Municipalities Financial Recovery Act

Exit Plan

City of Reading
Berks County, Pennsylvania

Prepared on behalf of the

Commonwealth of Pennsylvania
Department of Community and Economic Development
Governor's Center for Local Government Services

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Executive Summary

In November 2009, the Pennsylvania Department of Community and Economic Development (DCED) designated the City of Reading (City) as financially distressed according to the criteria in the Municipalities Financial Recovery Act (Act 47 of 1987). The Commonwealth selected Public Financial Management (PFM) a month later to serve as Reading's Recovery Coordinator.

Act 47 required PFM to complete a Financial Condition Report earlier this year to evaluate the City's current fiscal position and recommend that Reading follow one of three paths: terminate distressed status and exit oversight; initiate the fiscal emergency process that potentially results in receivership; or adopt a three-year Exit Plan.

PFM evaluated the City's fiscal position according to the four criteria that a municipal government must meet to exit oversight successfully. The first criterion requires the "reasonable probability of future balanced budgets absent participation in this act" and the fourth criterion requires that "reasonably projected revenues of the municipality are sufficient to fund ongoing necessary expenditures."

PFM updated the baseline analysis that was presented in the original and Amended Recovery Plans and has been discussed periodically and publicly since 2009. That analysis shows a deficit starting at $2.3 million in the adopted 2019 budget and growing each year going forward. City government's ability to manage away from those projected deficits while delivering critical municipal services is contingent on the City having strong financial management in place. The City struggled to fill key financial management positions and only filled its vacancies days before the Financial Condition Report was released[1].

In light of these vulnerabilities in the City's financial performance and its financial management capacity, PFM recommended that the City adopt a three-year Exit Plan. The input received during the period for public comment on the Financial Condition Report generally endorsed this approach, so PFM finalized the recommendation, submitted it to the Commonwealth and began work on this Exit Plan.

The Exit Plan is similar in some ways to the original Recovery Plan that the City adopted in 2010 and the Amended Recovery Plan adopted in 2014. It begins with a baseline projection of City government's financial performance in its primary operating fund, and it carries over some of the same protective and corrective measures from those earlier Plans.

But this Exit Plan is not merely the third in a series of multi-year financial plans written during Commonwealth oversight. As Act 47 states, the Exit Plan "shall contain such elements as may be necessary to ensure termination of distressed status after three years." The City only has one chance under the Act to adopt an Exit Plan, implement it and exit oversight successfully. The only options remaining to Reading are exiting oversight or initiating the fiscal emergency process that can result in receivership.

As one Council person said earlier this year, the Exit Plan should provide Reading with a strategy to strengthen its team and position City government for success once oversight ends. The socioeconomic challenges that Reading faces as a community, such as a high poverty rate and low per capita income, will undoubtedly continue after oversight ends. But City government now has the opportunity to be a constructive partner in addressing those challenges, and not just focus on its own financial sustainability.

That is the goal of this Exit Plan.

[1] The City subsequently learned that one of the critical financial management positions will become vacant in August 2019.

The key to exiting Act 47 oversight: Strong financial performance, strong financial management

Reading's ability to exit Act 47 oversight and remain fiscally stable into the future depends on City government's ***financial performance*** (e.g. avoiding deficits, maintaining an appropriate level of reserves, funding a capital budget) and its ***financial management*** (e.g. budget execution and monitoring, revenue collection, adequate internal controls).

Quoting the Act's exit criteria, the City needs to demonstrate the "reasonable probability of future balanced budgets absent participation in this act." ***The first financial goal guiding this Plan is that it should close the projected baseline deficit by the end of the Plan period.***

The City should also build on its progress to date under oversight, and one tangible measure of that progress is the City's success in building a meaningful level of reserves.

These reserves help the City pay its obligations early in the year before tax revenues arrive, without paying interest on borrowed money to fund basic operations. The reserves provide a buffer against unexpected revenue shortfalls or unbudgeted expenditures. They provide a resource for paying down long-term liabilities and making strategic investments. And they help counter the negative factors that drag down Reading's credit rating and make it more expensive for City government to issue debt.

The City adopted an ordinance in 2017 requiring it to retain a minimum fund balance (i.e. financial reserves) of 20 percent of regular General Fund operating expenditures or $22 million, whichever is higher. Complying with its own policy is a good way for City government to demonstrate its ability to manage its finances once oversight ends. ***The second financial goal guiding this Plan is that it should keep the fund balance in compliance with the City's policy.***

This Plan continues some deficit-closing strategies from the prior Recovery Plans. There are provisions to moderate the growth in City spending on personnel costs for active employees. There are prohibitions on enhancements to employee pension and retiree health insurance benefits that already consume a large part of the budget. There are initiatives related to debt refinancing and, if resources allow, early debt repayment.

On the revenue side, the Plan encourages the City to reach a multi-year agreement with the Reading Parking Authority (RPA) that would set the amounts and terms of the RPA's annual contribution, similar to the one the City has with the Reading Area Water Authority[2]. The Plan recommends a course of action to ensure that the recent slide in non-tax revenues is the result of deliberate policy decisions, not poor financial management[3].

Like the prior two Recovery Plans, the Exit Plan also anticipates that the City will have to increase its real estate tax rate in the next couple years. The Plan shows a 1-mill tax increase in 2019 and another 1-mill increase in 2022[4]. Executing Plan initiatives could enable the City to reduce those tax increases, as would better-than-projected growth in the City's resident earned income tax revenues. If resident EIT revenues continue to grow at the pace set through May 2019 for the rest of the year, that growth would cut the 2020 real estate tax increase almost in half. The City will not balance its budget by simply managing toward the status quo, but the real estate tax increases described in this Plan are not a forgone conclusion.

The table below summarizes how the Plan initiatives accomplish the two key primary financial goals.

[2] Please see initiative GP01 in the General Provisions chapter for more information.
[3] Please see initiative FM07 in the Financial Management chapter for more information.
[4] Please see initiative GP06 in the General Provisions chapter for more information.

Exit Plan Scenario Projections

		2019	2020	2021	2022
Baseline	Surplus / (Deficit)	($2,300,000)	($2,874,000)	($2,925,000)	($3,506,000)
	Reserves comply with City policy?	YES	YES	NO	NO
Plan Scenario	Surplus / (Deficit)	($2,300,000)	($403,000)	($521,000)	$45,000
	Reserves comply with City policy?	YES	YES	YES	YES

As we emphasized in the Financial Condition Report, not all operating surpluses are created equal.

If the City has reasonable revenue estimates and then economic growth drives revenues higher than expected, that is a positive contributor to a surplus. It is also positive if the City identifies efficiencies where it can deliver the same quality of service at a lower cost during the year and reduces its expenditures below budgeted levels.

But negative factors can also contribute to an operating surplus. If the City incorporates expenditures in its budget for an important project and then fails to execute it – because of lack of capacity, inefficient work processes or disagreement on how to proceed -- that produces savings relative to the budget at the cost of effective government.

There is evidence that is occurring.

The 2017 audit showed a $3.5 million surplus at the end of that year. Total General Fund revenues finished almost exactly at the level budgeted. So the surplus was generated by spending less than budgeted. That variance was primarily in active employee health insurance, where the City spent $1.7 million less than budgeted, and non-personnel expenditures. The City budgeted $1.0 million for a demolition and roof replacement program that it did not execute. There were also large budget-to-actual variances in Public Works' budget for traffic engineering and public property maintenance. Subsequent discussions with management indicated that the City had difficulty executing some projects incorporated in the 2017 budget.

These problems were not a one-time event. The City allocated $440,000 for sidewalk repairs in 2018, but did not record any expenditures. The City also allocated $1.1 million for services related to Public Works Administration, Highways (road maintenance), Public Property (facility maintenance), and Traffic Engineering and only spent $565,000. City government's difficulty executing projects may be related to the problems the City is having at different stages in its procurement process and lack of capacity in the Public Works department, so the Exit Plan has initiatives to address those issues[5].

Making these improvements is not just a matter of better policy and more efficient processes. City government also needs the right *people*. The Administrative Services Department has been short-handed for years because of problems filling four positions that are critical to financial management[6]. The City finally reached the point where it had four individuals filling four positions in March 2019, only to learn that one of the four individuals will leave City government within weeks of this Plan's release. The City needs capacity and stability in this area to manage toward a successful exit from oversight.

[5] Please see initiatives FM05 in the Financial Management chapter and CP01 in the Capital and Debt Chapter.
[6] The four positions are Managing Director, Director of Administrative Services, Controller and Accounting Manager.

Economic and community development: Benefits beyond the bottom line

When Reading's potential exit from Act 47 oversight is discussed, one common question is, "How will City government replace the money it loses when the commuter tax is eliminated?"

Since 2010, the City has used the extraordinary taxing powers in Act 47 to tax the earnings of people who work in Reading but live elsewhere. The non-resident (or commuter) tax generated $3.3 million in 2018 which the City split between the General Fund, where it paid for daily operations, and the Capital Project Fund, where it funds projects like public safety vehicle replacement and building repairs. Effective January 2019 the City will use all current year commuter tax revenue for capital improvement projects. The Exit Plan continues the 0.3 percent commuter tax provision with all current year revenue designated for capital projects.

As the law currently stands, Reading cannot levy the commuter tax after it leaves Act 47 oversight. City officials have advocated for the Pennsylvania General Assembly to change the law so that Reading can still levy the commuter tax after leaving Act 47 oversight. They note the importance of fairly distributing the cost of providing local government services in a regional employment hub like Reading to all the people who benefit from those services, including commuters. We support the continuation of a commuter tax where the revenue is used to fund capital improvements that benefit residents and commuters.

Meanwhile the resident EIT generated $23.3 million in 2018, much of which went to the General Fund where it covers the cost of providing services like police patrol and fire suppression. The primary variables that drive resident EIT revenue are the number of employed residents, the amount of income each one earns and the tax collection rate. Two of those three variables are determined in part by having job opportunities available to Reading residents and Reading's ability to attract and retain residents with growing income. So the potential for continued growth in the City's most important revenue depends in part on economic and community development.

The strength of the local economy is critical to City government's other major revenue sources. After the earned income tax, the largest tax revenues are tied to the assessed value of property in Reading (real estate tax), the market value of real estate sold in Reading (deed transfer tax), the level of specific types of business activity conducted in Reading (business privilege tax) and the number of people working in Reading (local services tax).

While local leaders have called for new revenue streams to fund local government, Pennsylvania's tax structure does not reward creativity. There are a limited number of taxes that local governments can levy, even for Home Rule municipalities like Reading. Pennsylvania law instead stresses the importance of how much economic activity occurs within that municipality's borders.

	April 2019	Goal
CD Director	Split	Yes
Codes Manager	Acting	Yes
Chief Building Officer	Vacant	Yes
Planning Manager	Split	Yes

Meanwhile City government's primary department assigned to facilitating economic and community development has the same problem with vacancies in key positions that Administrative Services has.

As of June 2019, the City had an Acting Director of Community Development, an acting Codes Manager and a vacancy in the Chief Building Officer position. That means three of the Department's four divisions in the General Fund – Administration, Property Maintenance Inspection, and Building and Trades – do not have a permanent leader. The fourth division is led by the Planning Manager who is splitting his time between leading that division and serving as the Acting Department Director. The City has two people to fill four positions.

Capacity problems extend beyond the senior positions. The City's revenues from rental property inspections fell each year from 2014 to 2017 because inspector vacancies or training needs hampered the City's ability to complete inspections[7]. The Department has a backlog of unresolved housing/zoning permit applications which hampers zoning enforcement. Department management expressed concerns about the Building and Trades Division's ability to continue to meet the 30-day standards for timely plan review and approval. The vacant Chief Building Officer is a particularly high priority because lack of capacity there stalls the reviews related to health and safety, economic development and tax base growth.

Economic and community development is good for City government's bottom line, but its value is more than that. The benefits of clean, vibrant and attractive neighborhoods extend to the everyday lives of Reading's residents. The absence of an effective strategy to deal with vacant, blighted or dilapidated properties also has a broad negative impact, as speakers passionately described in the public meeting related to the Financial Condition Report.

