



PFM

***Town Hall Meeting:
Baseline Financial Projection***

August 20, 2014

- 2009: Former mayor Tom McMahon petitioned the Commonwealth of Pennsylvania for Reading to be designated as distressed under the criteria in the Municipalities Financial Recovery Act (Act 47). Pennsylvania Secretary of Community and Economic Development approved the petition and appointed PFM as the Recovery Coordinator
- 2010: PFM-led team met with City officials, managers, unions and others in the community to gather input on the city's challenges and opportunities. PFM wrote a Recovery Plan that described City government's financial, operational and strategic challenges and outlined a multi-year approach to addressing those challenges. In June 2010 City Council approved the Recovery Plan and Mayor McMahon signed it into ordinance
- July 2010 – Present: City implementing Plan provisions and dealing with other financial, operational and strategic challenges

The original Recovery Plan was based on a set of financial projections that PFM produced in 2010 covering the period 2010 through 2014. PFM is now writing an Amended Recovery Plan that will cover 2015 through at least 2017, and maybe longer. The process is similar to the one we followed in 2010 – PFM will meet with several people to gather input, quantify the City government's financial challenges and write a plan to address those challenges. The Plan must be passed by ordinance using the City's usual procedures.

Financial progress to date



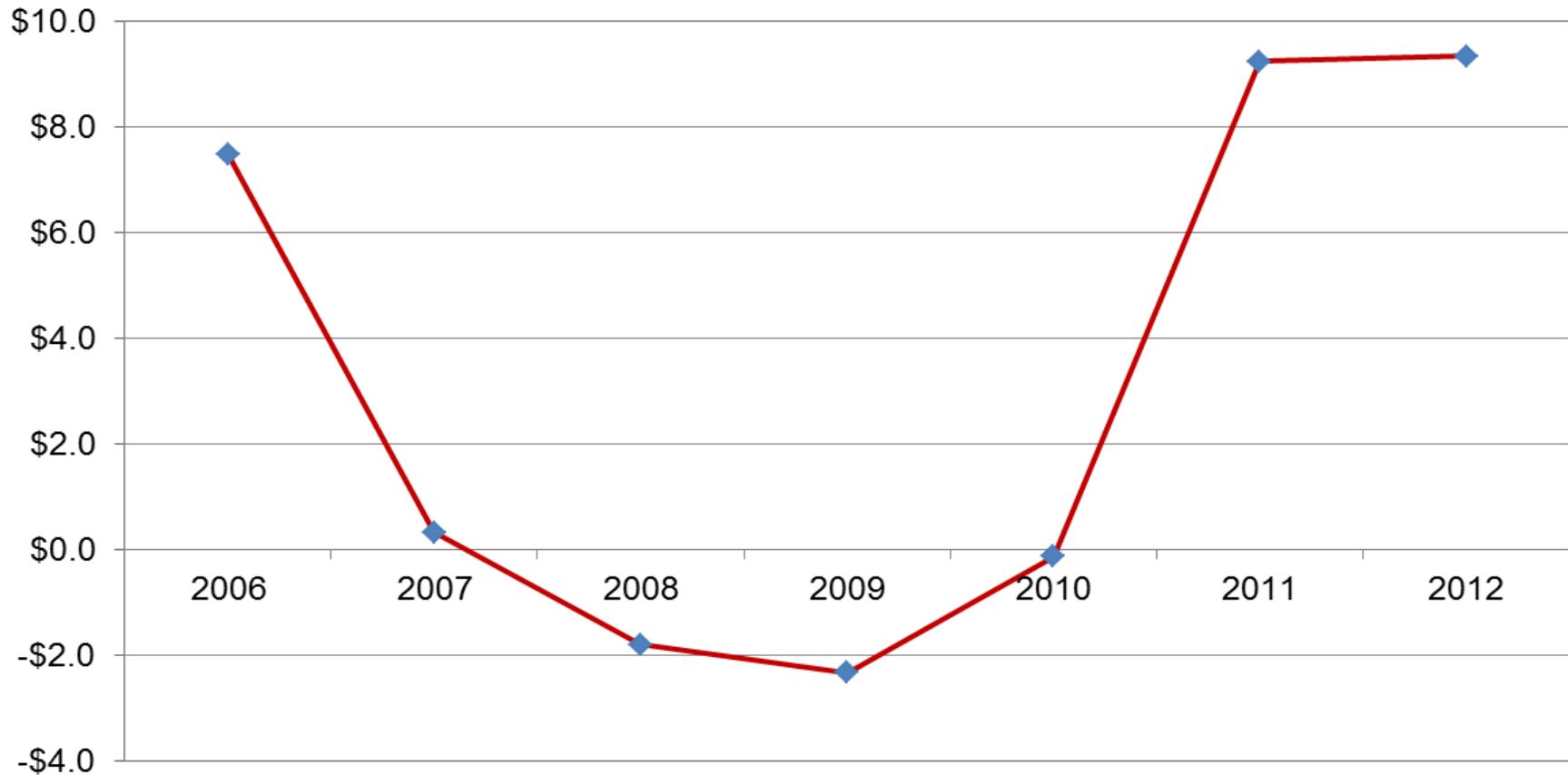
Before entering Act 47 oversight, the City had recurring annual deficits in the fund that covers most departmental operations (i.e. police, fire, public works). The 2009 audited financial statement showed a \$6.5 million negative General Fund balance entering 2010.

