

# Municipalities Financial Recovery Act Consultative Evaluation

City of Reading, Berks County, Pennsylvania | October 14, 2009

Conducted by:  
Governor's Center for Local Government Services  
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## INTRODUCTION

The Municipalities Financial Recovery Act (Act 47 of 1987, as amended) was enacted to foster the fiscal integrity of municipalities so that they can provide for the health, safety and welfare of their citizens; pay principal and interest on their debt obligations when due; meet financial obligations to their employees, vendors and suppliers; and provide for proper financial accounting procedures, budgeting and taxing practices. The failure of a municipality to do so shall affect adversely the health, safety and welfare not only of the citizens of the municipality but also of other citizens in this Commonwealth.

The Municipalities Financial Recovery Act (Act 47), in Section 202-Standing to Petition for a Determination, provides ten categories of parties and individuals who have standing and may request a determination of municipal financial distress from the Secretary of the Department of Community and Economic Development (Department).

One party that has standing to allege that the municipality is financially distressed is “the chief executive of any city.”

A Request for Determination of Municipal Financial Distress was filed by Thomas M. McMahon, Mayor of the City of Reading, under the Municipalities Financial Recovery Act. The Request was notarized on September 8, 2009 and received by the Department on September 10, 2009. The Request asks that the Department determine the City’s eligibility as a distressed municipality under the provisions of the Municipalities Financial Recovery Act (Act 47).

Section 203(c) of Act 47 authorizes the Department to conduct a consultative investigation into the financial affairs of the municipality after receiving a Request but prior to conducting a public hearing as required under Section 203(b) of Act 47. A public hearing is scheduled for Wednesday, October 14, 2009 at 7:00 PM to receive testimony of the petitioner, City Officials and other interested parties relative to whether the Department should declare the City of Reading a distressed municipality under Act 47.

Section 201 of Act 47 enumerates eleven criteria, at least one of which must be present in order for a municipality to be considered for a distressed determination by the Department. The chief executive of the City of Reading, Mayor Thomas M. McMahon alleges that the following criteria as set forth in Section 201 of Act 47 are present:

- (1) The municipality has maintained a deficit over a three-year period, with a deficit of 1% or more in each of the previous fiscal years.
- (2) The municipality’s expenditures have exceeded revenues for a period of three years or more.

- (7) The municipality has accumulated and has operated for each of two successive years a deficit equal to 5% or more of its revenues.

### **SCOPE OF EXAMINATION**

Our review of the financial position of the City relied upon the accuracy and completeness of the financial information that was presented to us by City representatives as well as certain information that was obtained from other sources. We examined financial, personnel and other pertinent administrative records and information including interim financial reports to the extent that they were available. We made limited effort to verify information presented to us by comparing with original source documents, as would be done on a selective basis in an audit of the municipality.

We are pleased to acknowledge the assistance of the Mayor, appointed officials and employees of the City for their assistance and cooperation in gathering information during the course of our consultative field work.

### **OBJECTIVES OF THE FIELD CONSULTATIVE EFFORT**

The objectives of this Consultative Evaluation are twofold:

- (1) To determine whether the City had met one or more of the eligibility requirements for a determination of distress under Act 47, and if so,
- (2) To examine available financial records and other relevant data in order to recommend whether or not the City should be determined to be distressed under the provisions of Act 47.

The Mayor's request for a determination of financial distress alleges the presence of Section 201 criteria numbers 1, 2, and 7. Central to criterion 1 is validation of the existence of a deficit of 1% or more in each of the previous three fiscal years; validation of criterion 2 requires evidence of expenditures in excess of revenue for a period of three years; and, criterion 7 requires the municipality to have operated with a deficit of 5% or more of its revenues for two consecutive years. A deficit is defined under Section 103 of Act 47 as "the excess of expenditures over revenues, stated as a percentage of revenue, during an accounting period."

## CONCLUSIONS ON PRESENCE OF DISTRESSED CRITERIA

Based upon an analysis of available records and interviews with City officials, it is our conclusion that the City of Reading can be considered for a distressed determination because criteria 1, 2, and 7 are present.

### Act 47, Section 201, Criteria 1, 2 and 7 Examined and Validated

The following summary and related charts are provided to validate the criteria alleged by the City for Act 47 consideration. The City has set forth criteria 1, 2, and 7 under Section 201 of the Act that they believe makes them eligible to be considered for an Act 47 determination.

The Summary of Revenues and Expenditures for all Governmental Fund found in Table 1 indicates a six-year history of structural deficits. The summary includes both the General Fund and all other governmental funds including debt service and capital funds. In fact, expenditures have exceeded revenues by more than 20% in 2003, 2004, and 2006 and over 10% in years 2007 and 2008.

<b>Table 1 - Net Operating Revenue and Expenditures- Governmental Funds</b>				
	<b>Revenues</b>	<b>Expenditures</b>	<b>Surplus Deficit</b>	<b>Percent Deficit</b>
<b>2003</b>	\$43,937,615	\$60,218,012	(\$16,280,397)	-37.05%
<b>2004</b>	\$55,244,964	\$70,145,153	(\$14,900,189)	-26.97%
<b>2005</b>	\$69,519,011	\$75,126,887	(\$5,607,876)	-8.07%
<b>2006</b>	\$69,152,981	\$126,976,849	(\$57,823,868)	-83.62%
<b>2007</b>	\$65,786,246	\$76,999,755	(\$11,213,509)	-17.05%
<b>2008</b>	\$71,418,656	\$84,453,647	(\$13,034,991)	-18.25%
	\$375,059,473	\$493,920,303	(\$118,860,830)	
<b>Source: Independent Audit Report</b>				

The above data validates three of the Act 47 criteria that the City has alleged. They have maintained a deficit in excess of 1% over a three year period; expenditures have exceeded revenues for a period of three years or more; and they have operated with a deficit in excess of 5% for two consecutive years.

In 2006 there was a significant structural deficit. The City made a \$47 million dollar contribution to its pension plans to address a growing unfunded liability. A \$48 million dollar pension bond was issued to cover the costs of the pension contribution and related financing costs. This borrowing added to an already significant debt burden for the City.

This pattern of operating deficits is unsustainable and if left unabated will force the City to significantly reduce or eliminate fundamental services that may adversely affect the health, safety, welfare, and quality of life of the citizens.

The City in cooperation with Berks County obtained an Early Intervention Program (EIP) grant in 2006 and engaged Management Partners, Inc. to undertake a review of its Finances. The ensuing report foretold the anticipated deficits though not to the degree that has occurred. The consultants did not have the benefit of knowing that an economic crisis would begin in mid-2007. This crisis has persisted into late 2009 and has further compounded the City's deficit. Economists do not anticipate significant relief from the recession until late 2010.