City government will not drive economic and community development on its own and the battle to overcome Reading's biggest economic challenges will continue long after oversight ends. But this Plan charts the next steps City government's leaders should take so their organization is a constructive partner in efforts to overcome these challenges, including the following:

- Adding a position to help address the current and avoid future backlogs of zoning/housing permit applications[8]
- Increasing the allocation for non-represented employees to ease recruitment of the next Chief Building Officer[9]
- Potentially allocating a portion of the City's real estate transfer tax revenue to fund the Housing and Blight Strategy[10]
- Establishing more regular, public reporting on the rental inspection program that regulates housing for a large portion of City residents[11]

City government should also lead by example and execute capital projects that repair, replace or renovate City-owned assets like fire stations, parks, roads and bridges. Relative to other Pennsylvania municipalities, Reading is an enviable position. It has a $7 million annual pay-as-you-go capital budget, at least for the term of this Exit Plan; a relatively good capital budgeting process in its ordinances; and a recently completed assessment of its needs at most City-owned facilities. Now the City needs to translate these advantages into results that people can see, touch, walk into, work in and drive on.

Capital project execution is complicated and time-consuming, particularly when the project involves funding from multiple sources; oversight of design or engineering work, including the associated procurement process; and oversight of construction work, and its associated procurement process. So the Plan creates and funds a new Capital Project manager position[12], and it requires more regular and more meaningful progress reports for a section of the budget that is now larger than the operating budget for every department except Police[13].

[7] The vacancies were since filled and revenues rebounded in 2018, but turnover remains a challenge in this Division.
[8] Please see initiative ED02 and ED05 in the Economic and Community Development chapter.
[9] Please see initiative ED01 in the Economic and Community Development chapter.
[10] Please see initiative ED04 in the Economic and Community Development chapter.
[11] Please see initiative ED03 in the Economic and Community Development chapter.
[12] Please see initiative CP01 in the Capital and Debt chapter.
[13] Please see initiative CP02 in the Capital and Debt chapter.

Some officials will rightfully note that City's ability to fund capital projects will not be as robust once Reading leaves Act 47 oversight, unless the General Assembly empowers Reading to use the commuter tax beyond that point. Losing the commuter tax would cut the City's capital budget in half. The best way for Reading officials to show the value of the commuter taxing power is to put it to good use while it is in place.

A different kind of Plan

The original Recovery Plan adopted by the City in 2010 was over 300 pages and had dozens of initiatives. The Amended Recovery Plan adopted in 2014 was similar in length and scope. This Exit Plan is less than a third of those Plans' size.

This is partially a reflection of the progress City government has made since Reading entered oversight in 2009. The Exit Plan's baseline projection shows deficits in the primary operating fund, just as the prior two Plans did. But those deficits are smaller and grow at a slower rate, and so the scope of changes needed to close them is also smaller.

Baseline Deficit Projections ($ Millions)

2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Original Recovery Plan				**Amended Recovery Plan**					**Exit Plan**		
($14.3)	($16.6)	($19.0)	($21.4)	($3.1)	($8.8)	($11.3)	($13.1)	($14.8)	($2.9)	($2.9)	($3.5)

While the prior two Plans had wage freezes, the Exit Plan's maximum annual allocations for employee compensation assume across-the-board wage increases for all employees in each year, and the percentage wage increases grow from 2 percent in 2020 to 3 percent in 2022.

There is a potential two-mill real estate tax increase, just as there was in the Amended Recovery Plan, but strong execution of other Plan initiatives and growth in resident EIT revenues could reduce those tax increases, which would be the City's first since 2016. The first two Plans required position cuts. This Plan does not, and adds a couple positions back.

This should not be misinterpreted as a sign that City government has solved its financial problems.

Some of those problems – concentration of poverty, low income and housing values relative to the rest of Berks County, a mismatch between the demand for service and the resources available to pay for those services – will remain for years. City government also still commits a large percentage of its current-year resources to pay for services delivered and obligations incurred in the past. The City's expenditures on debt, employee pension benefits and retired employee health insurance still consume more than a third of the General Fund budget and will do so throughout this Exit Plan.

Long-Term Liabilities ($ Millions)

	2015 Actuals	2016 Actuals	2017 Actuals	2018 Budgeted	2019 Budgeted	2020 Projected	2021 Projected	2022 Projected
Debt service	$12.0	$18.8	$13.3	$11.7	$11.4	$10.7	$11.2	$11.2
Retiree health insurance	$4.6	$5.5	$5.2	$5.0	$5.2	$5.8	$6.4	$7.1
City pension contributions	$13.2	$14.3	$14.9	$17.1	$17.1	$17.4	$16.2	$15.8
Long-term liability subtotal	**$29.7**	**$38.7**	**$33.3**	**$33.7**	**$33.7**	**$33.9**	**$33.8**	**$34.2**
% of Total	**34.9%**	**41.8%**	**38.4%**	**36.4%**	**35.8%**	**34.9%**	**33.8%**	**33.2%**

But Reading's progress toward financial stability since entering oversight is real. Its ability to build on that progress over the long term depends in part on these three long-term liabilities.

The Exit Plan's shorter length is an intentional decision to give City officials more flexibility to manage operations with less prescriptive direction from the Coordinator[14]. The Exit Plan still sets parameters for tax rates and expenditures, but it transitions some responsibility for multi-year financial planning back to the City in preparation for life after Act 47. It recommends that City officials start to think about new positions during the budget process in terms of whether the City *needs* them and *can afford* them, instead of whether the Coordinator *will allow* them.

City government has an opportunity to graduate from this phase in its financial recovery and move to another in which the focus shifts even more from the organization's financial survival to the organization's capacity to contribute to the community's revival. That will be a phase in which Reading officials are responsible for managing their financial affairs without Commonwealth oversight.

As noted earlier, this is Reading's only chance to prove it is ready for that opportunity. The only options remaining to Reading are exiting oversight or initiating the fiscal emergency process that can result in receivership. We look forward to working with Reading's leaders to finish the work we started together in 2010 and prepare them for the work that lies ahead, after Act 47 oversight.[15]

[14] The Coordinator reserves the right to itself only to amend, in its sole discretion, the Exit Plan provided that it follows the same filing, notice and public meeting procedures as specified in section 255 of Act 47. Any such amendment will also comply with sections 256(b) and (c) of Act 47 relating to the contents of and the process of adopting exit plans.

[15] During the Exit Plan public comment period, City Council expressed interest in having continued external technical support after Reading exits oversight. While the Exit Plan only covers the period during oversight, we agree that the City would benefit from continued external support and will discuss that possibility with the Commonwealth.

Baseline Projection

Like the original and Amended Recovery Plans, this Exit Plan begins with a baseline projection of the City's General Fund revenues and expenditures in a *status quo* scenario. The baseline projection is a diagnostic exercise to identify the critical factors that drive financial performance; determine and quantify any structural deficit; and provide an important reference point for gap closing initiatives.

Act 47 required PFM as Recovery Coordinator to provide a similar projection as part of the Financial Condition Report submitted earlier this year. During that process, we reviewed whether the City's revenues will be "sufficient to fund ongoing necessary expenditures," as one of the criteria for exiting Act 47 oversight. The Financial Condition Report presented a baseline projection that showed a deficit of $2.3 million in 2019 growing to $4.2 million in 2022.

The City provided its unaudited year-end 2018 financial results after we submitted the Financial Condition Report. We reviewed those results and updated the baseline projection accordingly, resulting in a slightly smaller deficit. This chapter provides a more detailed explanation of that baseline projection, with more discussion of the City's recent financial performance.

The baseline projection uses the adopted 2019 budget as the starting point; accounts for known future changes (such as scheduled debt payments or lease agreement terms); and then applies growth rates calculated based on a combination of historical performance, socioeconomic trends, and other factors. The City's 2019 budget includes a $2.3 million deficit between revenues and expenditures in the General Fund, and the baseline projection shows the deficit growing to $3.5 million, or 3.4 percent of total expenditures, in 2022.

General Fund Baseline Projection

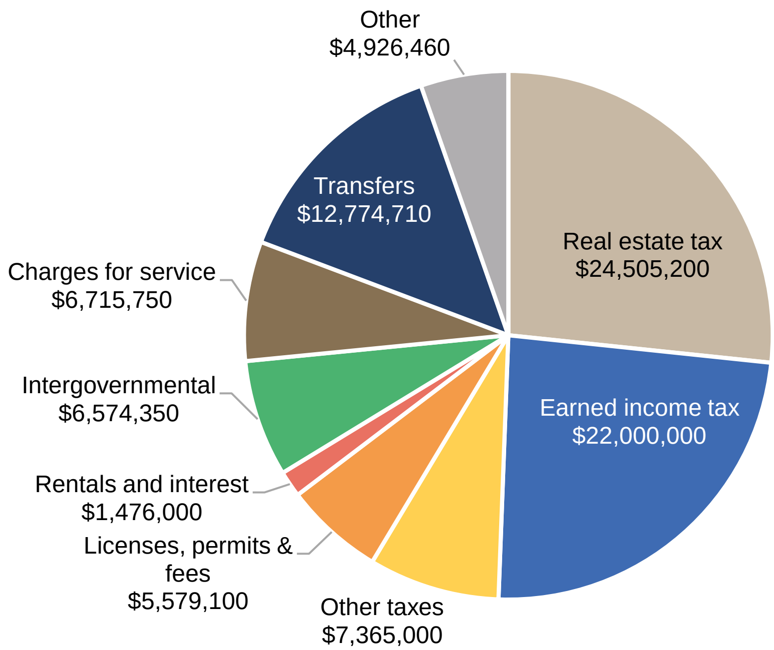
	2019 Budget	2020 Projected	2021 Projected	2022 Projected	CAGR[16]
Total revenues	$91,917,000	$94,349,000	$96,908,000	$99,396,000	**2.6%**
Total expenditures	$94,217,000	$97,223,000	$99,832,000	$102,902,000	**3.0%**
Surplus / (Deficit)	**($2,300,000)**	**($2,874,000)**	**($2,924,000)**	**($3,506,000)**	**N/A**
% of Expenditures	**-2.4%**	**-3.0%**	**-2.9%**	**-3.4%**	**N/A**

[16] Compound annual growth rate (CAGR).

Major Revenue Assumptions

About half of the City's General Fund revenue comes from the real estate tax and the earned income tax (EIT). Those two items, combined with the revenue from other taxes and interfund transfers, account for over 70 percent of the 2019 General Fund revenue budget.

2019 General Fund
Revenue Budget ($91.9 Million)[17]



	2019 Budget	2020 Projected	2021 Projected	2022 Projected	CAGR 4 Year
Real Estate Tax	24,505,200	24,821,374	24,922,524	24,934,030	0.6%
Earned Income Tax	22,000,000	22,361,000	23,104,000	23,719,000	2.5%
Other taxes	7,365,000	7,795,900	8,037,264	8,289,597	4.0%
Charges for service	6,715,750	6,731,250	6,747,231	6,763,706	0.2%
Licenses, permits & fees	5,579,100	5,657,951	5,739,762	5,824,659	1.4%
Intergovernmental	6,574,350	6,730,951	6,892,087	7,057,892	2.4%
Rentals and interest	1,476,000	1,476,000	1,476,000	1,476,000	0.0%
Other	4,926,460	5,779,872	6,697,529	7,740,730	16.3%
Transfers	12,774,710	12,994,456	13,291,372	13,590,493	2.1%
Total Revenues	**91,916,570**	**94,348,754**	**96,907,769**	**99,396,108**	**2.6%**

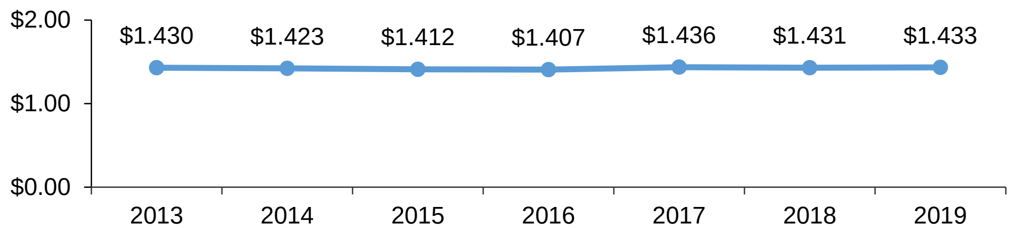
[17] This excludes the $2.3 million carryforward from 2018 that the City uses to close the budget deficit.

Real estate tax

The City's real estate tax generates a little more than a quarter of the City's General Fund revenues. The City projects approximately $24.5 million will come from this source, including delinquent payments, in 2019. The 2019 tax rate is 17.489 mills with an additional 0.20 mills levied to support the City's separate Shade Tree Fund. The City enacted real estate tax increases in 2011, 2013 and 2016 and has held the tax rate constant since then.