- **2010:** The City adopts the Recovery Plan in June and functions most of the year on the budget adopted before entering oversight. The City needs a \$17.2 million bank loan to repay an \$11 million loan to the Sewer Fund, retire its past due pension obligations and maintain operations for the rest of the year.
- **2011:** The City's financial statement shows revenues exceeding expenditures by \$7.5 million, but that includes \$2 million from 2012 received in late December 2011 and \$4.5 million refunded from 2010. Absent those items, the City's finances are more narrowly balanced.
- **2012:** The City's financial statement shows revenues falling \$4.6 million short of expenditures, but that excludes \$2 million that was received in late December 2011 instead of early January 2012. The City was also able to pay \$4 million in debt ahead of schedule to reduce future debt service payments. Absent those items, the City's finances are narrowly balanced.
- **2013:** The City's financial statement is not yet complete, but preliminary results show revenues exceeding expenditures by \$4.6 million.

Financial progress to date: Cash (\$ Millions)



**Cash and Cash Equivalents
(Annual Financial Statements)**



Baseline projection basics



The Amended Recovery Plan will start with a baseline projection of the City's revenues and expenditures. We are presenting our baseline projection as it stands today, and will continue to refine it until the Plan is released this fall.

- **Start with the 2014 budget:** Our projection process starts with a set of figures that are fixed (i.e. not changing) and known. We're using the 2014 budget for now
- **Post budget adjustments:** The City adopted the 2014 budget in late 2013. Through our cycle of quarterly reviews, we've learned that some revenues and expenditures are likely to be higher or lower than budgeted this year. We've adjusted our baseline accordingly
- **Growth rates:** Using historical trends, economic data and other information, we've calculated annual growth rates that project how the revenues and expenditures will change. In some cases, third party subject matter experts have provided growth rates (health insurance costs) or specific projections (debt payments and pension contributions)
- **Baseline assumes no changes:** The baseline shows what the City's financial performance is likely to be based on a particular set of assumptions and our analysis of information available today. It generally assumes no changes in tax rates, employee head count or service levels, with exceptions noted.

Revenue: Where the money comes from



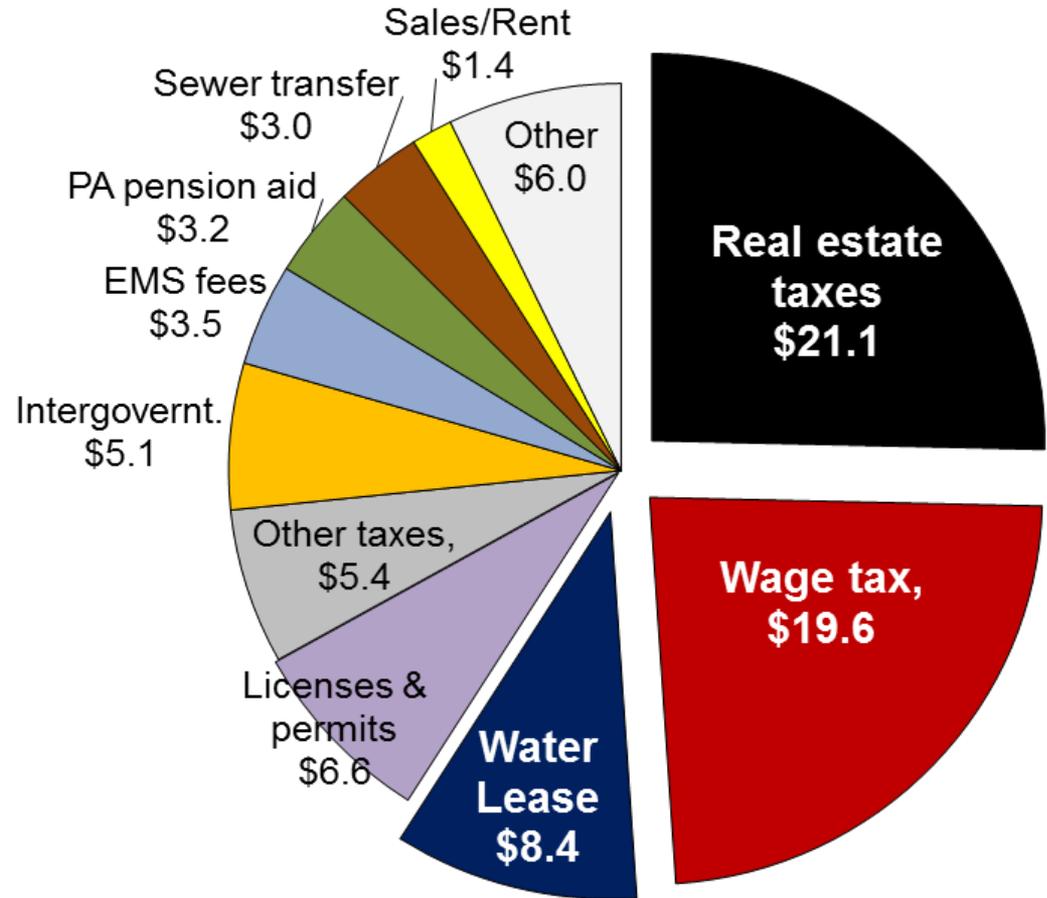
2014 General Fund Budget (\$M)

Nearly half of the City's General Fund revenue comes from two sources – the real estate tax and the earned income (or wage) tax.

The City's other taxes combined only generate six percent of the total (grey slice).

The water lease accounts for 10 percent of the total. The sewer system generates another 4 percent (brown slice).

Most of the "other revenues" (white slice) comes from a federal grant to the City that funds some firefighter salaries and benefits in 2013 – 2015.