The consultants provided numerous recommendations and possible remedies to the City's Administration and City Council. Some of the recommendations were implemented by the Administration such as an EIP, Phase II grant which funded a study of City assets to determine if the Reading Parking facilities should be sold and a detailed review of the City's user fee and charges for services structure. The study was conducted and completed in 2008. The fee structure study found that the City was not covering the cost of various services and could raise more than one million dollars by increasing service fees and renting City properties. The City will incorporate many of the studies recommendation in the 2010 budget recommendations. The Mayor and Administration will use the study results as a means to defend increases in user charges and fees.

In April 2009 the Administration and the City Council commissioned a Blue Ribbon Panel to evaluate the present fiscal position. The panel's recommendations were intended to provide both short and long-term financial solutions. The panel in its report issued August 2009 acknowledged the structural deficit and believed drastic action would need to be taken to solve it. The panel emphasized that the City stands at a major crossroad. It must address the root causes of the problem they face. The panel has resolved to recommend a number of solutions that could make the City of Reading more fiscally sound and that promote an environment that supports community and economic development.

Some of the recommendations of the Blue Ribbon Panel include the development of a five-year strategic management plan that would include the Administration and the City Council. This would allow for an exchange of policy recommendations including a vision and mission statement and an outline of policy goals and objectives. The panel has recommended numerous changes in the information systems of the City. They recommend developing standard operating procedures for business functions so that they can be incorporated into the information system process. The panel also recommended improving tax collections particularly the earned income tax collection. The panel also discussed general revenue enhancement through gain sharing and entrepreneurship.

The General Fund is the city's primary operating fund. A more in depth review of it provides greater insight into the causes of the city's structure deficits. Table 2 highlights the General Fund structural deficits for a six year period. This history will help to highlight the major variances that occurred from year-to-year.

<b>Table 2 – City of Reading – General Fund Revenues &amp; Expenditures</b>				
<b>Year</b>	<b>Revenue</b>	<b>Expenditures</b>	<b>\$ Surplus (Deficit)</b>	<b>Percent Deficit</b>
<b>2003</b>	\$33,765,978	\$46,215,599	(\$12,449,621)	-37.00%
<b>2004</b>	\$38,565,461	\$48,709,551	(\$10,144,157)	-26.30%
<b>2005</b>	\$49,277,696	\$54,785,263	(\$5,507,567)	-11.20%
<b>2006</b>	\$52,679,592	\$108,873,469	(\$56,193,877)	-106.70%
<b>2007</b>	\$55,100,508	\$64,900,407	(\$9,799,899)	-17.80%
<b>2008</b>	\$56,387,899	\$64,694,852	(\$8,306,953)	-14.70%
<b>Source: Independent Audit Report</b>				

To further understand the deficit situation, it would be wise to examine the revenues and expenditures separately. This examination will clarify the specific income and expense categories that contribute to the deficit.

First, we will look at the audited revenue sources to determine where specific problems exist.

<b>Table 3 - City of Reading General Fund Revenue</b>								
	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>Change</b>	<b>Actual Revenue Increase/Decrease 2004-2008</b>	<b>Average Annual Revenue Percentage Increase/Decrease</b>
<b>Taxes</b>	\$24,422,433	\$31,740,420	\$33,515,167	\$34,373,453	\$30,748,701	\$6,326,268	6.48%	54.53%
<b>Charges for Services</b>	\$1,987,952	\$4,158,326	\$5,404,246	\$5,534,626	\$6,166,168	\$4,178,216	52.54%	10.94%
<b>Interest &amp; Rents</b>	\$1,219,811	\$1,374,129	\$1,493,663	\$2,345,054	\$1,425,607	\$205,796	4.22%	2.53%
<b>Intergovernmental</b>	\$4,980,857	\$5,460,360	\$5,469,630	\$5,655,580	\$5,947,538	\$966,681	4.85%	10.55%
<b>Licenses &amp; Permits/Cable TV</b>	\$3,603,927	\$3,968,431	\$4,605,039	\$3,897,845	\$5,345,445	\$1,741,518	12.08%	9.48%
<b>Other Miscellaneous</b>	\$2,350,414	\$2,576,030	\$2,191,847	\$3,293,950	\$6,754,440	\$4,404,026	46.84%	11.98%
<b>TOTAL</b>	\$38,565,394	\$49,277,696	\$52,679,592	\$55,100,508	\$56,387,899	\$17,822,505	11.55%	100.00%
<b>ANNUAL \$ CHANGE</b>	\$	\$10,712,302	\$3,401,896	\$2,420,916	\$1,287,391			
<b>Source:</b>								

Table 3 illustrates a steady increase in total General Fund Revenues over the five-year period. In 2005 the Earned Income Tax Rate went from 1.0% to 1.2%. As shown in Table 3 this correspondingly increased the Earned Income Tax Revenue sharply from 2004 to 2005. Pursuant to state legislation permitting an increase in the Local Services Tax from \$10 to \$52/year, the City implemented the \$42 increase in 2005 and

experienced a significant increase in Local Services Tax revenue. Realty transfer taxes prior to 2007 had grown substantially but the recession in the housing market quickly reduced collections and in 2009 this downward trend continues. Tax revenues since the 2005 tax increases showed modest growth in 2006 and 2007 but declined in 2008.

The charges for services income rose sharply in 2005. Based upon a recommendation found in the City’s EIP Report, the City performed a fee structure study for the various services provided by the City. The City hired a consultant to perform the study and, as a result, was able to more appropriately recoup the costs associated with codes enforcement services and other charges for services. The study also recommended increases in license and permit fees that resulted in increased collections in 2006 and 2007.

Table 4 illustrates the percentage breakdown of revenue by source for 2004 and 2008.

<b>Table 4 - City of Reading Percentage of General Fund Revenue</b>			
	<b>2004 Percentage of General Fund Revenue</b>	<b>2008 Percentage of General Fund Revenue</b>	<b>Percentage Increase/Decrease of General Fund Revenue</b>
<b>Taxes</b>	63.33%	54.53%	(8.75%)
<b>Charges for Services</b>	5.15%	10.94%	5.78%
<b>Interest &amp; Rents</b>	3.16%	2.53%	(0.63%)
<b>Intergovernmental</b>	12.92%	10.55%	(2.36%)
<b>Licenses &amp; Permits/Cable TV</b>	9.34%	9.48%	0.14%
<b>Other Miscellaneous</b>	6.09%	11.98%	5.89%
<b>TOTAL</b>	100%	100.00%	
<b>Source: Annual Audit Financial Report DCED</b>			

Despite the 2005 tax increases, tax revenue as a percentage of General Fund revenue has declined by almost 9% in 2008 compared to 2004. Charges for services and Miscellaneous revenue both increased by almost 6% as percentage of General Fund revenue. Thus, Table 4 illustrates the City’s increasing dependency on non-tax sources for General Fund revenue from 2004 to 2008.

Although the City’s overall revenue receipts increased from 2004 to 2008, expenditures also grew more substantially during the five year period effectively eliminating the impact of the revenue increases during this period.