The total assessed value for taxable property in Reading has been flat since 2013, growing by just 0.2 percent from $1.430 billion that year to $1.433 billion in 2019. The real estate tax base for 2019 was a little larger than the City assumed in its 2018 budget[18], so if we apply the historical collection rate for current year real estate taxes, the City can expect to receive $170,000 more than budgeted in its General Fund this year.

Taxable Assessed Value Growth ($ Billions)



The baseline projection accounts for the expiration of tax incentives that properties currently receive under two programs:

- The **Keystone Opportunity Zone (KOZ)** program provides a 100 percent real estate tax abatement for roughly 10 years post-KOZ designation to businesses property owners and residents located or partially located within the zone. In order to receive KOZ benefits, all participants must reapply annually to ensure eligibility. About 50 parcels will be placed on the City's real estate tax rolls after the KOZ benefits expire at the end of 2020. Their total assessed value is $5.7 million so they would generate $90,000 in current year real estate tax revenue starting in 2021, assuming the City's tax rate and collection performance remains the same. Another set of properties that includes the Doubletree Hotel will have its KOZ abatements expire in 2024, which is outside our projection period.

- The **Local Economic Revitalization Tax Assistance (LERTA)** program exempts a portion of a property's total assessed value from taxes on a declining scale. The program provides a 100 percent exemption in the first year, a 90 percent exemption in the second year and so on until the exemption expires in the 11th year. The exemption only applies to industrial, commercial and business properties where there is new construction or improvements to those properties. There are only a handful of properties currently receiving the LERTA benefits and the expiration of tax benefits adds less than $1 million a year to the tax rolls during the Exit Plan period.

The baseline projection assumes the tax base remains flat through 2023 except for these adjustments related to expiring tax benefits.

The City's current year collection rate has hovered between 87 and 90 percent over the last five years, even after the two-mill tax increase in 2016. The baseline projection assumes an 89.2 percent collection

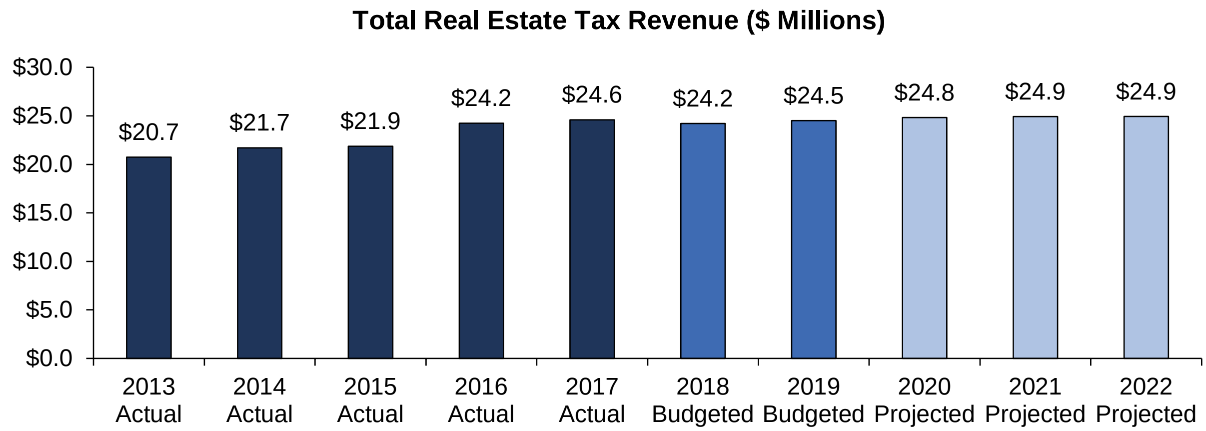
[18] The City assembled the 2019 budget in September 2018, at which point the most recent set of property valuation figures were from 2018. The County provided an updated property valuation in early 2019, which is the actual basis for the City's real estate taxes.

rate through 2023. The tax rate is also held constant at 17.489 mills in the baseline scenario, excluding the 0.2-mills designated for the separate Shade Tree Fund.

Berks County collects delinquent real estate tax revenue and remits it to the City. Delinquent tax revenues grew by 14 percent in 2017, which could be caused in part by the 2016 tax increase. The City increased the tax rate by 13 percent in 2016 and it would take a couple of years for that increase to fully impact delinquent revenues that are collected one to three years after the tax took effect. The preliminary 2018 year-end results show another nine percent growth to $2.6 million.

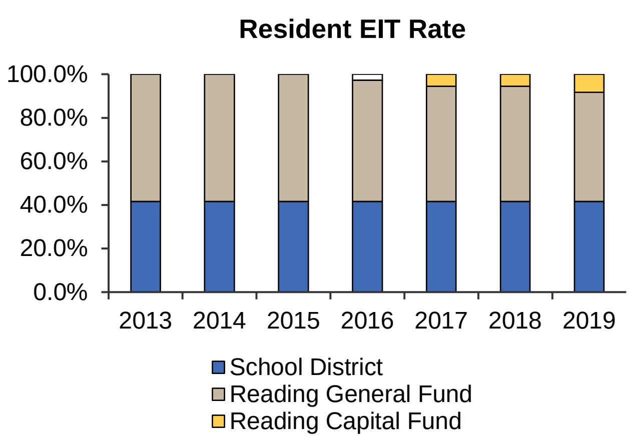
In light of this performance, the baseline projection adjusts the delinquent real estate tax target from $2.32 million in 2019 to $2.45 million in 2020, which is roughly the midway point between the 2017 and 2018 results and gives some measure of conservativism in case the final audited 2018 results are lower than the City reported or inflated by large one-time payments. The baseline then carries forth the $24.5 million in prior year real estate tax revenue through 2022.

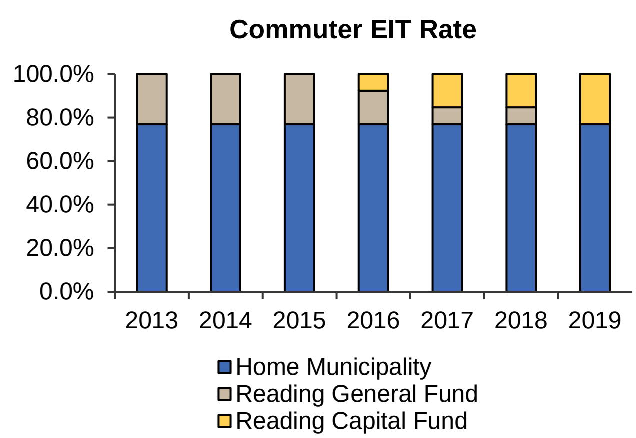
This translates to minimal expected growth in total real estate tax revenues -- they increase from $24.5 million budgeted in 2019 to $24.9 million in 2022.



Earned income tax

The earned income tax (EIT) is the second largest source of General Fund revenue and the largest source of tax revenue overall, once EIT revenue dedicated to the separate Capital Project fund is included. The City has been shifting a growing portion of the resident and commuter earned income tax rate to the Capital Project fund, as shown in the graphs below.





The Amended Recovery Plan required this shift, partly to help the City make progress against the backlog of critical capital projects and partly to reduce the City's dependence on the additional taxing power tied to its Act 47 status. The City cannot levy the commuter tax once it exits Act 47 oversight.

Starting January 1, 2019, the City no longer uses any current year commuter EIT to fund daily operations. Commuters will generally pay 1.0 percent to their home municipality[19] and 0.3 percent to Reading to fund Capital Projects. Because of the time lag between when the EIT is levied and when the revenue is remitted to the City, Reading will receive some commuter EIT associated with late 2018 in its General Fund in early 2019, and then minimal commuter EIT revenues in that Fund after 2019.

We have monitored the trends in Reading's EIT receipts closely throughout the oversight process because of their size relative to most other revenues and their growth relative to the flat real estate tax base. To isolate the effects of rate changes, the aforementioned time lag, and changes in delinquent collections, we have calculated the amount of revenue that each 0.1 percent of EIT generates per quarter in current year revenues. We have then compared that to external data that provides insight on how the tax base itself is growing in terms of the number of employed residents and the median household income.

Resident EIT Revenue and Tax Base Growth, 2013 – 2017[20]

	2013	2014	2015	2016	2017	CAGR
Resident revenue per tenth percent per quarter	$180,222	$191,334	$203,251	$217,944	$235,515	**6.9%**
Annual growth	N/A	6.2%	6.2%	7.2%	8.1%	
Employed residents	34,486	34,153	34,076	34,032	33,925	**-0.4%**
Annual growth	N/A	-1.0%	-0.2%	-0.1%	-0.3%	
Median Household Income	$26,777	$26,867	$26,784	$27,247	$28,755	**1.8%**
Annual growth	N/A	0.3%	-0.3%	1.7%	5.5%	

Source: EIT receipt data from Berks EIT, Incorporated; Number of employed residents from the US Bureau of Labor Statistics, Local Area Unemployment Statistics; Median Household Income from the US Census Bureau's American Community Survey, 5-year estimates.

EIT receipts consistently grew more than the two variables that should drive growth in the tax base. The number of employed residents in the City did not grow by this measure and the median household income had very modest growth until 2017. Meanwhile, current-year revenue collected from residents per 0.1 percent per quarter grew by 6.9 percent. One explanation for the divergent trends is that the current year collection performance has been improving as the collector improves its processes and software and identifies more existing tax payers.

The City increased the resident EIT from 1.7 to 2.1 percent under the terms of the original Recovery Plan, temporarily reduced the tax rate to 1.9 percent in 2012, restored the tax rate to 2.1 in 2013 and has held it level since then. Over the 10-year period of Act 47 oversight, this translates to a 2.1 percent annual increase in the EIT rate.

[19] This depends on the earned income tax rates in the commuters' home municipality. Commuters living in municipalities where the resident EIT rate is less than 1.0 percent will pay more to Reading and commuters living in municipalities where the resident EIT is more than 1.0 percent will pay less to Reading.

[20] The 2018 ACS data on median household income is not yet available for comparison.

Real Estate and Resident Earned Income Tax Rates[21]

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Real estate tax (GF + Shade Tree)	11.945	11.945	14.334	14.334	15.689	15.689	15.689	17.689	17.689	17.689	17.689
% change		0.0%	**20.3%**	0.0%	**9.5%**	0.0%	0.0%	**12.9%**	0.0%	0.0%	0.0%
Resident EIT (GF + Capital)	1.7%	2.1%	2.1%	1.9%	2.1%	2.1%	2.1%	2.1%	2.1%	2.1%	2.1%
% change		**23.5%**	0.0%	**-9.5%**	**10.5%**	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%

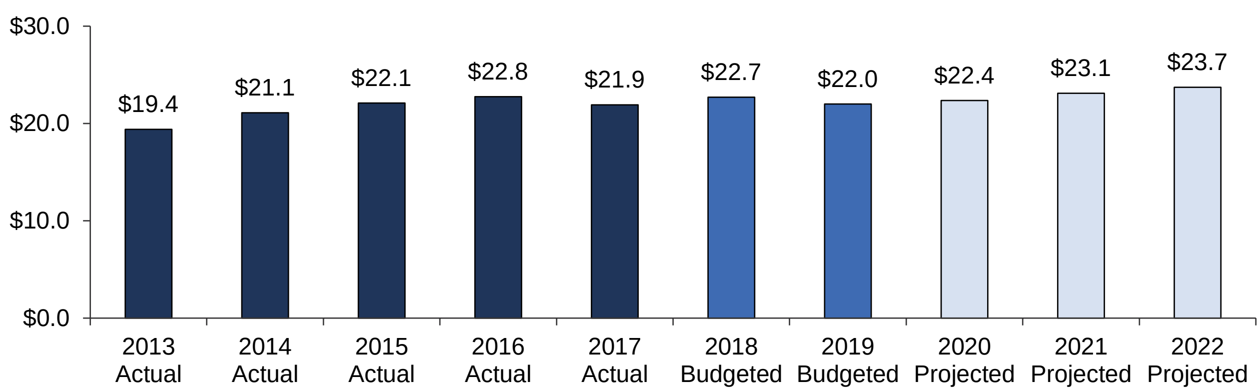
The good news is that Reading's EIT receipts have grown consistently and often more than expected. Even in years where the City expected General Fund EIT revenues to drop because part of the tax rate was shifted to the Capital Fund, they either did not drop (e.g., 3.0 percent growth in 2016) or dropped less than expected. Strong EIT performance has compensated for minimal or sporadic growth in other revenues absent tax increases.