Baseline projection: Tax revenues



	2014 Budget	2015 Projected	2016 Projected	2017 Projected	2018 Projected	2019 Projected
Real Estate Taxes, Current	19,783,000	19,638,000	19,638,000	19,638,000	19,638,000	19,638,000
Real Estate Taxes, Prior	1,300,000	1,744,000	1,744,000	1,744,000	1,744,000	1,744,000
Earned Income Tax	19,603,000	19,511,000	17,987,000	16,399,000	15,525,000	15,541,000
Business Privilege Tax	2,100,000	1,513,000	1,543,000	1,574,000	1,606,000	1,638,000
Real Estate Transfer Tax	1,983,000	2,023,000	2,063,000	2,104,000	2,146,000	2,189,000
Local Services Tax	1,100,000	1,111,000	1,122,000	1,133,000	1,145,000	1,156,000
Per Capita Tax	205,000	205,000	205,000	205,000	205,000	205,000
Tax total	46,074,000	45,745,000	44,302,000	42,797,000	42,009,000	42,111,000

The **real estate tax** is based on the assessed value of taxable land and buildings in the City. The value of taxable property decreased slightly and the value of tax exempt property increased slightly from 2013 to 2014. That plus a small reduction in the assumed collection rate leads to a small reduction in revenues for 2015. Assuming no tax increase, revenues remain flat through 2019.

Mid-year results for **prior year real estate taxes** are ahead of last year's pace while mid-year results for **business privilege taxes** are behind last year's pace. So they are adjusted accordingly for 2015.

The City recently changed the rate and collector for the **per capita tax** so we're using the 2014 budgeted amount for all years until we have more information on the result of those changes. Last year the City collected \$62,000 from the per capita tax.

Baseline projection: Earned income tax



	2014 Budget	2015 Projected	2016 Projected	2017 Projected	2018 Projected	2019 Projected
Resident EIT rate	2.1%	2.0%	1.9%	1.8%	1.7%	1.7%
Resident EIT revenue	N/A	17,000,000	16,497,000	15,971,000	15,416,000	15,430,000
Non-resident EIT rate (Act 47)	0.3%	0.2%	0.1%	0.0%	0.0%	0.0%
Non-resident EIT revenue	N/A	2,511,000	1,490,000	428,000	109,000	111,000
Total EIT revenue	19,602,820	19,511,000	17,987,000	16,399,000	15,525,000	15,541,000

Using the additional taxing authority in Act 47, the City levies a 0.3 percent earned income tax on non-residents who work in the City. Most non-residents pay a total EIT of 1.3 percent – 1.0 percent goes to their home municipality and 0.3 percent to the City of Reading. The City needs to approve the Amended Recovery Plan to levy a non-resident earned income tax under the provisions of Act 47 next year.

As a Home Rule municipality, the City controls its earned income tax rate on residents. Right now residents pay a 3.6 percent EIT – 1.5 percent to the Reading School District and 2.1 percent to the City of Reading. City officials want to match any reduction in non-resident EIT with a reduction in resident EIT, but the resident rate is not tied to Act 47 status.

There is potential legislation pending in the Pennsylvania General Assembly that would limit the amount of time that Reading could be in the current form of Act 47 oversight. One version of that bill would allow the City to increase the local services tax (currently \$52 on residents and non-residents) in exchange for eliminating the commuter EIT.

Given all the variables, the baseline currently assumes that the City will levy a non-resident earned income tax in 2015, but will reduce that levy by one-tenth of one percent each year. The resident EIT is reduced by 0.1 percent per year down to the 1.7 percent rate in place when the City entered Act 47 oversight.

Baseline projection: Water lease revenues



This year the City's budget includes \$8.4 million in revenue from the lease agreement between the City and the Reading Area Water Authority (RAWA). That includes the original lease amount (est. \$4.3 million), a meter surcharge that predates the City's entry into Act 47 (\$1.7 million) and the additional contribution that RAWA makes to the City according to a recommendation in the 2010 Recovery Plan (est. \$2.4 million).

Under the terms of Act 73 of 2012, a municipal water or sewer authority may not use "any grant, loan or other expenditure for any purpose other than a service or project directly related to the mission or purpose of the authority." This is generally interpreted as prohibiting RAWA from making an additional contribution to the City above the agreed-upon lease amount. RAWA could increase its lease payment to the City based on the value of the system.

If the City did not amend its lease with RAWA, it would receive only the lease payment in 2015, which PFM estimates at \$4.32 million. Under the terms of the lease amendment negotiated by RAWA and City Council, the lease payment would be \$8.0 million from 2015 through 2019 and then increase by CPI or 2.5 percent per year, whichever is more. For now we are assuming the \$8.0 million in our baseline projection.

	2014 Budget	2015 Projected	2016 Projected	2017 Projected	2018 Projected	2019 Projected
Without Lease Amendment	8,370,000	4,320,000	4,320,000	4,320,000	4,320,000	4,320,000
With Lease Amendment (Baseline)	8,370,000	8,000,000	8,000,000	8,000,000	8,000,000	8,000,000

Baseline projection: Service charges



	2014 Budget	2015 Projected	2016 Projected	2017 Projected	2018 Projected	2019 Projected
Housing (Rental Permits/Inspection Fees)	2,196,817	2,241,000	2,286,000	2,331,000	2,378,000	2,425,000
Cable Franchise Fees	725,000	740,000	754,000	769,000	785,000	800,000
District Court Summary Offense	850,000	876,000	902,000	929,000	957,000	985,000
Quality of Life Fines	390,000	250,000	250,000	250,000	250,000	250,000
Business Privilege Licenses	350,000	316,000	323,000	329,000	336,000	342,000
Other	2,050,000	2,092,000	2,136,000	2,180,000	2,225,000	2,272,000
License, permit and fees	6,561,817	6,515,000	6,651,000	6,788,000	6,931,000	7,074,000
EMS User Fees	3,536,638	3,258,000	3,323,000	3,390,000	3,457,000	3,527,000

The City has several service charges that are intended to help recover the cost of services provided to specific individuals or entities. This includes license and permit charges, fines and fees.