Table 5 provides a description of the City’s audited General Fund Expenditures.

**Table 5 - General Fund Expenditures**

	2004	2005	2006	2007	2008	\$ Change	Actual Expenditures Increase/ Decrease 2004-2008	Average Annual Expenditures Percentage Increase /Decrease
<b>General Government</b>	\$4,050,099	\$6,005,606	\$7,219,098	\$7,609,568	\$8,197,620	\$4,147,521	25.60%	12.67%
<b>Police</b>	\$20,430,513	\$22,125,402	\$24,447,227	\$23,715,580	\$24,766,730	\$4,336,217	5.31%	38.28%
<b>Fire</b>	\$8,627,777	\$9,864,805	\$10,232,975	\$10,702,747	\$11,379,791	\$2,752,014	7.97%	17.59%
<b>EMS</b>	\$0	\$2,889,237	\$3,128,181	\$3,585,381	\$3,702,026	\$3,702,026	9.3%	5.72%
<b>Public Works</b>	\$7,867,260	\$7,858,120	\$8,522,763	\$9,310,308	\$8,839,784	\$972,524	3.09%	13.66%
<b>Parks &amp; Recreation</b>	\$1,495,416	\$1,202,646	\$1,268,824	\$1,334,673	\$1,366,546	(\$128,870)	-2.15%	2.11%
<b>Community Dev</b>	\$1,575,835	\$448,484	\$389,100	\$390,555	\$526,671	(\$1,049,164)	-16.64%	0.81%
<b>Pension Obligation</b>			\$47,474,680					
<b>Debt Service-Principal</b>	\$2,558,981	\$2,078,246	\$2,794,436	\$3,708,357	\$1,523,961	(\$1,034,730)	-10.11%	2.36%
<b>Debt Service-Interest</b>	\$2,103,700	\$1,762,279	\$2,072,810	\$4,543,238	\$4,391,723	\$2,288,023	27.19%	6.79%
<b>Debt Svc Cost</b>		\$448,739	\$1,323,375					
<b>TOTAL</b>	\$48,709,551	\$54,785,263	\$108,873,469	\$64,900,407	\$64,694,852	\$0	8.20%	100.00%

Source: Annual Audit Financial Report DCED

Table 5 illustrates the steady increase in total General Fund Expenditures over the five-year period. Total Actual Expenditures increased from \$48,709,201 in 2004 to \$64,694,852 in 2008, growing at an annual averaged rate of 8.2% or 33% from 2004 to 2008. General Government grew at average annual rate of over 25.6% or over 102% from 2004 to 2008. Public safety—Police, Fire and EMS—grew at a combined annual average rate of 22.5% or 90% from 2004 to 2008. Debt Service grew at average annual rate of 27.19% or over 108% from 2004 to 2008. From a fiscal standpoint the City cannot sustain these average annual growth rates into the future.

Table 6 illustrates the percentage breakdown of expenditures by category for 2004 and 2008.

<b>Table 6 – City of Reading Percentages of General Fund Expenditures</b>			
	<b>2004 Percentage of General Fund Expenditures</b>	<b>2008 Percentage of General Fund Expenditures</b>	<b>Percentage Increase/Decrease of General Fund Expenditures</b>
General Government	8.31%	12.67%	4.36%
Police	41.94%	38.28%	(3.66%)
Fire	17.71%	17.59%	(0.12%)
EMS	0%	5.72%	5.72%
Public Works	16.15%	13.66%	(2.49%)
Parks & Recreation	3.07%	2.11%	(0.96%)
Community Development	3.24%	0.81%	(2.42%)
Pension Obligation	0.00%	0.00%	0.00%
Debt Service Principal	5.25%	2.36%	(2.90%)
Debt Service Interest	4.32%	6.79%	2.47%
Total	100%	100%	
<b>Source: Annual Audit Financial Report DCED</b>			

Police and Fire Department expenditures made up 59.65% of General Fund Expenditures. In 2008, Police and Fire Department expenditures comprised 55.87% of General Fund expenditures. However, adding Emergency Management Services (which did not exist in 2004) to the 2008 Police and Fire percentage increases the public safety expenditures in 2008 to 61.6 % of General Fund expenditures. In 2008, the three public safety Departments (Police, Fire EMS) combined actual expenditures represented \$39,848,547 or 71% of General Fund revenue in 2008. In 2008 the City only collected \$30,748,701 in tax revenue. Simply stated the City does not generate enough General Fund tax revenue to cover these three basic services.

Debt service has averaged more than 10% of total General Fund Revenues. Debt service interest costs have more than doubled over the last four years. The 2006 Pension Obligation borrowing compounded this problem and will continue to plague City's finances if other solutions or remedies are not found.

**Table 7 - City of Reading Revenues, Expenditures, & Changes in Fund Balance**

	2004	2005	2006	2007	2008
<b>Revenues/Other Financing Sources</b>					
Taxes	\$24,422,433	\$31,740,420	\$33,515,167	\$34,373,453	\$30,748,701
Charges for Services	\$1,987,952	\$4,158,326	\$5,404,246	\$5,534,626	\$6,166,168
Interest & Rents	\$1,219,811	\$1,374,129	\$1,493,663	\$2,345,054	\$1,425,607
Intergovernmental	\$4,980,857	\$5,460,360	\$5,469,630	\$5,655,580	\$5,947,538
Licenses & Permits/CableTV	\$3,603,927	\$3,968,431	\$4,605,039	\$3,897,845	\$5,345,445
Other Miscellaneous	\$2,350,481	\$2,576,030	\$2,191,847	\$3,293,950	\$6,754,440
<b>Revenue Total</b>	<b>\$38,565,461</b>	<b>\$49,277,696</b>	<b>\$52,679,592</b>	<b>\$55,100,508</b>	<b>\$56,387,899</b>
Operating Transfers In	\$8,770,464	\$8,798,449	\$7,848,278	\$7,188,684	\$6,283,677
Proceeds from Long Term Debt	\$0	\$15,800,000	\$55,215,000	\$0	\$0
Proceeds from Swaps	\$700,197	\$3,091,200	\$4,500,397	\$0	\$0
<b>Other Financing Sources Total</b>	<b>\$9,470,661</b>	<b>\$27,689,649</b>	<b>\$67,563,675</b>	<b>\$7,188,684</b>	<b>\$6,283,677</b>
<b>Expenditures/Other Financing Uses</b>					
General Admin	\$4,050,099	\$6,005,606	\$7,219,098	\$7,609,568	\$8,197,620
Public Safety	\$29,058,290	\$34,880,144	\$37,808,383	\$38,003,708	\$39,848,547
Public Works	\$7,486,077	\$7,269,598	\$8,031,591	\$8,209,450	\$8,029,854
Culture and Recreation/Com Dev	\$3,071,251	\$2,340,651	\$2,149,096	\$1,725,228	\$1,893,217
Pmts Pension Oblig.	\$0	\$0	\$47,474,680	\$0	\$0
Debt Service Costs <sup>1</sup>	\$4,662,681	\$4,289,264	\$6,190,621	\$8,251,595	\$5,915,684
Other	\$381,153	\$0	\$0	\$1,100,858	\$809,930
<b>Expenditure Total</b>	<b>\$48,709,551</b>	<b>\$54,785,263</b>	<b>\$108,873,469</b>	<b>\$64,900,407</b>	<b>\$64,694,852</b>
Payment to Escrow Agent/Refunding		\$14,828,404			
Transfer Out	\$1,321,827	\$1,224,784	\$1,806,079	\$1,763,632	\$1,505,105
Swap Termination Fees	\$0	\$0	\$0	\$0	(\$13,211,300)
<b>Other Finc Uses Total</b>	<b>\$1,321,827</b>	<b>\$16,053,188</b>	<b>\$1,806,079</b>	<b>\$1,763,632</b>	<b>(\$11,706,195)</b>
<b>Over Expenditures and Other Uses</b>	<b>(\$1,995,256)</b>	<b>\$6,128,894</b>	<b>\$9,563,719</b>	<b>(\$9,799,899)</b>	<b>(\$3,133,296)</b>
<b>Beginning Fund Blnc</b>	<b>(\$3,018,324)</b>	<b>(\$7,220,468)<sup>2</sup></b>	<b>(\$1,091,574)</b>	<b>\$8,472,145</b>	<b>\$6,647,298<sup>3</sup></b>
<b>Ending Fund Balance</b>	<b>(\$5,013,580)</b>	<b>(\$1,091,574)</b>	<b>\$8,472,145</b>	<b>\$4,097,298</b>	<b>\$3,514,002</b>
<b>Source: Independent Audit Report</b>					