The bad news is that, if this growth is primarily because of improving collection performance, eventually that growth will slow once the collector reaches the point where it is collecting everything it can from the existing tax payers. According to the federal data, the number of resident tax payers is not growing and the income for each tax payer has grown by a much slower rate. Eventually, we expect the EIT growth rate to drop closer to what the tax base is doing, though we cannot predict when that will happen. The amount of resident revenue per tenth percent per quarter grew by 6.3 percent in 2018 versus 8.1 percent in 2017, so perhaps that is already happening.

The 2019 budget anticipates 5.0 percent growth in the resident EIT revenue generated per 0.1 percent per quarter and the baseline continues that downward trend, lowering it to 4.0 percent in 2020, 3.0 percent in 2021 and 2.5 percent in 2022. Even that level would be a little higher than the compounded annual growth in median household income in recent years.

Once the impact of the tax rate shift and the time lag between tax levy and revenue collection are taken into account, the City's annual General Fund EIT revenues are projected to grow on average by 2.5 percent during the projection period. We will continue to monitor this trend closely because it is critical to the City's financial stability.

Total General Fund Earned Income Tax Revenue ($ Millions)



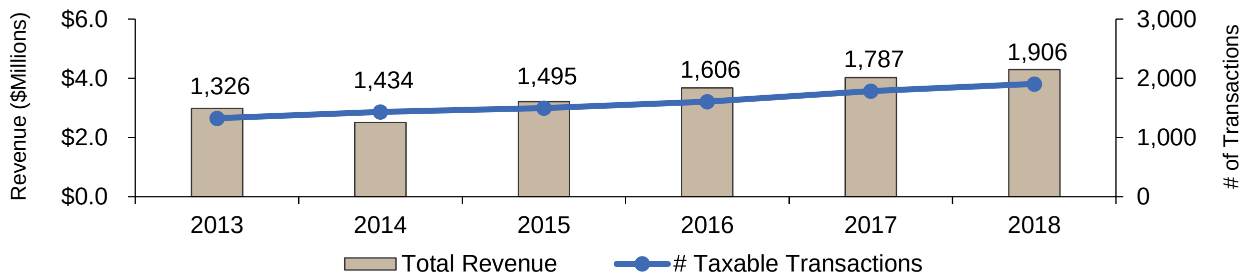
[21] The real estate tax rates includes 0.2 mills for the Shade Tree Fund and 0.2 mills for the Library, which is passed through the General Fund. The resident EIT rates include the growing portion shifted to the Capital Project Fund beginning in 2016. It excludes the 1.5 percent that City residents pay to the Reading School District.

Other tax revenues[22]

The City levies a 3.5 percent **real estate (or deed) transfer tax** on the value of real estate transferred by deed, instrument, long-term lease or other writing. Transfer tax revenue rose from $2.8 million in 2013 to $4.0 million in 2017, which translates to an average annual increase of 9.2 percent, but with a lot of volatility between those two end points. Transfer tax revenues fell by 11.2 percent in 2014, shot up 27.7 percent in 2015 and then grew at declining (but still large) rates in 2016 (14.6 percent) and 2017 (9.5 percent).

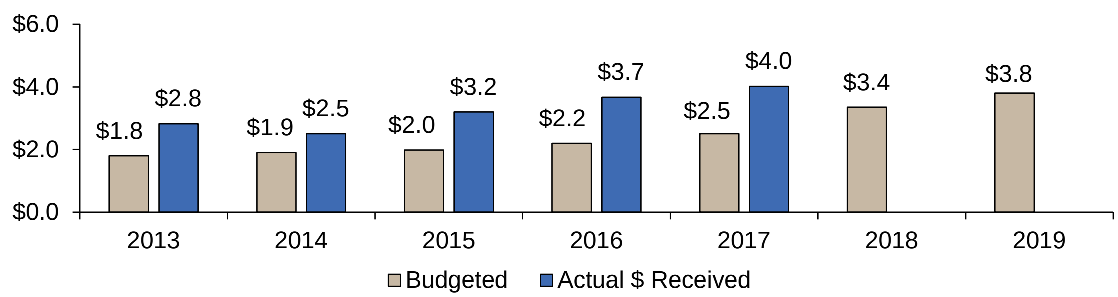
Analysis of monthly State Tax Equalization Board (STEB) reports and the City's Auditor's quarterly reports shows that transfer tax revenue growth is driven at least in part by a steady increase in the total number of taxable transactions. The wide variance of growth across the years can be attributed to the presence or absence of larger, commercial property sales.

Volume of Real Estate Transfer Transactions vs. Revenue



Historically, the City has budgeted conservatively in anticipated revenues from this source and has received an average of 56 percent more than it budgeted each year from 2013 through 2017. The preliminary 2018 results show $4.3 million versus $3.4 million budgeted.

Budgeted vs. Actual Real Estate Transfer Tax Revenues ($ Millions)



The City budgeted $3.8 million for 2019, which is 13.4 percent higher than the 2018 budget target, but less than the $4.0 million collected in 2017. The baseline assumes that the City will collect $4.0 million in transfer tax revenue in 2019, and that revenues from this source will continue to grow by 5% each year through 2022. In light of historical trends, this is still a conservative estimate. The tax's volatile nature makes it a problematic source for funding predictable, recurring expenditures, but a useful one for funding special projects. The Economic Development chapter has an initiative related to using additional revenue above this baseline projection[23].

The **business privilege tax (BPT)** is levied on the gross receipts of all entities engaged in commercial activities for gain or profit within Reading's borders. Certain businesses, such as manufacturers, are exempt from the tax. The tax is 0.5 mills on whole sale businesses, 0.75 mills on retail businesses and 1.5 mills on

[22] The City's admissions tax is grouped under service charges and discussed there.
[23] Please see initiative ED04.

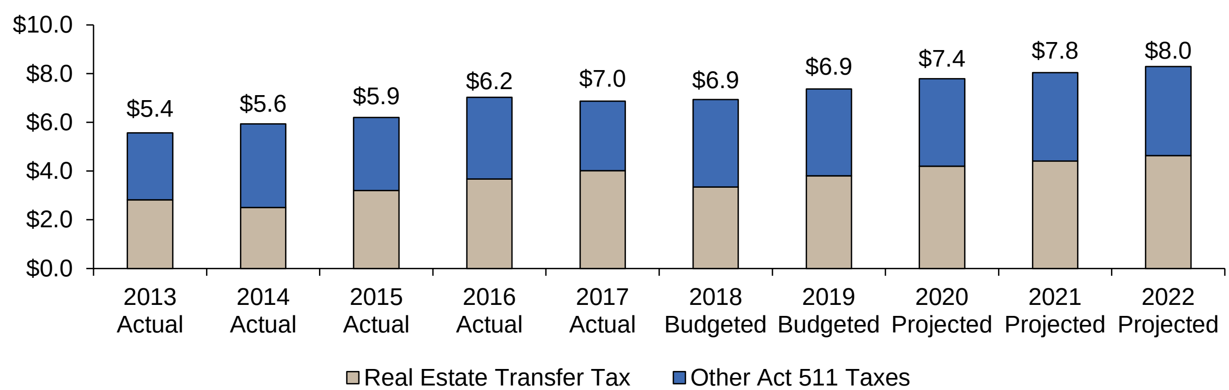
other businesses. Current year BPT revenues have alternated a year of growth with a year of decline since 2013, growing at a compound annual rate of 1.4 percent over that period. The baseline projection assumes 1.5 percent growth in line with that historical average.

The **local services tax (LST)** is a weekly tax of $1 per employee working in Reading for anyone who earns more than $12,000 a year. The tax is levied based on where a person works, so it includes commuters working in the City. Similar to the BPT, total LST revenues have alternated a year of growth with a year of decline since 2013 and have hovered around $1.2 million. The City budgets that amount for 2019 and we carry it forward.

The City levies a $20 tax on each City resident who is at least 18 years old and the Reading School District adds another $10 for a total annual **per capita tax** of $30. As discussed frequently, the collection rate for the per capita tax rate has been very poor. The City collected $263,000 in current year PCT revenue in 2017, which translates to 22.2 percent of the City population over age 17 paying the tax. Collection performance did improve over 2016 levels (14.3 percent), and the City has changed external collectors in the hope of further improvements. Population growth slowed to effectively zero from 2013 to 2017 (0.1 percent per year) so we do not anticipate much natural growth in the tax base. The baseline carries the City's $275,000 budget target forward.

Taking all of these taxes together, the baseline projects 3.1 percent annual growth within this category, mostly due to the real estate transfer tax.

Other Act 511 Tax Revenue ($ Millions)



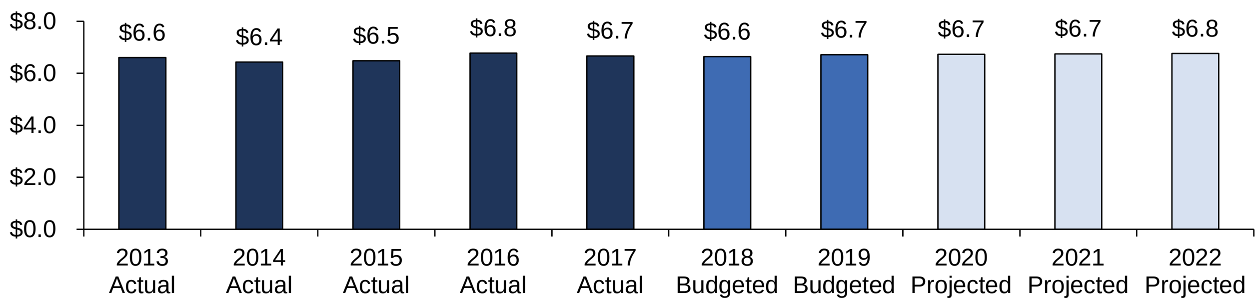
Charges for service

The City has several fees and service charges that are intended to cover most, if not all, of the costs associated with providing services to specific individuals or organizations. The largest item in this category are the **emergency medical service (EMS) user fees** that the Reading Fire Department receives. User fee revenues have been flat at $2.9 million since 2013, so the baseline does not project any growth in revenues from this source.

The second largest item is $1.7 million from a **water meter surcharge**, which is a flat transfer amount from the Reading Area Water Authority. The next largest item is the 5.0 percent **admissions tax** the City levies on events at the Santander Arena, Santander Performing Arts Center and FirstEnergy Stadium. After three years of declining revenue, admissions tax receipts jumped from $419,000 in 2015 to $542,000 in 2016 (a 29.3 percent increase) and then settled into a more moderate 2.3 percent growth rate in 2017.

The baseline projection applies the historic growth rate in the County gross domestic product (3.1 percent from 2013 – 2017) as a reflection that these venues draw from the regional economy. Other items in this category are generally held flat since that is the trend across items except for the admissions tax.

Charts for Service Revenue ($ Millions)

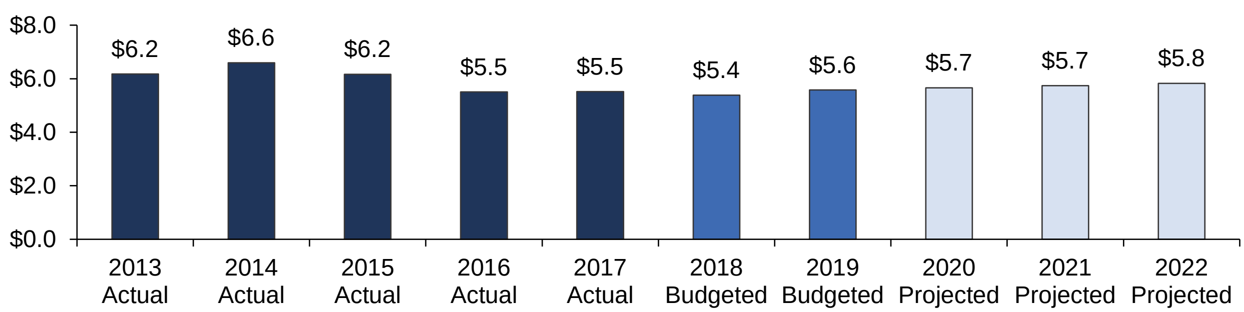


Licenses, permits and fees

The largest item in this category is **rental housing permits**, the revenue from which grew each year from 2013 through 2017. Code enforcement staff explained that the City has been able to identify and register more rental housing units. Meanwhile revenue from **rental housing inspections** dropped over that same period so that the trend across the category was negative for 2013 through 2017 (-1.6 percent per year). Code enforcement staff noted that vacancies and turnover contributed to the declining inspection revenue and that the unit was closer to fully staffed as of April 2019. The preliminary 2018 year-end results show that the trends reversed themselves last year. Current year rental permit revenues dropped to their lowest result since 2014 while current year rental inspection revenues reached their highest amount since that same year. The baseline projection carries forward the City's 2019 budget targets for both categories through 2022.