The largest category of service charges are the **EMS user fees** that the City Fire Department charges to people who use the City's ambulances. The City added a fourth ambulance in late 2013 with the goal of increasing the City's EMS revenues from \$2.9 million to \$3.5 million. So far the City's revenues have increased, but not as much as projected in the 2014 budget. The most recent projection is \$3.3 million per year starting in 2015.

According to the 2014 mid-year results, collections from the **quality-of-life fines** and the **business privilege licenses** are behind the pace needed to hit the year-end target. We have reduced the projections accordingly for 2015.

Housing service charges are also important given the City's recent investments in the rental housing permit and inspection processes and the relatively large revenue target.

Baseline projection: Other revenues



	2014 Budget	2015 Projected	2016 Projected	2017 Projected	2018 Projected	2019 Projected
Intergovernmental	5,081,976	4,912,000	4,962,000	5,013,000	5,065,000	5,119,000
PA pension aid	3,150,000	3,245,000	3,342,000	3,442,000	3,545,000	3,652,000
Sewer Transfer	3,000,000	3,000,000	3,000,000	3,000,000	3,000,000	3,000,000
Sales & Rentals	1,410,000	1,410,000	1,410,000	1,410,000	1,410,000	1,410,000
Other	5,960,706	5,493,000	4,769,000	4,905,000	4,950,000	4,997,000

The largest source of Commonwealth funding to support City operations is the **pension aid**. The amount of aid that the City receives depends on the amount of revenue generated by state taxes on out-of-state insurance policies and the City's headcount. Pension aid is projected to grow by 3.0 percent per year, which is the average over the last 10 years.

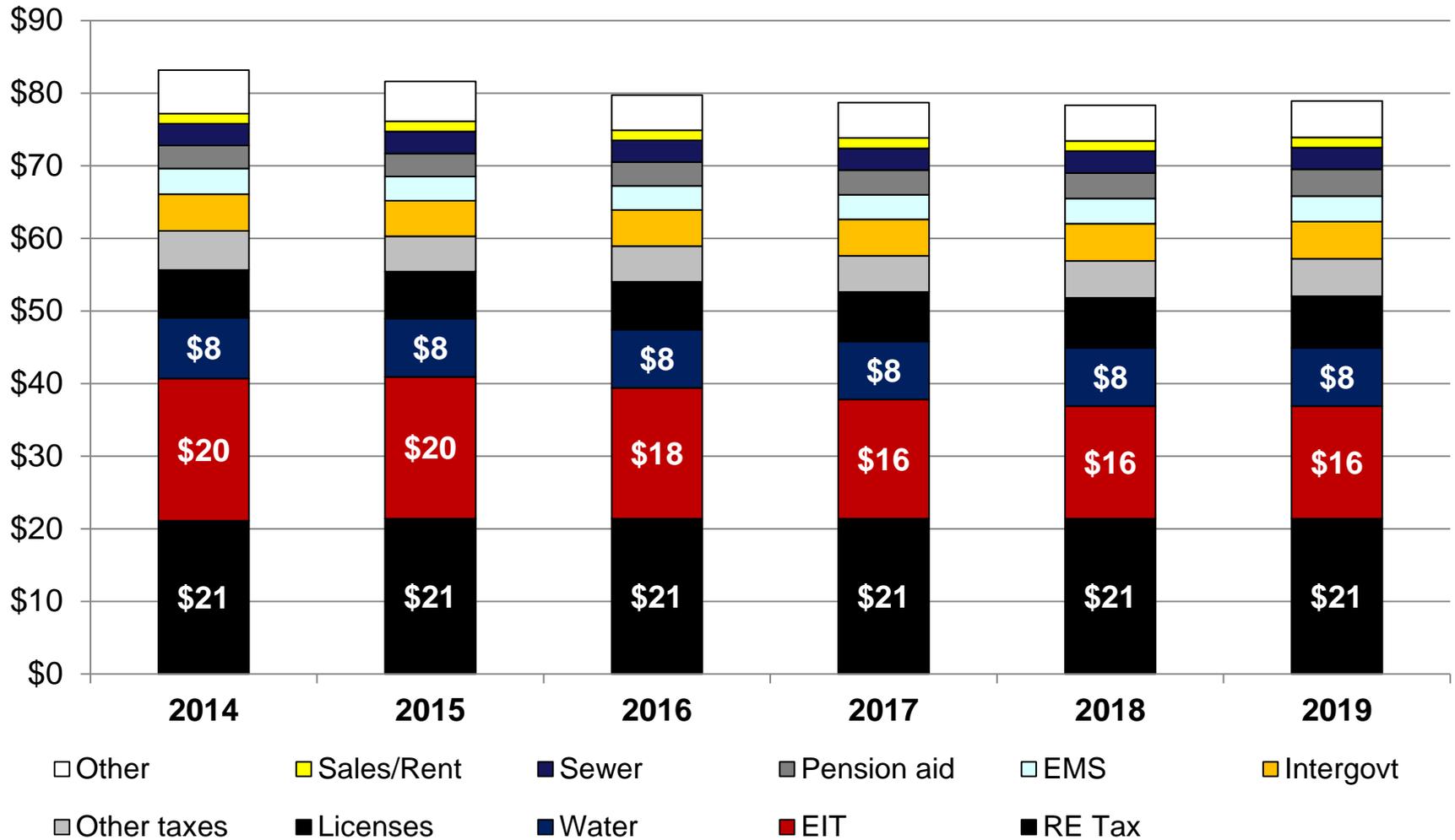
A federal consent decree related to the wastewater treatment plant limits the City a \$3.0 million annual **sewer transfer** to the General Fund.

The other major **intergovernmental revenues** are cost reimbursements to the General Fund from different enterprise funds (\$1.7 million budgeted in 2014), pass-through revenues for the Reading Public Library (\$768,000) and federal grant revenues that offset some of the City's code enforcement costs (\$500,000).

