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Pittsburgh Faces a Major Budget Problem

A year ago the Institute published an updated report on its Benchmark City comparison with Pittsburgh. That report served as a reminder that Pittsburgh still has a long way to go to approach the kind of government financial performance exhibited by comparably sized regional hub cities across the country.

The report offered plenty of evidence that Pittsburgh clearly needed to remain under state supervision. Debt service is still very high relative to general fund spending and the number of city employees per resident—even after declining somewhat over the last ten years—remains 30 percent above the composite Benchmark City average. Spending and taxes per capita are on the order of 50 percent higher than the Benchmark while workers' compensation payments per resident are three times those in our composite city. Moreover, Pittsburgh has very generous employee compensation packages that include extraordinary levels of overtime (premium) pay, especially in the fire department, as well as longevity pay for some employees.

What is surprising is that the City's Act 47 coordinators, in late 2012, recommended to the Department of Community and Economic Development and the Governor that the City be removed from distressed status despite the enormous problems it still faced. Granted, there had been progress as a result of the new taxes created by the Legislature for Pittsburgh and some serious belt tightening for a couple of years that persuaded the coordinators to feel that the City had satisfied the four criteria in the law to be removed and, even with an end to Act 47, the City would still fall under the supervision of the oversight board, meaning "external guidance and support for continued progress is assured" according to the rescission report.

The state overruled the coordinators, kept the City in Act 47 status, and a third recovery plan was drafted and released on May 30th. That plan says the City is facing a substantial budget deficit problem for 2015 and following years. And this news is of recent vintage in light of the City's budget forecast from February that foresaw balanced budgets through 2018. What happened?

The Act 47 team says the City lowered its real estate millage farther than necessary to comply with requirements to arrive at a revenue neutral amount following a reassessment

and that the reduction of the rate of return for pensions means more money must be put into the pension funds—certainly much more than the City's financial plan from February had foreseen. One thing the City did to recognize a serious flaw in its pension plans was to lower the rate to return used in evaluating assets to 7.5 percent to be in line with state's two pension plans. The Institute argued in an August 2012 *Policy Brief* that the City should go at least that far. Although that is still not in line with what private sector firms are required to do. This was the right thing for the City to do even though it has caused a jump in the annual amount the City must pay into the pension plans. To be sure, Pittsburgh is not alone in facing pension funding issues.

When a government makes financial promises it must legally keep and fails to set aside adequate dollars necessary to fund them, a day of reckoning will assuredly come. The only question is who will have to pay to keep those promises? Will it be taxpayers in the form of higher taxes or employees in the form of other compensation reductions or perhaps loss of jobs?

In the present situation, the Act 47 coordinators reworked the February plan numbers for revenue and expenditures and made large changes in some budget items. When the City released its five year financial forecast in February, 2015 revenues were projected at $494.3 million and expenditures at $493.5 million. Interestingly, the Act 47 team produced a new baseline that lowered the 2015 forecast for real estate taxes by $4.2 million but raised other revenue projections, particularly for parking tax, payroll preparation tax, and intergovernmental transfers. Also included was an adjustment of $1.9 million to 2015 revenues as a result of the fund balance shift being used for the Severance Incentive program. All told, these adjustments puts the forecast for total revenue at nearly the same place the February final budget and fiscal plan had it—$494 million.

Thus, the newly found budget problem centers on the spending side of the ledger. According to the Act 47 team, the February budget forecast for 2015 is $10.2 million lower than their new number—February's $493.5 million compared to the new figure of $503.7 million. Note that the February budget forecast had a surplus of almost $900,000. That, combined with the slightly higher revenue forecast by the Act 47 coordinators, places the newly forecast deficit for 2015 at $8.9 million. The team also posts even larger increases in projections for the spending gap between February's out year projections and its new predictions.

What is the prime source of the jump in the Act 47 team's newly calculated 2015 numbers compared to earlier projections? Most of the rise comes from a significantly higher estimate of employee benefits, primarily pension and health care costs that boost total benefits $11 million above the forecasted February financial plan. And this gap continues or widens a bit through the five year outlook period.

The Act 47 team recommends two major changes to fix the financial problems their projections now contemplate. First, on the revenue side by boosting the property tax millage to add revenues of $6.6 million per year, lifting the parking rates to raise another

$1.1 million and finally to add to the charges for some services to generate another $550,000 per year for a total of $8.3 million in new revenue. Second, lowering employee cost by $4.66 million in 2015 (primarily through salary reductions) and higher amounts in later years. The plan also calls for annual non-personnel savings of $2.6 million to $2.7 million going forward after 2015. The Act 47's baseline projections with these initiatives would result in revenues of $503 million and expenditures of $497.6 million in 2015.

In sum, the savings and higher taxes are projected to generate surpluses for several years even after additional borrowing costs are incurred to undertake capital projects.

If enough savings can be achieved along with expected higher revenues from existing sources without raising property taxes that would be sufficient to cover the expected deficit, why is it necessary to raise the property tax? Indeed, there are very rich opportunities for savings beyond those called for by the Act 47 team. None of their plans include discussion of outsourcing or privatization. Their virtual ignoring of the premium pay problem and outrageous workers' compensation spending levels is a continuation of the unwillingness to deal aggressively with the City's fundamental problems. The Act 47 team does recommend that overtime be removed from calculating firefighter pensions (a recommendation they made in 2009 as well) and, while accrued workers' compensation fell $20 million from where it stood in 2009 the 2013 amount of $131 million, it is $20 million above the amount when the City entered distressed status ten years ago.

Moreover, the forecasts of property tax revenue foresee minimal growth in the City's taxable property values through new construction and rehabilitation of existing property—or City challenges to assessments for properties that are grossly under assessed. That would appear to be very shortsighted.

Perhaps the oversight board will weigh in on these issues more forcefully.

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