Revenues from **cable franchise fees** grew by 5.2 percent per year over this period, and the baseline projects 5.0 percent annual growth going forward. Fine revenues related to **District Court Summary Offenses** dropped from $1.0 million in 2014 to $368,000 in 2017 because the City decriminalized parking-related offenses and that revenue now flows to the Reading Parking Authority. For all other license, permit and fee revenues, the baseline projects flat or inflationary growth off the 2019 budgeted amounts, assuming the City the does not make significant changes in its enforcement efforts or fee levels.

Licenses, Permits and Fees Revenue ($ Millions)



Intergovernmental

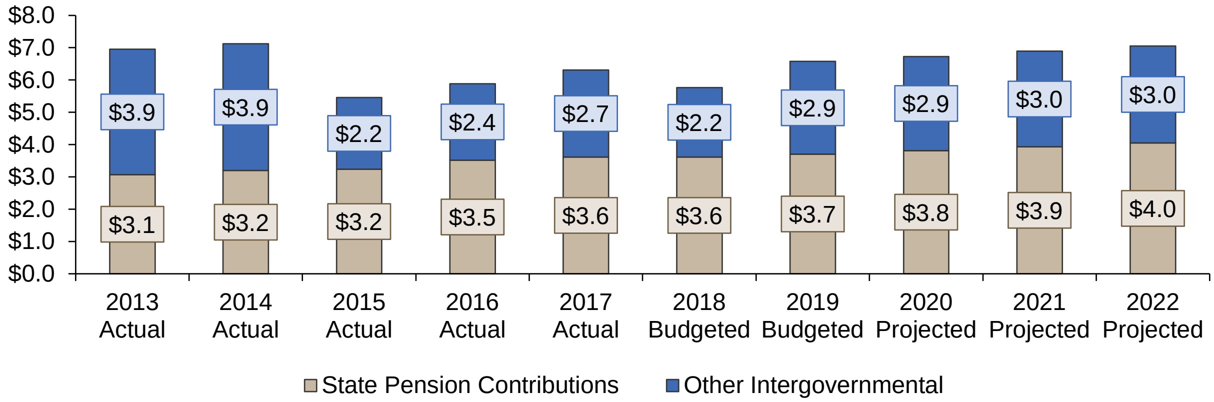
The largest item in this category is the **Commonwealth pension aid**, which is based on the City's employee headcount and the amount of revenue that the Commonwealth collects from taxes on out-of-state insurance policies. Assuming that the City's headcount remains constant, the baseline applies the 3.0 percent historical growth rate in the State Aid unit value[24] to the $3.7 million budgeted for 2019. The second largest

[24] This is the amount of State pension aid provided for each City employee with two units provided for each police officer or firefighter.

item is the **Reading Public Library** contribution from Berks County that helps offset the salary costs of the Library employees who work for the City. The amount recorded in the City's financial records fluctuates year to year, partly depending on when the City receives it. The compound annual growth rate from 2014 through 2017[25] was 3.0 percent, so the baseline applies that going forward. Other items in this category grow by inflation or are held flat depending on their funding source and historical trend.

The graph below shows the City's revenues from 2013 actual through 2022 projected. The large drop from 2014 to 2015 was due to the City moving $1.5 million related to the water system lease to the transfer category. The City also changed how it records reimbursements related to employee prescription drug coverage which created the fluctuation from 2017 through 2019.

Intergovernmental Revenue[26] ($ Millions)



Rentals and interest

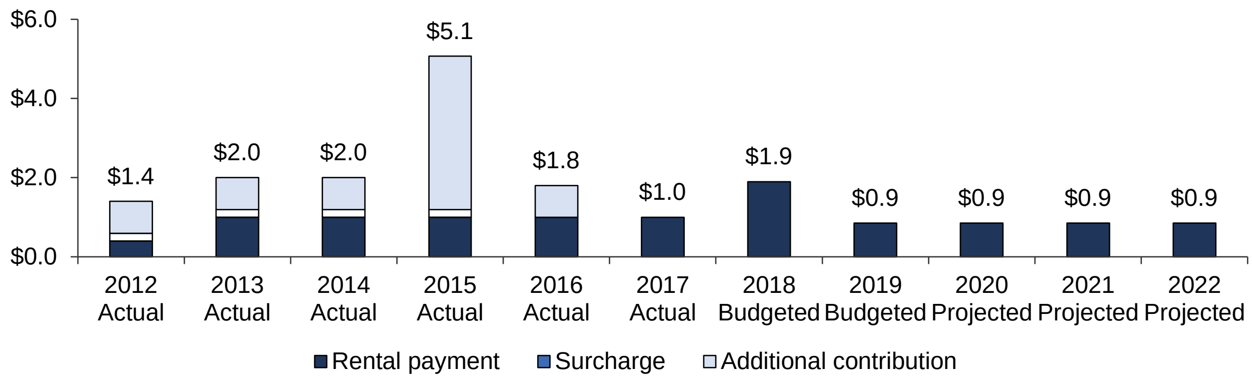
The 2019 budget has $1.5 million in revenue associated with this category, most of which comes from the **Reading Parking Authority (RPA)**. The RPA has historically paid the City an amount associated with the parking meters, and then made a supplemental payment to support City government's General Fund operations[27]. The RPA also previously transmitted $190,000 to the City for a parking-related surcharge. The total RPA contribution across these three items jumped from $2.2 million in 2014 to $5.3 million on a one-time basis in 2015, and then dropped back to $1.8 million in 2016.

The City budgeted $1.3 million for 2017 and the RPA paid $1.0 million. The City consolidated the three items into one line budgeted at $1.9 million in 2018. Midway through 2018, the RPA explained that it could not afford to make this level of contribution because of its own financial challenges. The 2018 preliminary year-end results show a $400,000 RPA rental payment versus the $1.9 million in the budget.

The RPA sent the City a letter during the 2019 budget process in which they agreed to make an $850,000 payment to the City in 2019. The RPA has not agreed to any contribution beyond 2019, though the baseline carries the $850,000 contribution amount through 2022. The General Provisions chapter has an initiative related to this issue[28].

[25] The 2013 contribution was unusually low so we use 2014 as a more standard starting point for the growth rate calculation.
[26] Other Intergovernmental Revenue totals shown for 2013 and 2014 include $1.5 million in RAWA lease payments, and are now recorded as Transfers from the Water Bureau. Revenues from this source are discussed further in the Transfers section of this chapter.
[27] The RPA has also collected some revenue, such as traffic fines, and remitted it to the City. In those cases, the RPA is not contributing money to the City but rather acting as a pass through.
[28] Please see initiative GP01.

RPA Related Revenues ($ Millions)



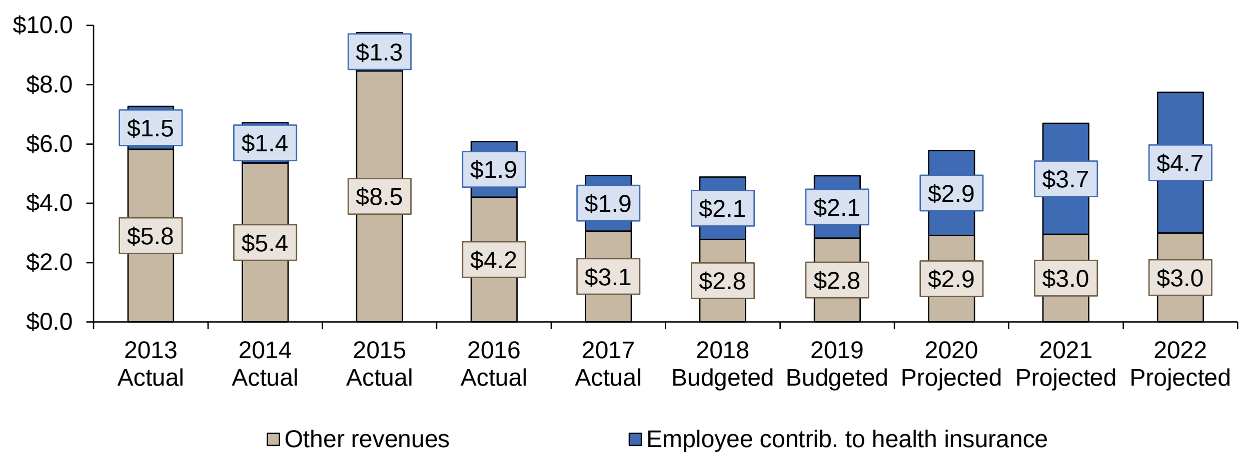
The other two significant items in this category are the rental payment for use of FirstEnergy Stadium and the interest earnings that the City gains from General Fund investments. The baseline projects $300,000 in stadium rental revenue, which has been the payment amount each year since 2013 and mostly offsets costs associated with the facility. The baseline carries the City's $250,000 interest earnings target forward, even though the preliminary 2018 results show the City falling $27,000 short of its $175,000 target last year.

Other revenues

This catch-all category includes all other items not counted in the previous categories. The largest item is the **employees' contributions to the premium costs of their health insurance**. The City budgets the full premium costs of employee health insurance on the expenditure side, and then records the employees' share as revenues. For reasons that we explain in the expenditure section, the baseline projection currently shows employee contributions increasing from $2.1 million in the 2019 budget to $4.7 million in 2022.

This category also includes the **indirect cost reimbursements** that the General Fund receives from other funds, primarily the sewer funds. This is a common mechanism that governments use to recover the cost of services provided to the City's separate enterprise operations (e.g. sewer, recycling). The baseline projects these indirect cost reimbursements to grow at inflation as a proxy for the cost recovery calculations that should be updated periodically through a cost recovery study.

Other Revenues ($ Millions)[29]



[29] Total 'Other revenues' in 2015 includes $4.1 million in additional parking authority revenues. As noted in the Rentals and interest section of this chapter, revenues from this source have decreased as a result of the Authority being unable to contribute at this level.

Transfers

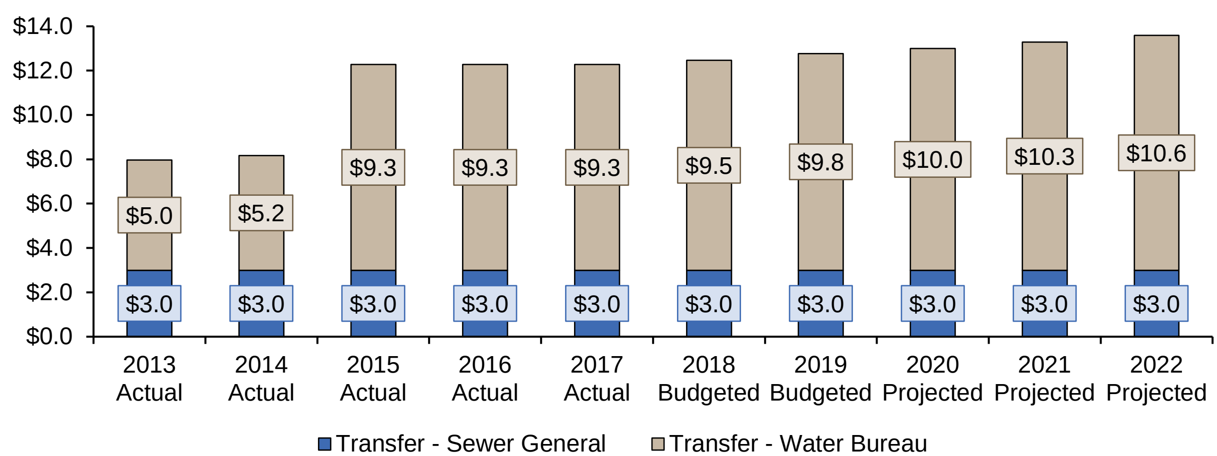
The City receives two large interfund transfers into the General Fund, which appear as revenues in the budget[30]. The **Reading Area Water Authority (RAWA**) leases and operates the water filtration and distribution system from City government, and pays the City an agreed-upon amount under the terms of its lease arrangement. The City then transfers a portion of the lease payment into the General Fund. The 2019 budget anticipates that the City will receive a lease payment of $9.6 million in addition to a $125,000 bonus lease payment as a result of the Authority's new contract with the Birdsboro Power Plant. The baseline projection grows the 2019 initial lease payment portion by 1.5 percent each year, as outlined in the City's lease agreement.