Most **sales and rental** revenues come from the City's lease agreement with the Reading Parking Authority (\$1 million annually) and the Reading Fightin Phils for FirstEnergy Stadium (\$300,000 annually).

The largest items in the "other" category are employee health insurance contributions (\$1.5 million budgeted in 2014) and the federal grant that covers the salary and benefit costs for 21 firefighters (\$1.9 million in 2014). That grant expires next year, so projected revenue in that category drops from \$5.5 million in 2015 to \$4.8 million in 2016.

Baseline revenue projection (\$ Millions)



Expenses: Where the money goes (category)



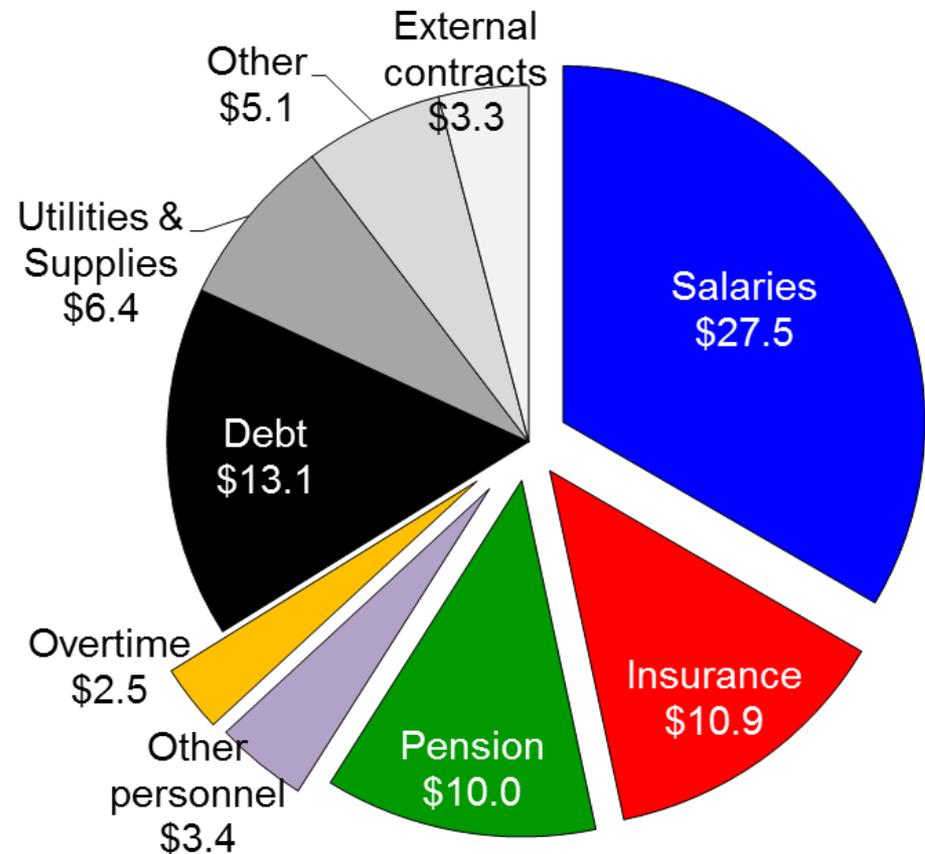
2014 General Fund Budget (\$M)

Like other cities, Reading spends the majority of its budget on its employees. Two-thirds of the 2014 budget covers employee salaries, other forms of cash compensation, health insurance and the City's pension contribution.

The City's required contribution to the three employee pension plans is \$10.0 million in 2014, net of the employees' contributions.

Other personnel covers social security, extra pay for working holidays and wages for temporary employees.

The utility and supply category includes equipment, repairs and postage.



Expenses: Where the money goes (department)



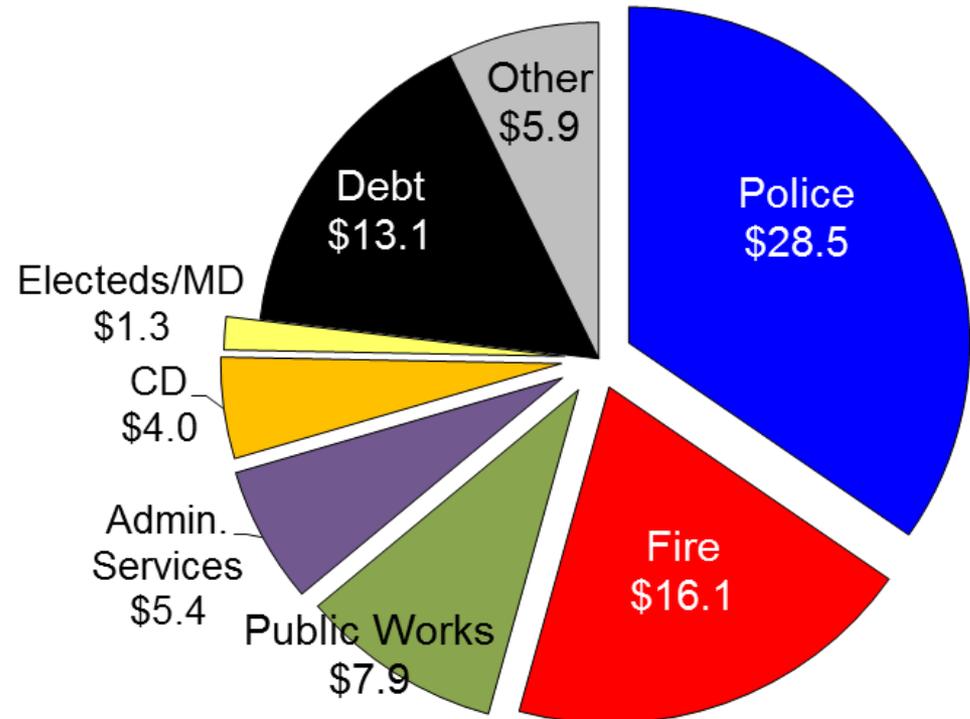
Reading spends the majority of its budget on Police and Fire, including emergency medical services. Those departments account for \$44.6 million, or 55 percent of the 2014 General Fund budget.