<sup>1</sup> Debt Service Costs Include Principal, Interest, and Refinancing costs.

<sup>2</sup> Beginning General Fund accumulated deficit of (\$5,013,580) plus (\$2,206,888) due to the consolidation of EMS fund into the General Fund.

<sup>3</sup> Beginning year General Fund balance adjusted for prior year meter surcharge from the Reading Area Water Authority of \$4,550,000.

In analyzing the City's Fiscal Position over the last five years we found that the only way the City was able to fund ongoing operational costs was through the use of operating transfers, the sale of assets, the incurrence of debt and other one-time financing sources.

In 2004 Other Financing Sources were used to offset the ending fund balance deficit. An operating transfer-in to the General Fund of \$8,770,464 came from the water and sewer funds to offset operational costs and bond proceeds of \$700,197 were realized from swap transaction.

The 2004 Other Financing Uses included an operating transfer-out of the General Fund for \$1,321,827 of which the majority was dedicated to capital projects expenses. The ending fund balance for 2004 was (\$5,013,580). This negative General Fund ending fund balance was of great concern and caused the City to take further actions in 2005.

The 2005 Other Financing Sources included proceeds from refunding bonds \$15,800,000; proceeds from an interest rate swap contract \$3,091,200; and operating transfers-in of \$8,798,449 from the proprietary funds.

The 2005 Other Financing Uses included payment to escrow agent for refunding of bonds for \$14,828,404 and operating transfers-out \$1,224,784. The 2005 ending fund balance was (\$1,091,574). The 2005 deficit is particularly alarming since the City issued debt in order to offset the deficit and it still ended the year with a negative fund balance.

As mentioned earlier in 2006 the City undertook a major borrowing to help to fund their pension obligations. Bond proceeds of \$47,000,000 were deposited into the City's pension funds to offset a growing unfunded liability. The City also realized \$4,500,397 in proceeds from a swap transaction. The City was also able to transfer-in \$7,848,278 from its proprietary funds.

During 2006 an operating transfer-out to capital projects fund of \$1,806,079 was made. The ending fund balance for 2006 was \$8,472,145. This was the first positive fund balance in three years and occurred only through borrowing and other one-time revenues.

The 2007 Other Financing Sources included a transfer-in from the proprietary funds of \$7,188,684 and the Other Financing Uses of \$1,763,632. The ending fund balance was \$4,097,298 a negative change in fund balance of \$4,374,847.

The 2008 Other Financing Uses included a swap termination fee (\$13,211,300), bond discount \$250,000, and an operating transfer out of \$1,505,105. The ending fund balance was \$3,514,002, a further decline of \$860,845.

This analysis validates two consecutive years of negative ending fund balances. It also emphasizes the overuse of bond proceeds and interfund transfers from the proprietary funds to produce a positive ending fund balance in the succeeding years.

The City has experienced a structural deficit of core revenues over core expenditures for a period of five years. In fact, the structure deficits have seriously affected cash flow by continuously tapping into the cash available to supplement the structural deficits. The analysis of the cumulative core deficit magnifies the inability of the City to raise sufficient revenue to cover the expenditures.

## LIQUIDITY

Cash flow history indicates a serious reduction in cash and investments and corresponding increase in current liabilities. A good measure of a City's short-run financial condition is its cash position. Cash position determines a City's ability to pay its short-term obligations. This is known as liquidity. Insufficient liquidity results in insolvency. The standard ratio for evaluating a City's liquidity is cash and short term investments divided by current liabilities. If this ratio is less than one to one, the City is considered to be facing liquidity problems. A less than one to one ratio for one year would be considered a negative factor. A less than one to one ratio for more than two years is considered a decidedly negative factor. Table 8 below provides an historic perspective of the increasing liquidity problem for the City over the past five years and finds that the City has faced a negative liquidity ratio in the final year of the analysis 2008. The City has addressed this liquidity problem by transferring funds from bond proceeds, proprietary and other dedicated special revenue funds in order to meet current payroll and accounts payable obligations.

<b>Table 8- Formula: Cash &amp; Short Term Investments -General Fund (Year End)</b>						
<b>Reading Current Liabilities- General Fund*</b>						
	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>
Cash & Short-Term Investments <sup>4</sup>	\$8,206,596	\$3,681,679	\$5,844,759	\$10,963,899	\$2,576,918	\$230,644
Current Liabilities <sup>5</sup>	\$802,241	\$1,432,727	\$1,074,509	\$2,463,688	\$2,579,605	\$2,193,233
Liquidity General Fund	1022%	256%	543%	445%	99.8%	10.52%
<b>Source: Independent Audit Report</b>						

<sup>4</sup> Cash and Short Term investments include only cash, investments, accounts receivables

<sup>5</sup> Current liabilities include accounts payable and outstanding payroll liabilities.

## **DISTRESS DETERMINATION**

Based upon the above analysis, our report has validated the presence of Criteria of 1, 2, and 7 as enumerated in the Act. The fact that Criteria 1, 2, and 7 were found to be present enables the Department to conduct a further evaluation and recommend whether or not the City of Reading should be designated as distressed under Act 47.