The lease requires the Authority to pay the City 25 percent of the net annual revenues generated when the Authority enters into a contract to "supply new commercial customers with water in an amount in excess of ten percent (10%) of the current permitted capacity.[31]" In 2018, RAWA reached an agreement to provide water to a new power plant in Birdsboro. RAWA anticipated $500,000 in revenue from this new customer in 2019, a quarter of which (or $125,000) will go to the City's General Fund. The City received $50,000 in the first quarter of 2019, which translates to $200,000 a year.

We have amended the baseline projection to show $200,000 in revenue from the Birdsboro Power Plant in 2020. The power plant is not fully functional yet but, once that occurs, its water usage will increase and so will the revenues for RAWA and the City. We have estimated that the City will receive $500,000 by 2022 and adjusted the Exit Plan's revenue projection accordingly. When combined, total revenues from the RAWA lease agreement are projected to reach $10.6 million by 2022.

Additionally, the City transfers $3.0 million per year from its **Sewer Fund** to the General Fund as required by a federal consent decree enacted in November 2005[32]. The baseline holds that transfer payment flat through 2022.

Total Transfers into the General Fund ($ Millions)

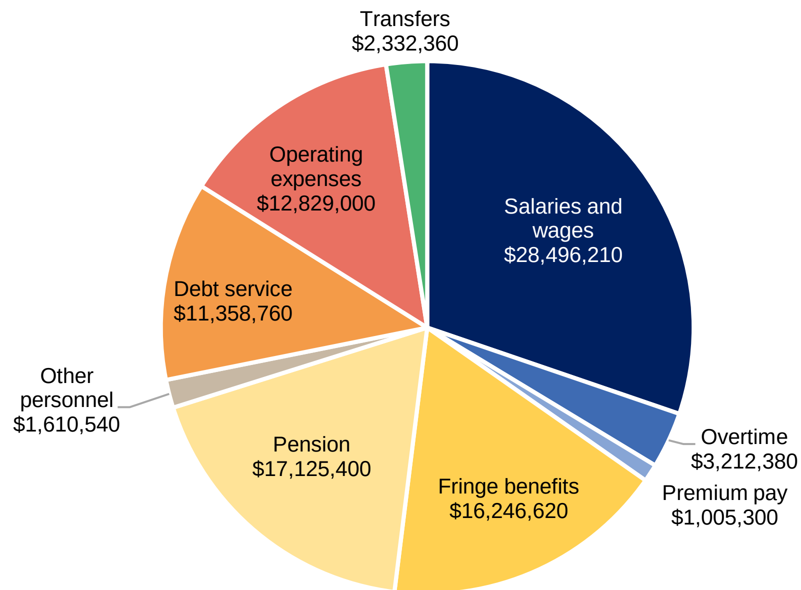


[30] Interfund transfers are not revenues from a traditional accounting perspective, but Pennsylvania local governments often record them as such in their budget and related documents.
[31] 2017 Amended Lease Agreement, section 6.03.
[32] Please see the General Provisions chapter for more information.

Major Expenditure Assumptions

Like other Pennsylvania cities, Reading spends most of its General Fund budget on its employees. Personnel expenditures – including employee salaries, overtime, other forms of cash compensation, health insurance and the City's pension plan contribution – account for more than 70 percent of the 2019 budget. Debt accounts for another 12.1 percent, which leaves less than 17 percent to cover everything else.

2019 General Fund[33]
Expenditure Budget ($94.2 Million)



	2019 Budget	2020 Projected	2021 Projected	2022 Projected	CAGR 4 Year
Salaries and wages	28,496,210	29,806,955	30,705,524	31,466,735	3.4%
Overtime	3,212,380	3,310,778	3,419,116	3,507,614	3.0%
Premium pay	1,005,300	1,020,177	1,048,666	1,069,630	2.1%
Fringe benefits	16,246,620	18,033,748	20,017,461	22,219,381	11.0%
Pension	17,125,400	17,401,800	16,150,800	15,812,600	-2.6%
Other personnel	1,610,540	1,575,285	1,604,720	1,631,635	0.4%
Debt service	11,358,760	10,686,313	11,209,922	11,209,157	-0.4%
Operating expenses	12,829,000	13,055,160	13,343,770	13,653,312	2.1%
Transfers	2,332,360	2,332,360	2,332,360	2,332,360	0.0%
Total Expenditures	**94,216,570**	**97,222,576**	**99,832,339**	**102,902,424**	**3.0%**

[33] This chart only shows the personnel related expenditures from the City's General Fund. The City has other employee compensation expenses in its enterprise funds.

Cash compensation

The City allocates 30.2 percent of its 2019 General Fund budget for employee salaries and wages, including those paid to temporary, part-time or seasonal workers. Total spending on employee salaries within the General Fund was flat from 2013 through 2017, rising by just $0.7 million (or 0.7 percent per year) across all employees. Employees received base wage increases over that period, though they were limited by the terms of the Recovery Plans. Employees who were eligible for tenure-based step increases[34] received them and individual employees received promotion-based raises, so wages for individual employees were not as flat as the overall trend. However, turnover-related savings and vacancies kept the City's total spending on employee salaries and wages below the budgeted level in recent years.

Salaries and Wages in the General Fund (All Departments, All Employees)

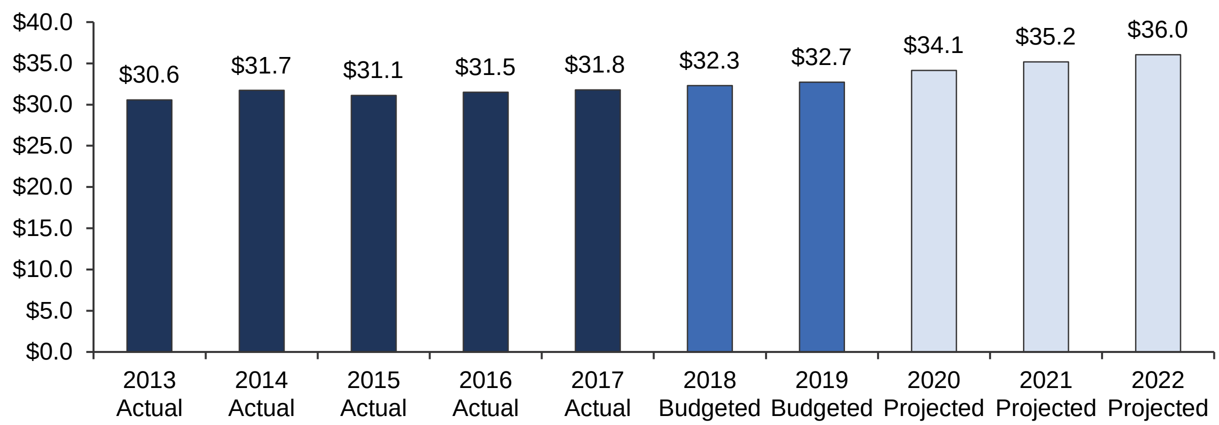
2015			2016			2017		
Actual	Budget	%	Actual	Budget	%	Actual	Budget	%
$27,164,187	$28,680,444	94.7%	$27,086,151	$28,473,699	95.1%	$27,256,695	$28,118,837	96.9%

While salary spending has been flat, the City increased its spending on **overtime** in the General Fund from $3.0 million in 2013 to $3.6 million in 2017, or 4.8 percent per year. Most overtime spending occurs in the Police Department ($1.9 million budgeted in 2019) and Fire Department ($1.2 million budgeted in 2019) because of the around-the-clock nature of those operations.

The City allocates $1.0 million for additional cash compensation related to employees working on holidays (holiday pay) or tenure-based longevity payments. Spending on holiday pay, which is indexed to base salaries, was flat from 2013 through 2017. Spending on longevity dropped because the Recovery Plans' cost control provisions freeze the payment amounts and eligibility for those payments, so turnover gradually reduces total expenditures.

The baseline projection assumes 2.0 percent wage increases for all employees in all years and assumes any employee eligible for a step increase receives it. Expenditures indexed to salaries, such as overtime and the City's share of payroll taxes[35], also increase by 2.0 percent. Items that are a flat dollar amount under the terms of the current collective bargaining agreements are projected to remain flat.

Cash Compensation ($ Millions)[36]



[34] This is primarily police officers and firefighters in the early part of the career.
[35] The City's share of payroll taxes and uniform allowance account for the majority of the expenditures grouped in Other Personnel in the table on the previous page.
[36] This includes salaries and wages, including those paid to temporary, part-time and seasonal employees; overtime; and premium pay.

Fringe benefits

This category is primarily the City's expenditures on employee medical and prescription drug insurance coverage, with smaller amounts recorded for employee dental, vision and life insurance coverage. As noted earlier, the City budgets the full premium costs of employee health insurance on the expenditure side, and then records the employees' premium contributions as revenues. The City is also self-insured, so it pays the cost of claims as employees receive medical care with some time lag associated with the medical billing and payment posting process. The City has a stop-loss insurance policy that covers an employee's medical treatment after the total costs for an injury or illness reach $225,000.

The City allocates $11.0 million for active employee fringe benefits in its General Fund and another $5.2 million for retired employees in 2019. From 2013 to 2017, spending on retiree health insurance grew faster than spending on active employee insurance (10.9 percent per year for retirees versus 4.9 percent for active employees). Across all employees, the City's total spending grew by 7.1 percent per year net of employee contributions.

General Fund Fringe Benefit Expenditures

	2013 Actuals	2014 Actuals	2015 Actuals	2016 Actuals	2017 Actuals	CAGR
Active employees	$6,584,351	N/A	$7,757,503	$8,038,466	$7,966,000	4.9%
Retired employees	$3,437,477	N/A	$4,588,965	$5,537,924	$5,192,328	10.9%
Gross expenditures	**$10,021,828**	**$11,630,373**	**$12,346,468**	**$13,576,390**	**$13,158,328**	**7.0%**
Employee contributions	($1,451,416)	($1,362,744)	($1,289,566)	($1,875,949)	($1,874,349)	6.6%
Net expenditures	**$8,570,412**	**$10,267,630**	**$11,056,902**	**$11,700,441**	**$11,283,979**	**7.1%**
Annual % change	N/A	19.8%	7.7%	5.8%	-3.6%	N/A

We consulted with the City's third-party health insurance administrator (TPA) to get their insight on how the City's health insurance expenditures may grow over the projection period. Based on national trends, the TPA suggested an 11 percent growth rate for future health insurance costs was reasonable, for both active and retired employees. The baseline caps the growth in the City's share of total premiums for active employees at 5 percent per year[37]. That means any cost growth over the 5 percent would shift to the employees and be recorded as additional employee contributions on the revenue side. Employees could also switch to lower cost health plans that are already available or agree to plan design changes that lower the costs. The impact of the premium increases on retirees, which are not subject to these caps, would vary according to their date of retirement, the plan they use, and their cost sharing agreement.

The baseline projection shows the City's net share of expenditures growing by 7.3 percent – more than the 5 percent cap because many retirees are not subject to the same cost sharing provisions as active employees.

[37] Please see initiative WF02.

General Fund Baseline Projection – Fringe Benefits

	2019 Budget	2020 Projected	2021 Projected	2022 Projected	CAGR
Active employees	$11,026,500	$12,239,415	$13,585,751	$15,080,183	11.0%
Retired employees	$5,220,120	$5,794,333	$6,431,710	$7,139,198	11.0%
Gross expenditures	**$16,246,620**	**$18,033,748**	**$20,017,461**	**$22,219,381**	**11.0%**
Employee contributions	($2,100,000)	($2,866,590)	($3,744,284)	($4,746,644)	31.2%
Net expenditures	**$14,146,620**	**$15,167,158**	**$16,273,176**	**$17,472,737**	**7.3%**
Annual % change	N/A	7.2%	7.3%	7.4%	--

There are some important contextual notes for this part of the projection:

- The City is self-insured so its actual expenditures could vary significantly from the projections, depending on the volume and cost of medical care that employees actually receive. As shown above, the City's expenditures on active employee health insurance grew by 4.9 percent from 2013 to 2017, which was less than half of the 11 percent projected. From 2015 to 2017, expenditures on active employees grew by only 1.3 percent per year. So, while the 11 percent projection is based on the best information available at this time – and it is close to the recent expenditure growth for retirees -- actual expenditure growth could be lower.