The City budgets \$5.5 million for Administrative Services – finance, HR, IT and the Citizens Service Center.

The City budgets \$4.0 million for Community Development (CD), with most for code enforcement and related activities (\$2.5 million).

The “Other” category includes the City’s transfer to the self-insurance fund (\$2.5 million), Law Department (\$1.0 million) and the Library (\$0.8 million).

2014 General Fund Budget (\$M)



Baseline projection: Salaries and cash comp



	2014 Budget	2015 Projected	2016 Projected	2017 Projected	2018 Projected	2019 Projected
Salaries	27,529,911	28,303,000	28,393,000	29,043,000	29,649,000	30,270,000
Overtime	2,497,300	2,568,000	2,605,000	2,667,000	2,718,000	2,771,000
Social security	1,045,650	1,071,000	1,085,000	1,109,000	1,131,000	1,155,000
Temporary Wages	956,629	976,000	995,000	1,015,000	1,035,000	1,056,000
Premium pay	1,086,554	1,119,000	1,115,000	1,142,000	1,167,000	1,192,000
Other	341,561	315,000	322,000	330,000	338,000	346,000
Other personnel	3,430,394	3,481,000	3,517,000	3,596,000	3,671,000	3,749,000

The baseline projections assume 2 percent annual **salary** increases in any year not covered by a collective bargaining agreement and in all years for non-union employees. We are refining the projections by department and bargaining unit to account for any step increases and expected attrition. The baseline does not assume any layoffs.

The salary assumptions also impact the projected spending on **social security** and overtime since they are indexed to salaries. So overtime is projected to increase along with salaries.

The City spent \$3.7 million on **overtime** in 2012 and \$3.0 million in 2013. Mid-year results show the City is on pace to spend the budgeted amount on police OT and exceed the fire OT budget by \$54,000 (8.0 percent).

Baseline projection: Insurance

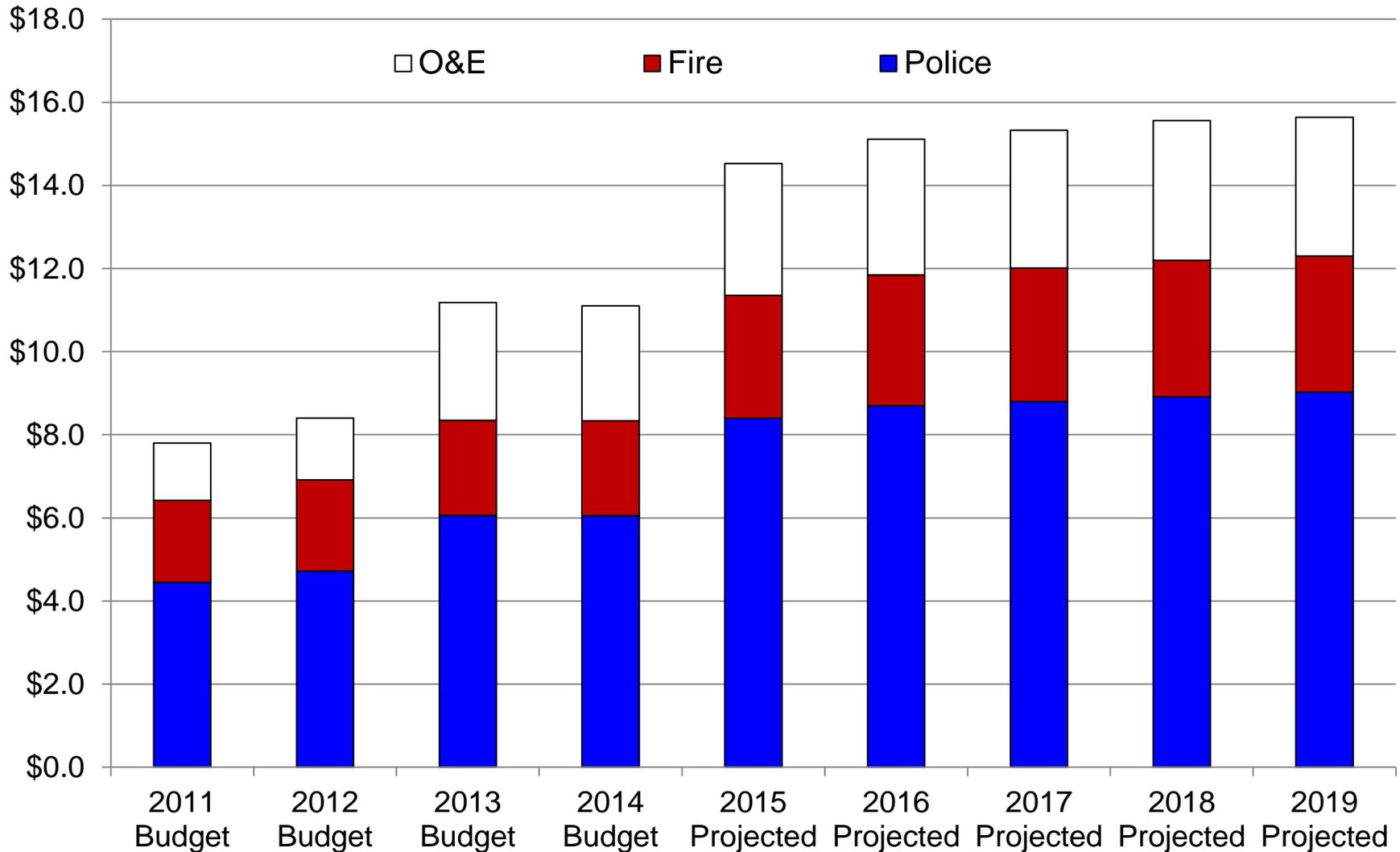


	2014 Budget	2015 Projected	2016 Projected	2017 Projected	2018 Projected	2019 Projected
Insurance for active employees	7,399,876	8,140,000	8,710,000	9,232,000	9,786,000	10,275,000
Insurance for retired employees	3,547,048	3,902,000	4,175,000	4,425,000	4,691,000	4,925,000
Fringe benefits	10,946,924	12,042,000	12,885,000	13,657,000	14,477,000	15,200,000