It is Commonwealth policy, as stated in Act 47, "to foster the fiscal integrity of municipalities so that they provide for the health, safety and welfare of their citizens; pay principal and interest on their debt obligations when due; meet the financial obligations to their employees, vendors and suppliers; and provide for proper accounting procedures, budgeting and taxing practices."

It is our opinion that the City of Reading has exhibited conditions that make it difficult to fulfill its responsibilities as outlined above. This conclusion is based upon a continued pattern of year-end structural deficits, increasing negative fund balances, and significant cash flow difficulties.

In addition to the above fiscal trends our analysis has found that debt obligations, expenditure patterns – especially in public safety - and socio-economic and demographic trends have further contributed to the financial difficulties of the City. Its tax base and revenues have been stagnant over the past five years while expenditures have grown at unsustainable levels. The City already has a non-competitive tax structure compared to other municipalities in the region, and coupled with its socio-economic trends has very limited ability to raise revenues through tax and fee increases.

**Accordingly, it is our recommendation that the City of Reading be declared financially distressed.**

In arriving at a recommendation our analysis also considered other relevant factors, which are discussed below:

1. Current and Projected 2009 Financial Position
2. Proposed 2010 Budget
3. Tax Base and Revenue Trends
4. Debt Burden
5. Pension Obligations
6. Service Levels and Work Force Trends
7. Socio-Economic and Demographic Trends
8. Administrative and Financial Management Practices

## **1. CURRENT AND PROJECTED 2009 FINANCIAL POSITION**

Table 9 below illustrates summaries for 2009 cash flow analysis.

<b>Table 9 - City of Reading -Cash Flow Projections for 2009</b>			
	<b>Revenues</b>	<b>Expenditures</b>	<b>Surplus (Deficit)</b>
YEAR TO DATE	\$40,876,454	\$43,054,244	\$(2,177,790)
OCTOBER	\$7,440,500	\$3,235,746	(\$500,234)
NOVEMBER	\$3,235,746	\$9,544,863	(\$6,309,117)
DECEMBER	\$6,639,821	\$6,723,900	(\$84,079)
<b>TOTALS</b>	<b>(\$58,192,521)</b>	<b>(67,263,742)</b>	<b>(\$9,071,221)</b>
<b>Source: City Year-to-Date Actuals through September 30, 2009</b>			

It is estimated that the City will end fiscal year 2009 with a negative net General Fund cash balance of (\$9,071,221). This cash flow situation is not sustainable and will create an inability to pay payroll or other vendors between now and the end of the year.

## **2. PROPOSED 2010 BUDGET**

On October 5, 2009 Mayor McMahon submitted his proposed 2010 budget. The budget totals \$60,908,739. The budget proposes to increase property taxes by .46 mills and earned income taxes by .5 percent. The City will also eliminate 109 positions including 45 police and 28 fire personnel. According to the Mayor the City has run out of one time fixes that it has relied upon to keep its budget in balance. These propose tax increases and personnel reductions are required to fill the estimated \$15 million dollar gap between revenue and expenses for 2010.

## **3. TAX BASE AND REVENUE TRENDS**

The City's tax base and revenues have been stagnant over the past five years. It is estimated that the City will experience little or no growth in real estate taxes over the next few years.

The City's Charter limits real estate tax increases to not exceed 5% above the revenue from the previous year's collection. Currently at 11.44 mills, the City is below the 25 mill maximum tax rate for City's established by the Commonwealth. The average millage rates for all the municipalities for Berks County is 2.31 mills.

According to the research from the Management Partner's EIP report, even if the City decides to increase the real estate tax by the maximum allowable amounts based on their charter limitation, it will still fall well short of addressing their cumulative deficit. One of the most significant factors contributing to the fiscal stress for the City of Reading is a stagnant tax base that cannot support the current level of expenditures or services. The inability of revenues to keep pace with expenditures has contributed to a growing fund balance deficit for the City over the last five years.

<b>Table 10 - City of Reading - Trends In Assessed Valuation</b>			
<b>Year</b>	<b>Assessed Valuation Taxable</b>	<b>Annual Change</b>	<b>Mills Levied</b>
<b>2002</b>	1,450,474,100		10.200
<b>2003</b>	1,455,145,400	.32%	10.200
<b>2004</b>	1,444,301,900	-.75%	10.300
<b>2005</b>	1,440,751,800	-.25%	10.300
<b>2006</b>	1,429,609,000	-.77%	10.400
<b>2007</b>	1,427,971,300	-.11%	10.400
<b>2008</b>	1,420,066,300	-.55%	10.90
<b>2009</b>	1,464,236,700	3.12%	11.44
<b>Source: Berks County Tax Records</b>			

The annual taxable assessed valuation has decreased every year since 2004 except for 2009 where there was a slight increase of 3.12%. Some of this may be attributed to the loss in housing value and the demolition of properties. Please see a summary in the socio-economic section that further supports this information.

Although real estate tax revenues increased (Table 11) during the five year period the increase was only 1% per year. There was however a significant decline in constant dollars in property tax revenue over the five year period. The analysis in constant dollars indicates a significant loss in real dollars and calls into question the ability for the City to rely on the property tax as a source of revenue growth. The City's collection rate for real estate taxes has also averaged in the low 90% range over the last 5 years. A collection rate in the mid 90% range should be their target.

<b>Table 11 - City of Reading – Real Estate Tax Revenues (General Purpose)</b>					
<b>Formula: Real Estate Tax Revenues - (Constant Dollars)</b>					
	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>
<b>Real Estate Tax Revenues</b>	\$14,629,341	\$14,995,914	\$15,154,040	\$15,384,219	\$15,221,298
<b>CPI for Local Area</b>	118.5	122.5	126.9	130.139	136.042
<b>CPI in Decimal</b>	1.19	1.23	1.27	1.30	1.360
<b>Millage Rates</b>	10.3000	10.300	10.400	10.400	10.900
<b>Real Estate Tax Revenues – constant \$</b>	\$12,293,564	\$12,191,800	\$11,932,315	\$11,385,015	\$11,192,131
<b>Source: Bureau of Labor Statistics Federal Government</b>					

In 2005 the Earned Income Tax (EIT) was increased from 1.0% to 1.2%. This resulted in a significant increase in EIT revenue in 2005. Outside of this increase actual EIT revenue has remained relatively flat. In constant dollars EIT revenue has declined by about 10% since 2005 even though the economy was growing thru much of this period. It was not until 2009 that most municipalities began to see the effects of the economic downturn on EIT revenues.