- In recent years, the City spent less than budgeted on health insurance for active employees and the gap between actual and budgeted expenditures grew. The City spent $1.5 million less than budgeted on active employee health insurance in 2016 and $2.1 million less in 2017. We calculated the cost of active employee health insurance for each position in the 2019 budget across all funds, based on the employee's level and type of coverage at the time and the TPA's premium equivalency rates. The aggregate cost in that analysis was $10.9 million, including dental and vision coverage, versus the $13.0 million in the budget. While it is reasonable for the City to budget conservatively for health insurance given its self-insured status, and position vacancies can reduce spending below budgeted levels, the City is budgeting more than it needs for active employee health insurance.

- For retiree health insurance, the City did the opposite in 2016 and 2017. The City spent $1.0 million (or 21.4 percent) more than budgeted for retiree health insurance in 2016 and $0.4 million more than budgeted in 2017. Estimating retiree health insurance costs is even more difficult than active employees because of the large variety of cost sharing arrangements depending on the employees' retirement date, plan selected and other factors.

The preliminary year-end results for 2018 show that the City again budgeted more than it needed for active employee fringe benefits. The actual-to-budget variance was $2.2 million, which was higher than in 2017 ($2.1 million) and 2016 ($1.5 million). Expenditures for retired employee fringe benefits were higher than budgeted in 2018, but by a smaller amount than in prior years.

General Fund Fringe Benefits Expenditures, Actual to Budget ($ Millions)

	2016			2017			2018		
	Actual	Budget	%	Actual	Budget	%	Est.	Budget	%
Active employee fringe benefits	$8.0	$9.6	84.1%	$8.0	$10.1	79.2%	$8.3	$10.5	78.7%
Retired employee fringe benefits	$5.5	$4.6	121.4%	$5.2	$4.8	108.8%	$5.1	$5.0	102.4%
Total employee fringe benefits	$13.6	$14.1	96.1%	$13.2	$14.8	88.7%	$13.4	$15.5	86.3%

The Coordinator reviewed these issues and adopted initiatives in the Workforce Chapter to improve the accuracy of the budgeting process as well as to adjust the cost sharing arrangements to reduce the growth in employee contributions while still allowing the City to retain the stability in year-to-year cost growth.

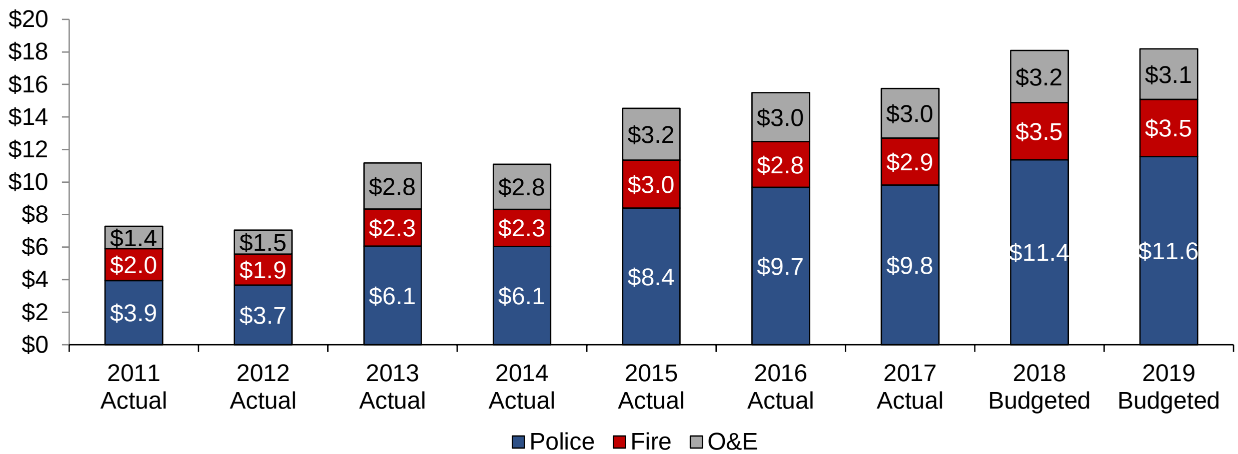
Pension

The City has three pension plans for its employees – one for police officers, one for firefighters and one for all non-uniformed employees. These are "defined benefit" pension plans, meaning the employee receives a pension benefit defined in their collective bargaining agreement or another document, regardless of the pension plan's funding level or investment performance. This stands in contrast to a defined contribution plan where the benefit an employee receives during retirement depends largely on the amount that the employee contributed to the plan (though there is often an employee matching contribution) and the investment performance of the plan over time. Defined benefit plans put the risk associated with poor investment performance or low funding levels on the employer (in this case City government) while defined contribution plans put this risk on the employees.

The City of Reading must make annual contributions to the pension plans called Minimum Municipal Obligations (MMOs) to ensure that the pension plans can pay for the full cost of prior and current employee's pension benefits. The MMOs are largely based on calculations made by an independent actuary. Every other year, the actuary produces an Actuarial Valuation Report (AVR) that describes the pension plans' benefit provisions, funding levels, liabilities and financial activity for the last two years. The AVRs also include several assumptions about factors that impact the City's MMOs including the level of expected earnings from pension plan investments; how the pension plan assets are valued; and assumptions regarding mortality, inflation, etc. These assumptions are generally reviewed every other year by the pension boards and then the actuary uses the boards' approved assumptions to produce the AVRs.

The City's General Fund covers the entire police and firefighter MMO and historically has covered about 60 percent of the non-uniformed employee MMO, with the rest covered by other funds (e.g. Sewer, Solid Waste, and Shade Tree). As has been described many times throughout the oversight process, the City's annual required contributions have increased at a faster rate than the other major forms of active employee compensation, especially for the police pension fund. The 2014 Amended Recovery Plan describes the police pension plan provisions that drive this rapid growth in more detail[38]. The graph below shows the contributions across all funds since 2011.

City Pension Contributions (All Funds, $ Millions)[39]

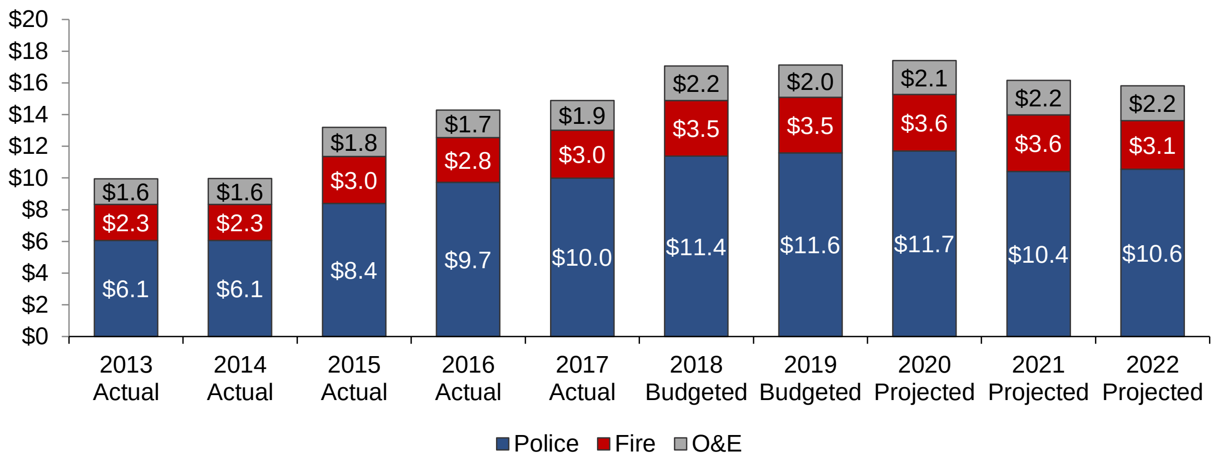


[38] Please see the Pension and OPEB chapter of the 2014 Plan, pages 58 – 64.
[39] The contribution amounts for 2011 through 2017 cover all funds. The budgeted amounts for 2018 and 2019 exclude small contributions that the City made from its Self-Insurance, Shade Tree and Community Development funds.

The most recent set of AVRs was released in March 2018 and covered the pension plans' performance through January 1, 2017. The City is moving towards creating an aggregated pension board that will work with the actuary on AVRs to cover the period through January 1, 2019. Those AVRs will in turn determine the City's pension MMOs beginning no later than 2021.

Until those reports are ready, we are using the MMO projections provided by the previous actuary using the assumptions in the 2017 AVRs. Those MMO projections show the City's contributions across all funds rising to $18.8 million in 2020 and then dropping to $17.6 million in 2021 and $17.3 million in 2022. The prior actuary explained that the anticipated drop was due to amortization bases expiring in the police and fire plans. The baseline projection incorporates these figures and assumes the General Fund will continue to cover 60 percent of the non-uniformed employee plan contribution.

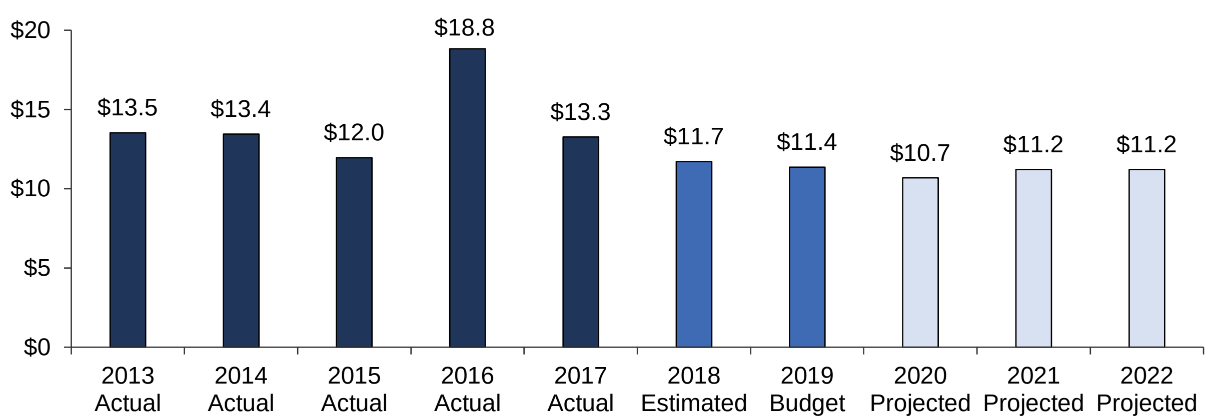
General Fund Pension MMO Projection ($ Millions)



Debt

The City allocates $11.4 million in its General Fund to repay principal and interest costs associated with its debt. Those debt service payments are currently scheduled to drop from $11.4 million in 2019 to $10.7 million in 2020, return to $11.2 million in 2021 and then stay at that level until 2029. This baseline projection incorporates the City's existing debt schedule and does not account for any new debt, though the City has discussed potentially issuing debt to help fund the fire station construction projects[40].

General Fund Debt Service Projection ($ Millions)



[40] Please see the Capital and Debt chapter for more information.

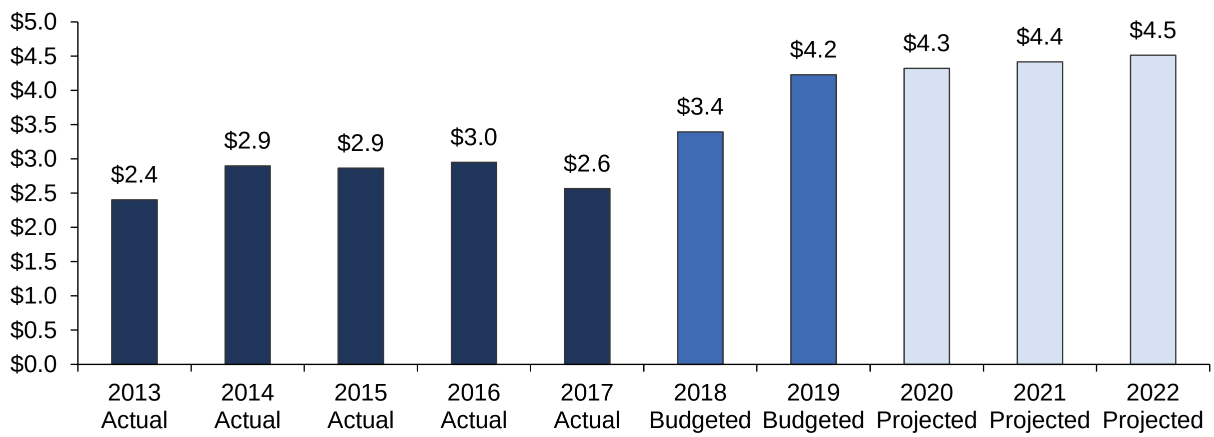
Operating expenditures

As noted at the beginning of the chapter, the City's expenditures for personnel and debt account for 84 percent of the 2019 General Fund budget, leaving less than 16 percent for everything else.