The City budgets \$10.9 million in 2014 for **fringe benefits**, which is mostly medical insurance and prescription drug coverage. The City also offers vision and dental insurance, which is paid by the employees, and life insurance, which is paid by the City. About two-thirds of the General Fund total covers 484 active employees and the other one-third covers 232 former employees.

The third-party administrator that helps the City manage its insurance estimates that the total cost of health insurance will increase by approximately 10 percent from 2014 to 2015 and then 5-7 percent in later years. For the active employees, the City covers the first five percent of any increase and then the employees are responsible for anything over five percent. Most retired employees make a fixed contribution to the cost of health insurance based on their retirement date and then the City covers the difference. So, as the cost of health insurance rises, the City covers a growing share of the total cost for retired employees.

Baseline projection: Pension contribution (\$M)



Baseline projection: Non-personnel expenses

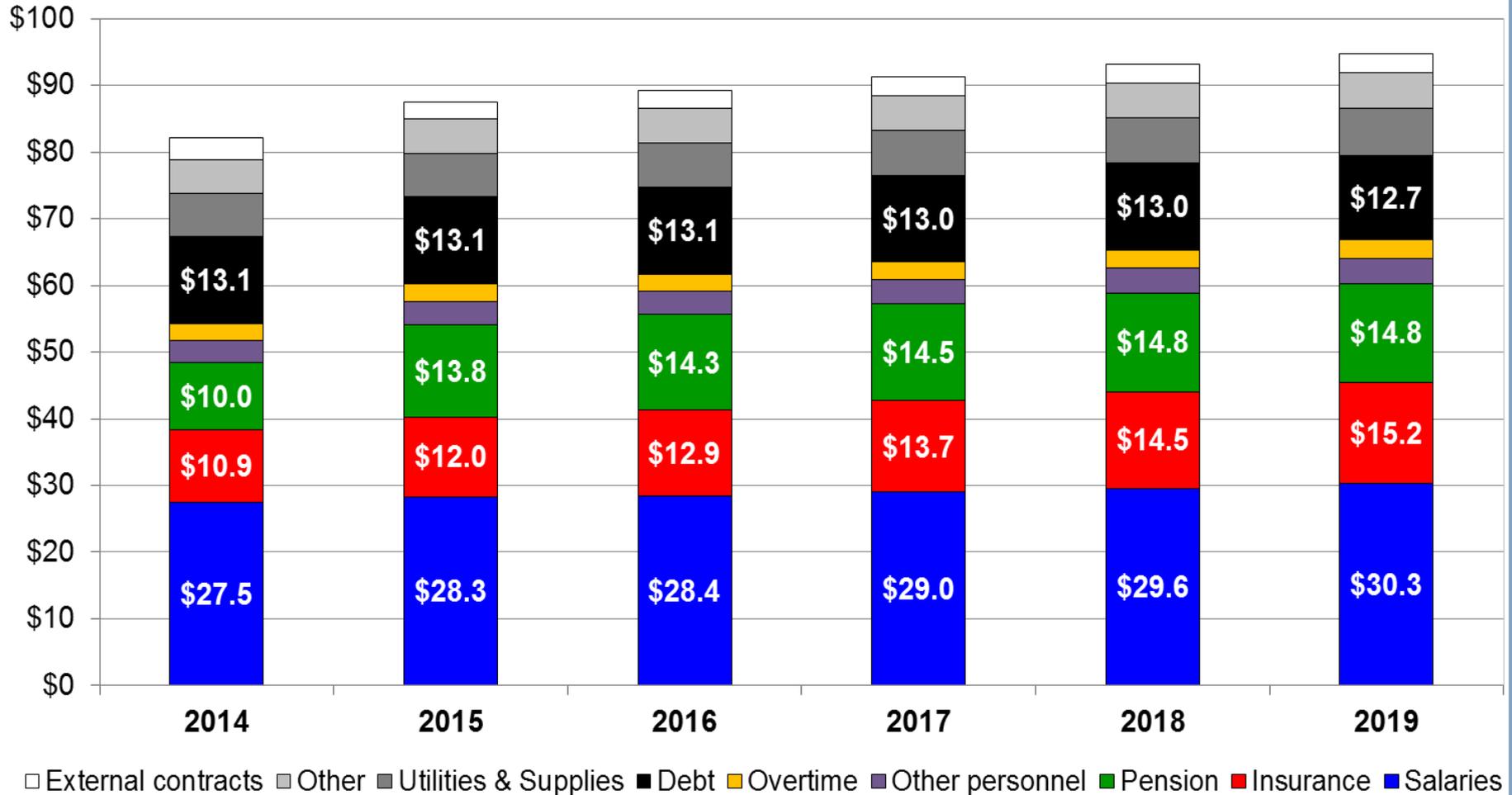


	2014 Budget	2015 Projected	2016 Projected	2017 Projected	2018 Projected	2019 Projected
Debt service	13,144,084	13,105,000	13,138,000	13,025,000	12,958,000	12,749,000
Utilities, supplies and equipment	6,353,392	6,493,000	6,636,000	6,784,000	6,935,000	7,090,000
Contracts and consulting	3,331,139	2,616,000	2,681,000	2,748,000	2,817,000	2,887,000
Other	5,051,951	5,148,000	5,172,000	5,195,000	5,233,000	5,291,000
Non-personnel (All Departments)	27,880,566	27,362,000	27,627,000	27,752,000	27,943,000	28,017,000