<b>Table 12 - City of Reading - Earned Income Tax-General Purpose Levy</b>					
Formula: Earned Income Tax-General Purpose - (Constant Dollars)					
	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>
<b>Earned Income Tax-General</b>	\$5,964,810	\$8,714,240	\$8,058,263	\$8,571,941	\$8,645,185
<b>CPI for Area</b>	118.5	122.5	126.9	130.139	136.042
<b>CPI Decimal</b>	1.19	1.23	1.27	1.30	1.360
<b>Earned Income Tax - constant dollars</b>	\$5,012,445	\$7,084,748	\$6,345,089	\$6,593,801	\$6,356,754
<b>Source: Business and Labor Statistics, Federal Government</b>					

Following the statutory change to the Occupation Privilege Tax in 2004, the City levied the new Local Services Tax for fiscal year 2005 in the amount of \$52 per person. This resulted in a significant revenue increase for this tax though due to a further change in collection procedures resulted in lower revenue for 2008. The Realty Transfer Tax after growing for several years suffered a 40% decline in 2008 as a result of the national economic crisis. It should be noted that the only instances where tax revenues increased significantly were when increases in EIT and the local services tax rates occurred.

Stagnant or declining trends for collections of real estate tax, earned income, and other Act 511 tax revenue are a serious problem for the City because tax revenue makes up over 54% of the City's total revenue base. An erosion of this revenue base makes it increasingly difficult, if not impossible, for the City to continue to provide the resources necessary to ensure the health, safety, and welfare of its citizens.

<b>Table 13 – Tax Revenue Trends</b>						
	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>
<b>RE Tax-Current</b>	\$14,632,135	\$14,788,624	\$15,044,499	\$15,003,554	\$15,384,219	\$15,221,298
<b>Realty Transfer</b>	\$1,407,604	\$2,655,353	\$3,809,713	\$7,454,727	\$6,715,624	\$4,003,296
<b>Act 511-EIT</b>	\$3,394,898	\$5,964,810	\$8,714,240	\$8,058,263	\$8,571,941	\$8,645,185
<b>OPT/LST</b>	\$ 200,947	207,664	1,669,926	\$1,747,730	\$1,813,132	\$1,175,307
<b>Other Act 511</b>	\$632,403	\$712,830	\$635,486	\$610,841	\$698,132	\$639,173
<b>Business</b>	\$1,353,793	\$1,345,055	\$1,608,902	\$1,625,072	\$1,855,899	\$1,617,757
<b>Total Tax Revenue</b>	<b>\$21,621,780</b>	<b>\$25,674,336</b>	<b>\$31,482,766</b>	<b>\$34,500,187</b>	<b>\$35,038,947</b>	<b>\$31,302,016</b>
<b>Source: Annual Audit and Financial Report DCED</b>						

Overall, the City's fiscal stress and increasing deficits cannot be addressed by raising tax revenues in any meaningful way, given the constraints on the taxing ability available to the City and the negative impact of an increasing tax burden on taxpayers who cannot withstand additional tax levies to support City services. The City has very little ability to increase its revenue base in the short term and only a limited ability to do so for the longer term.

#### 4. DEBT SERVICE OBLIGATIONS OUTLINED

A critical concern for the City of Reading that was identified by Pennsylvania Economy League in the “Structuring Healthy Communities Study” and verified by the DCED field study is an extraordinarily high debt service expense as a part of their total operating budget. A financial indicator warning trend is when debt service exceeds 10% of operating revenues. Reading has exceeded this benchmark in all but one of the last five years with a high of 15% in 2007. The 2006 Pension Obligation borrowing increased both principal and interest payments for overall debt service. Table 14 identifies the increasing debt service expenditures for the City over a five year period.

In 2008 the City did a large refunding to lower debt service obligations in 2008 and 2009. The City issued GO Bonds, Series C, D, E to advance refunded portions of the series 2006 GO bonds and Notes Series of 2005 and all of the outstanding principal and interest associated with the GO bonds for 2002. This refunding lowered the debt service for 2008. Without the refunding, the 2008 debt service would have been \$8,865,128.

<b>Table 14 - City of Reading - Debt Service Expenditures – 2004 – 2008</b>					
<b>Formula: Debt Service - General Fund</b>					
<b>Total Operating Expenditures</b>					
	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>
<b>Debt Service Expenditures</b>	\$4,662,681	\$4,289,264	\$6,190,621	\$8,251,595	\$5,915,684
<b>Total Operating Revenues</b>	\$38,565,394	\$49,277,696	\$52,679,592	\$55,100,508	\$56,387,899
<b>Debt Service Expenditures as a % of Operating Revenues</b>	12.1%	8.7%	11.8%	15%	10.5%
<b>Source: Annual Audit and Financial Report DCED FY 2005 and 2006 include debt refinancing costs.</b>					

A complete schedule of the City’s long term debt is set forth in Table 15 below.

<b>Table 15 – General Obligation Long Term Debt Schedule</b>				
<b>Issue</b>	<b>Issue Date</b>	<b>Loan</b>	<b>OSB* 2008</b>	<b>Type Debt</b>
GOB-2009	2009	\$25,000,000	\$25,000,000	General
GOB-2008	2008	\$48,000,000	\$45,800,000	Sewer
GOB-2008	2008	\$13,175,000	\$12,960,000	General
GOB-2008	2008	\$21,230,000	\$21,015,000	General
GOB2008	2008	\$16,950,000	\$16,925,000	General
GOB 2008	2008	\$6,649,000	\$3,342,000	General
GOB 2008	2008	\$5,525,000	\$5,210,000	General
GOB 2005	2005	\$15,800,000	\$2,570,000	General
LOC 2006	2006	\$8,000,000	\$5,000,000	General
GOB 2006	2006	\$48,800,000	\$32,905,000	General
GOB 2002	2002	\$12,023,969	\$12,023,969	General
<b>Total</b>			<b>\$182,750,969</b>	
<b>Source: DCED- Local Unit Debt Tracking System *Outstanding Balance</b>				

Table 15 identifies the outstanding balance for the total debt through 2008. In 2006 bonds were issued to pay for the City's unfunded pension obligation. This increase of \$48 million dollars increased the current debt load of the City by 10%. Total outstanding debt as of 12/08 is just shy of \$200 million. General Obligation debt supported by the City's full faith credit and taxing authority is \$182,750,969. This represents \$2,248/resident for each of Reading's 81,300 residents an extremely high burden. In comparison Reading's per capita debt is second only to the City of Pittsburgh's \$2,667 per capita debt which was the highest found in a review of comparably sized eastern and midwestern cities.

Table 16 below outlines the schedule of debt for the City over the five year period, 2009 to 2013. Debt service will increase significantly in 2010 to almost \$15 million and remain above \$13 million for the next 5 years.

In 2005 the City completed four major bond swaps generating \$3.09 million in bond proceeds.

In 2006 the City issued a \$48.8 million dollar pension bond to fund its three pension funds. By issuing a pension bond the City anticipated saving more than one million dollars annually over twenty years. The City also completed a forward starting swap on its 2008 Sewer bond generating an additional \$4.5 million in sources of funds.

In 2008 the City terminated two swaps for a total cost of \$13,211,300, including the termination fees and consulting fees.

