methods that itemize expenditures department by department similar to the methods used by the Commonwealth of Pennsylvania.

In conclusion, we are hopeful that your report will be comprehensive, based on empirical methods and address all components of the City's situation necessary to achieve passage of legislation this fall.

Thank you for your attention to this urgent matter.