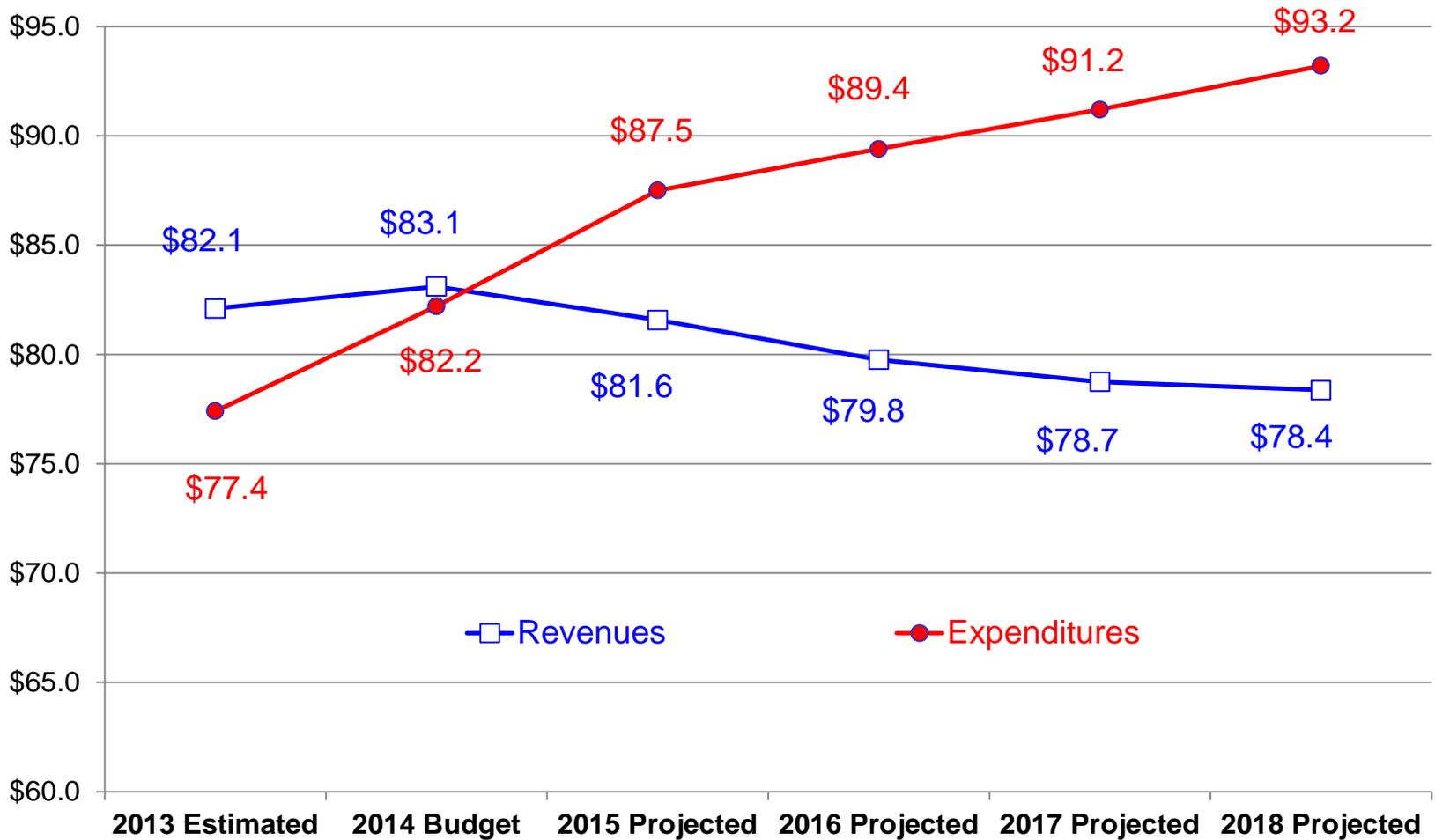
The baseline projection reflects the City's scheduled principal and interest payments for **debt**. There may be opportunities to reduce the debt below the levels shown above by refinancing, similar to someone refinancing their mortgage at a lower interest rate. The baseline assumes the City does not issue any new debt, which means the City will have to rely on pay-as-you-go funding for its infrastructure investments and capital improvements (e.g. street paving, major building repairs).

The projections assume utility costs will grow by 4.0 percent per year while other most non-personnel expenses grow by inflation (2.0 percent annually as projected by the US Federal Reserve Survey of Professional Forecasters).

Baseline expenditure projection (\$ Millions)



Bringing the pieces together (\$ Millions)



Bringing the pieces together (Trends)



Five key trends to help you understand the baseline projection

- 1) The City's largest source of revenue (real estate taxes) is not growing absent tax increases.
- 2) The City's second largest source of revenue (earned income tax) is growing, but the City has to reduce the tax rate to make progress toward exiting Act 47 oversight. So total EIT revenues are projected to drop.
- 3) The wage freezes adopted in the original Recovery Plan expire and salary expenditures are projected to increase by 2.0 percent, with additional adjustments steps and known attrition.
- 4) The City's pension contribution will almost double from \$8 million in 2011 to \$15 million in 2016.
- 5) As of January 1, 2015, 38 percent of total projected General Fund revenues will be already committed to legacy costs -- \$13.8 million for pension, \$13.1 million for debt and \$3.9 million for retired employee health insurance.