It is not uncommon to refinance existing debt and take the overall cash flow savings in the upfront period if there is an overall savings. This could result in annual debt service savings that could be applied to operational expenditures or used for capital purchases. Refinancing debt though to extend the term or to obtain upfront cash to fund operating expenses is a practice that should be avoided.

**Table 16- Long Term Debt- Annual Debt Service Payments**

<b>Loans</b>	<b>Rates</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>OSB</b>
GOB, SRS 2009	5.53%	\$	\$1,330,069	\$1,342,500	\$1,342,232	\$1,341,965	\$25,000,000
GOB, SRS 2002	4.40% TO 5.75%	\$575,000	\$590,000	\$785,000	385,000	3,455,000	\$12,023,969
GOB, SRS B, YBP 2008	3%	\$54,148	\$3,395,265	\$0	\$0	\$0	\$3,342,000
GOB-2008, Sewer Projects	4.053%	\$2,383,763	\$3,504,025	\$3,500,585	\$3,499,573	\$3,504,335	\$45,800,000
GOB-2008, SRS E	4.053%	\$643,253	\$802,147	\$1,868,825	\$2,106,940	\$612,762	\$12,960,000
GOB-2008, SRS D	4.053%	\$940,729	\$1,287,324	\$2,531,353	\$2,753,372	\$1,085,566	\$21,015,000
GOB2008, SRS C	4.053%	\$715,672	\$1,033,169	\$1,298,089	\$1,274,969	\$975,849	\$16,925,000
GOB 2008, SRS	0.000%	\$0	\$0	\$0	\$0	\$0	\$5,000,000
GOB 2008, SRS A	4.460%	\$541,183	\$658,411	\$658,564	\$657,825	\$656,194	\$5,210,000
GOB 2005	3.00% TO 3.75%	\$94,544	\$94,544	\$94,544	\$94,544	\$524,544	\$2,570,000
GOB 2006*	5.30% TO 5.53%	\$900,165	\$1,800,329	\$1,800,329	\$1,800,329	\$1,800,329	32,905,000
<b>Total Annual</b>		<b>\$6,273,457</b>	<b>\$14,495,283</b>	<b>\$13,879,789</b>	<b>\$13,914,784</b>	<b>\$13,956,544</b>	<b>\$182,750,969</b>

Source: City of Reading Debt Service Schedules

This schedule only includes payments for the general obligation and pension bonds

## **5. PENSION PAYMENTS AND MMO REQUIREMENTS**

The Municipal Pension Plan Funding Standard and Recovery Act (Act 205 of 1984, as amended) governs the actuarial funding of all municipal employee pension plans. The City of Reading has individual pension plans for police, firefighters and non-uniform employees which are funded through the City's General Fund budget appropriations, State Aid, and employee contributions. The amount of the City's budget appropriation for pension plans is determined annually by the Chief Administrative Officer of the pension plans and is known as the Minimum Municipal Obligation (MMO). This obligation includes funds received through State Aid for employee contributions and City funds.

By 2005, the City's funded ratio for its pension plans had dropped to 76% and its unfunded actuarial accrued liability (UAAL) was fast approaching \$38 million, at which time, the City made the decision to issue pension bonds to fund this growing liability and to make the 2007 MMO payment. In 2006 the City issued taxable pension bonds in the amount of \$48,000,000. The City deposited \$47 million dollar into its pension funds to offset its unfunded liability. This brought the City's funded ratio to near 100% but it significantly expanded its debt at a time when it could not easily repay the debt without reducing operational costs.

<b>Table 17 - City of Reading Pension Assets and Liability Summary</b>					
	<b>Year</b>	<b>Assets</b>	<b>AAL/UAAL</b>	<b>(Under) AAL</b>	<b>Funded Ratio</b>
<b>Police</b>	2003	\$43,823,323	\$58,403,692	\$14,580,369	<b>75%</b>
	2005	\$48,078,705	\$68,124,235	\$20,045,530	<b>71%</b>
	2007	\$81,188,059	\$88,275,688	\$(7,087,629)	<b>92%</b>
<b>Fire</b>	2003	\$29,346,110	\$34,142,374	\$4,796,664	<b>86%</b>
	2005	\$35,284,932	\$39,418,713	\$4,133,781	<b>90%</b>
	2007	\$47,326,524	\$48,343,372	\$1,016,848	<b>98%</b>
<b>Non Public Safety</b>	2003	\$37,920,154	\$49,181,881	\$11,261,727	<b>77%</b>
	2005	\$39,767,213	\$53,054,485	\$13,287,272	<b>75%</b>
	2007	\$57,572,084	\$57,081,669	\$(490,415)	<b>1.01%</b>
<b>Source: AG 385 Report</b>					

The current plans are nearly fully funded according to the most recent audit. The funded ratios of the plans are: Police Pension plan 98%; Fire 98%; and Non-Uniform 101%. The City's MMO for 2008 is: Police \$1,705,470, Fire \$1,289,485, and Non-Uniform \$598,539. The City met the 2008 MMO payment. Its MMO for 2009 is \$3,250,000 which the City anticipates paying by year-end. This would make the City current on its Minimum Municipal Obligation.

## **6. EXPENDITURES AND WORKFORCE TRENDS**

While the revenue trends have been flat or declining, expenditures, especially in the area of payroll and fringe benefits, have been escalating at about 9% per year over the past five years and are highest in the area of public safety.

Table 18 below demonstrates that the City public safety costs are increasing as a percentage of all revenues over time. As police and fire contractual obligations come due, the City is unable to respond in the form of increased revenues leaving a widening gap between revenues and expenditures. Over the last five years, Public Safety Expenditures as a percentage of total operating revenues have averaged 71%.

The continuation of this trend will require cuts to be made to the workforce in other quality of life areas such as code enforcement, community development, planning and zoning, public works, parks and recreation, administrative and financial management areas of the City's operation.

<b>Table 18 - City of Reading – Public Safety Expenses</b>					
<b>Formula: Public Safety Expenses</b>					
<b>Total Net Operating Revenues</b>					
	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>
<b>Public Safety</b>	\$29,058,290	\$34,874,444	\$37,808,383	\$38,003,708	\$39,848,547
<b>Total Net Operating Revenues</b>	\$38,565,394	\$49,277,696	\$52,679,592	\$55,100,508	\$56,387,899
<b>Public Safety as a Percentage of Total Net Operating Revenues</b>	75.35%	70.77%	71.77%	68.97%	70.67%
<b>Source: Annual Audit Financial Report DCED</b>					

During the course of our field survey work, the DCED staff was also able to verify all of the workforce numbers with the City staff. A complete review and breakdown of the City workforce history is included in Table 19 below. Although total complement has remained constant over the 5 year period, there have been changes within the various departments. The City has increased its staffing in police and administration while correspondingly decreasing staff in the community development/code enforcement and public works departments.

<b>Table 19 - City of Reading - Workforce History By Year</b>							
<b>DEPARTMENT</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>
Mayor	1	1	1	1	1	1	1
Council	7	7	7	7	7	7	7
Administration	41	53	52	84	91	88	61
Library	26	25	24	24	23	24	23
Solicitor	1	1	1	1	1	1	1
Engineering	1	1	1	1	1	1	1
Water	73	73	63	63	62	63	64
Community Development	41	41	42	12	12	23	21
Sewer	62	63	68	71	70	71	74
Public Works	88	78	79	74	74	74	66
Police	238	236	233	238	245	247	259
Fire	156	152	149	145	143	156	156
<b>Total</b>	<b>735</b>	<b>731</b>	<b>720</b>	721	<b>730</b>	<b>756</b>	<b>734</b>
<b>Source: City Finance Department</b>							

**7. SOCIO-ECONOMIC AND DEMOGRAPHIC TRENDS:**

In addition to the above fiscal trends, our analysis has found that socio-economic and demographic trends have further contributed to the financial difficulties for the City.

The City’s demographics clearly demonstrate it has one of the highest levels of poverty in the state. Over 34% of families in Reading are at or below the poverty level and 13.9% earn less than \$10,000 according to 2008 census estimates. It is a population that cannot withstand additional tax levies for any purpose – especially on earned income or real estate. The average housing value in Reading is approximately \$100,000 less than the average housing value in the Commonwealth and \$119,200 less than the average in Berks County. The City’s Per Capita Income is only 52% of the state’s average. In comparison to the nation it ranked 6<sup>th</sup> of the 10 highest poverty rates among 521 cities with populations of 65,000 or higher. Table 20 below sets forth income, poverty and housing values for the City, County and other cities of similar size and characteristics.

<b>Table 20 2008 American Community Survey Comparative Income &amp; Housing in Similar Sized Cities</b>						
	<b>2008 Median Household Income</b>	<b>2008 Per Capita Income</b>	<b>2008 % Families Below \$10,000</b>	<b>2008 % Families Below Poverty</b>	<b>2008 Median Home Value</b>	<b>2008 % Renter Occupied</b>
<b>Reading</b>	\$28,089	\$14,120	13.9%	34.3%	\$65,300	56.7%
<b>Erie</b>	\$33,172	\$17,806	9.4%	24.2%	\$79,900	42.5%
<b>Scranton</b>	\$32,794	\$19,034	8.8%	17.7%	\$104,900	49.8%
<b>Allentown</b>	\$39,036	\$17,544	9.4%	20.4%	\$152,000	46.9%
<b>Berks County</b>	\$54,616	\$26,102	3.6%	11.5%	\$184,500	27.1%
<b>Commonwealth</b>	\$50,713	\$27,280	4.1%	11.1%	\$164,700	29.2%
<b>Source: American Community Survey</b>						

Census statistics also show a higher percentage of adults without a high school diploma and a greater percentage of households paying over 30% of their income towards rent. According to the United State Department of Housing and Urban Development the acceptable threshold for a household to spend on rent is 30% or less of its income. As housing costs seem relatively low in the City of Reading they are still considered high in comparison to household income. It can be argued that higher educational levels relate to greater employment levels and thus a more sustainable economic impact.

Table 21 below provides data related to residents 25 years and over without a high school diploma as well as median rents and percentages of the population paying over 30% of household income towards rent.

<b>Table 21 - 2008 American Community Survey Comparative Education &amp; Rental information in Similar Sized Cities</b>			
	<b>Residents 25 &amp; older without a HS diploma</b>	<b>Population paying gross rent of 30% or more of house hold income</b>	<b>Median rent</b>
<b>Reading</b>	32%	60%	639/months
<b>Erie</b>	24%	53.6%	595/months
<b>Scranton</b>	16%	46.6%	575/months
<b>Allentown</b>	25%	55.3%	748/months
<b>Berks County</b>	17%	49.3%	720/months
<b>Commonwealth</b>	13%	47.2%	726/months
<b>Source: American Community Survey</b>			

It is obvious from the reported data that there is a low and diminishing ability for the residents to produce the necessary resources to support services.

In fact, the low median, per capita income and education levels contribute to the ever declining tax base and the inability of the City to raise additional revenue to support services. All of the demographics and socio-economic indicators demonstrate continuing downward trends that create barriers for the City in terms of raising enough income to provide services to ensure the health, safety, and welfare of City residents. The economic recession will continue to put fiscal pressures on individual residents and the City as a whole.

## **8. ADMINISTRATIVE AND FINANCIAL MANAGEMENT PRACTICES**

A review of city audits for years 2004, 2005, 2006, 2007, and 2008 did not reveal any material findings or questioned costs. However, a finding in the CPA audit from 2008 notes that the cash flow is negatively impacted by the City's less than timely draw down of grant funds. Improving the timeliness of the federal and state draw downs will improve cash flow and reduce any burden on current City's resources.

It is also worthy to note that in more than one instance during our review, the City's financial data varied from the financial data provided by the Independent Auditors. In an effort to promote consistency and accuracy, the audited financial numbers were used for this report to the extent they were available. The City's unaudited financial reports were used to complete the review of 2009 data.

Current management of expenses and cost containment is difficult. The City has negotiated collective bargaining agreements that contain significant, unsustainable financial impacts including pension and post retirement health care costs that are increasing at a pace far greater than the CPI. Typical of most municipal government operations, personnel and benefit costs are the largest budget category making it difficult to adjust operations to meet available income. Without further service reductions, there is little ability to reduce expenses to meet the current revenue stream.

The City has in effect three labor agreements, which cover approximately 90% of the total labor force. The Fraternal Order of Police Agreement is in effect through December 31, 2011. The International Association of Fire Fighters is in effect through December 31, 2010. The American Federation of State, County, and Municipal Employees expired on December 31, 2007 with an extension that runs through December 31, 2011.

## RECOMMENDATION

Based on our analysis of the City's fiscal condition, tax base and revenue trends, debt service obligations, current and projected 2008 financial position, expenditure and workforce trends, pension obligations, use of inter-fund transfers, socio-economic and demographic trends and administrative and financial management practices, it is our recommendation that the City of Reading be declared distressed under Act 47.

Clearly the City is and has been experiencing ongoing financial challenges over the past several years. These conditions make it difficult for the City to continue to fulfill its responsibilities to provide for the health, safety and welfare of its citizens. Our recommendation is based upon a pattern of:

- Increasing year-end deficits;
- Increasing negative fund balances;
- Decline of tax revenue in constant dollars taking inflation into account;
- Increasing annual costs particularly in public safety departments and employee benefits; and,
- Use of one-time revenue strategies that are not sustainable

Given Reading's current fiscal position there are serious questions and uncertainty as to its ability to maintain municipal services without an adverse impact on the health, safety and welfare of residents of the City. In our opinion, Reading is exhibiting symptoms of distress that support a distress determination under Act 47.