The City allocates $4.2 million for **contracts and consulting services** across all General Fund departments. The largest allocations in this category are in the Public Property section of Public Works ($600,000); the contribution to the Reading Recreation Commission ($500,000); and the Building/Trades section of Community Development ($400,000). While spending within individual lines fluctuates, the City's total spending on contracts and consulting services within the General Fund grew by 1.7 percent per year from 2013 to 2017.

The baseline grows these lines at an inflationary rate of 2.2 percent to account for gradual price growth, assuming the City continues the same level of activity as budgeted for 2019 through 2022. As described at the end of this chapter, the baseline projection also assumes the City will execute all the projects incorporated in its budget, though historically that has not been the case. For example, the City budgeted $247,000 for traffic engineering consulting services in 2017 and only spent $10,000. In 2018, the City budgeted the same amount and spent $44,000. Based on our discussions with management, the actual-to-budget variance is not because the City is budgeting more than it needs but it rather is struggling to execute the projects that are budgeted. Initiatives in the Financial Management and Capital chapters address these problems.

Contracts and Consulting Services ($ Millions)



The City allocates $2.4 million for **utility costs** paid from the General Fund with the largest amounts directed to street lighting ($900,000); light and power ($463,000) and telephones ($371,000). Historically, the City has used money from the Liquid Fuels Fund to cover most of its street lighting expenditures, with the smaller portion of these costs paid out of the General Fund. In 2014 and 2015, the City used money from the Liquid Fuels Fund for street paving, and covered most of its street lighting expenses with money from the General Fund. Aside from the increase in General Fund spending on street lighting expenditures in 2014 and 2015, the City held spending across all other utilities flat from 2013 through 2017. The baseline applies growth rates ranging from 2.5 percent to 3.6 percent, depending on the utility, based on average price projections from the U.S. Energy Information Administration's 2018 Annual Energy Outlook report.

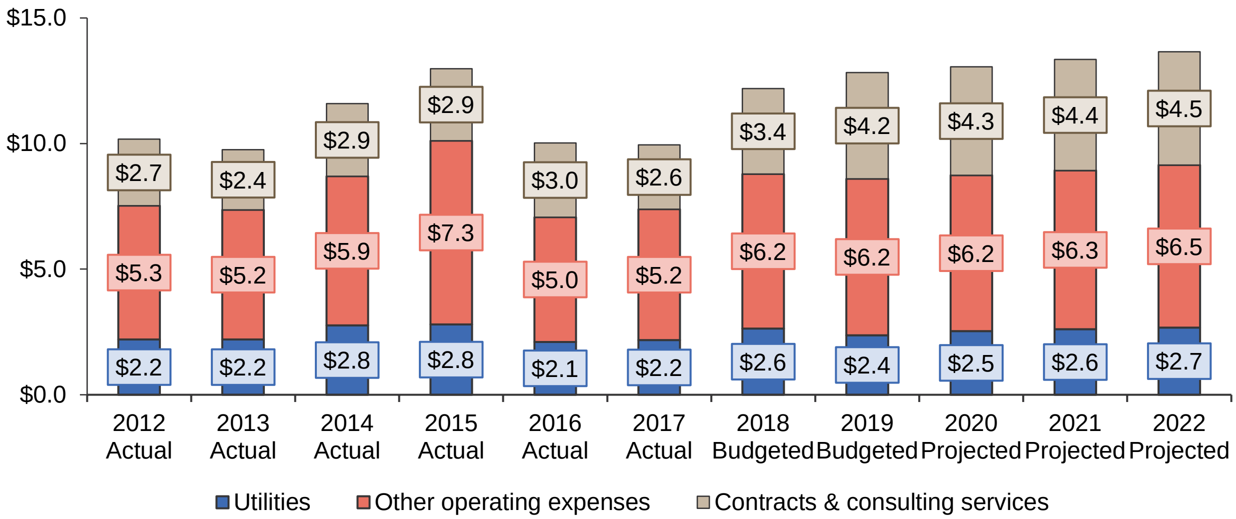
The City allocates $1.1 million for **maintenance and repairs to buildings, roads, vehicles and other equipment**. The largest allocations are in Public Works' divisions for Traffic Engineering ($276,000), the Vehicle Maintenance Garage ($260,000) and Highways ($175,000). The last item is a new allocation in the 2019 budget for maintaining roads and bridges. Given the City's minimal capital budget related to roads and bridges in prior years, we carry this allocation forward in the baseline projection. The City also allocates

$205,000 for building and equipment maintenance in the Fire Department. The City's expenditures grew by 1.0 percent from 2013 to 2017 across all lines in this category. The baseline uses a 2.2 percent inflationary growth rate show projected growth in these categories.

The City allocates $0.9 million apiece for **supplies** and **maintenance agreements**. Supply expenditures are scattered across the General Fund departments, while the maintenance agreement costs are primarily related to information technology. The baseline projection assumes that these expenditures will grow at the rate of inflation.

The City allocates $486,000 for **equipment** in 2019, including a grant-funded purchase in Fire that we removed from the baseline. The rest is projected to grow at an inflationary rate. The baseline also assumes that the **collection costs** the City pays to its third party tax collectors will grow at the same rate of its associated tax revenues since the collection cost is often tied to the amount collected.

Operating Expenses ($ Millions)[41]



<u>Transfer out of the General Fund</u>

The 2019 budget includes a $2.3 million **transfer to the Self-Insurance Fund** to cover the cost of general liability claims. The City has transferred at least that amount each year since 2013 so the baseline carries the transfer out of the General Fund through 2022.

Putting the baseline in context: Two key points

As noted at the beginning of the chapter, the baseline projection is a diagnostic exercise to identify the critical factors that drive financial performance; determine and quantify any structural deficit; and provide an important reference point for gap-closing initiatives. The narrative to this point describes the major individual revenues and expenditure categories that drive the City's financial performance. Pulling those items together will provide more insight into how the structural deficit is changing and the importance of key gap-closing initiatives.

Key Point #1: There is still a structural deficit, but it is smaller than when Reading entered oversight.

The Exit Plan's baseline projection shows a structural deficit in which recurring expenditures exceed recurring expenditures and the gap between the two grows over time. The baseline projection starts with

[41] Other operating expenses includes spending on equipment, maintenance and repairs, supplies, rentals, maintenance agreements, tax collection expenses, and other miscellaneous general operating expenditures.

the $2.3 million deficit in the 2019 budget and ends with a $3.5 million deficit in 2022. So the deficit grows over time because baseline expenditures grow more than baseline revenues (3.0 percent per year versus 2.6 percent a year).

While the baseline deficit needs to be addressed to exit Act 47 oversight, the baseline deficit in this Exit Plan starts smaller and grows less than it did in the original Recovery Plan adopted in 2010 and the Amended Recovery Plan adopted in 2014. The Exit Plan has a shorter projection period than the prior Act 47 Plans and it is reasonable to assume that the gap would continue to grow if the Exit Plan covered five years instead of three. But the structural deficit is smaller now than when the City entered oversight according to this diagnostic measure.

Baseline Deficit Projections ($ Millions)

2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Original Recovery Plan				Amended Recovery Plan					Exit Plan		
($14.3)	($16.6)	($19.0)	($21.4)	($3.1)	($8.8)	($11.3)	($13.1)	($14.8)	($2.9)	($2.9)	($3.5)

This is evidence that the City has made real progress since entering oversight. The measures included in the first two Act 47 Plans and the actions the City took on its own have improved the financial picture in the short-term, helping the City balance its budget and avoid annual deficits, and they also made the City's long-term financial situation more manageable.

Tax payers have made sacrifices and pay higher real estate taxes and EIT rates now than when Reading entered oversight, but the City has avoided tax increases since 2016, despite the requirement that it remove the Act 47-authorized commuter tax from the General Fund over that same period. City government has made sacrifices through wage freezes and going on a "debt diet" for capital projects. But City government has avoided layoffs to close its deficits – budgeted headcount in the General Fund is almost the same in 2019 (491 FTEs) as it was in 2011 (495 FTEs) – and the City is now in position to invest in infrastructure, which was needed but unmanageable when Reading entered oversight in 2010.

Reading's progress toward financial stability since entering oversight is real. Its ability to build on that progress over the long term depends on how it manages three long-term liabilities.

Key Point #2: Reading's ability to spend more on existing or new services will be constrained so long as it allocates a large share of its budget to debt and retired employee benefits

Three long-term liabilities account for 35.8 percent of the City's 2019 budget, and when combined, consumed close to 40 percent of actual expenditures in 2016 and 2017.

Long-Term Liabilities ($ Millions)[42]

	2015 Actuals	2016 Actuals	2017 Actuals	2018 Budgeted	2019 Budgeted	2020 Projected	2021 Projected	2022 Projected
Debt service	$12.0	$18.8	$13.3	$11.7	$11.4	$10.7	$11.2	$11.2
Retiree health insurance	$4.6	$5.5	$5.2	$5.0	$5.2	$5.8	$6.4	$7.1
City pension contributions	$13.2	$14.3	$14.9	$17.1	$17.1	$17.4	$16.2	$15.8
Long-term liability subtotal	**$29.7**	**$38.7**	**$33.3**	**$33.7**	**$33.7**	**$33.9**	**$33.8**	**$34.2**
% of Total	**34.9%**	**41.8%**	**38.4%**	**36.4%**	**35.8%**	**34.9%**	**33.8%**	**33.2%**

There is potential for some relief in each of these areas. The Capital and Debt chapter in this Plan describes one opportunity to refinance existing debt and another to pay debt off ahead of schedule. The City recently concluded an arbitration process through which it earned the ability to stop providing health insurance to retired police officers with access to similar health insurance coverage through their employment in Berks County government. The prior actuary projected the City's pension contributions could start to drop in 2021.

There is also potential that these costs will grow more than projected in the baseline. The baseline does not include the cost of any new debt, though practically that may be necessary to complete projects like the fire station construction. The projected growth in retiree health insurance costs looks aggressive, but the 11 percent compound annual growth rate suggested by the third-party administrator is close to the 10.9 percent compounded annual growth rate that the City experienced from 2013 through 2017. The City's experience in recent years with repeated, large increases in its MMO stands in stark contrast to the projected reduction in MMOs. The City has just begun the process that will determine whether and how much its employee pension contributions will change.

This Exit Plan has initiatives to reduce or limit the growth in spending on these long-term liabilities through 2022. But the limits that these liabilities place on the City's ability to invest in new or current services will continue beyond the City's time in financial oversight.

[42] The preliminary year-end figures for 2018 are close to the budgeted amounts shown above. The City spent $47,000 less than budgeted on employee pensions; $120,000 more than budgeted on retiree health insurance and $128,000 more than budgeted on debt.

Financial Management

The City of Reading's ability to exit Act 47 oversight and remain fiscally stable into the future depends on its ***financial performance*** (e.g. avoiding deficits, maintaining an appropriate level of reserves, funding a capital budget) and its ***financial management*** (e.g. budget execution and monitoring, revenue collection, adequate internal controls).

Inadequate financial management was a primary contributor to Reading entering Act 47 oversight in late 2009. In the original Recovery Plan we wrote, "The Finance Department has been at the center of the financial storm that has precipitated the City's entry into distressed status. It has had some of the same challenges as other departments related to changes in leadership, structure and technology and limited flexibility to add staff even where sorely needed, given the financial condition."[43] The original Plan highlighted the City's shortcomings in financial reporting, tax collection[44] and purchasing controls and, in recognition of this critical need, DCED provided a grant to fund the Controller[45] position over three years.

The Controller position is one of four within City government that are critical to financial management:

- The **Managing Director** is the "chief administrative officer of the City" according to the Home Rule Charter and has primary responsibility for preparing and submitting an annual budget and five-year financial plan to the Mayor for eventual introduction to City Council.
- The **Director of Administrative Services** reports to the Managing Director and, according to the Charter, is responsible for the "administration of the City of Reading personnel and finance departments and their functions as set forth in the Administrative Code." The Director oversees the units responsible for accounting, purchasing, human resources, information technology and the Citizens Service Center.
- The **Controller** position was created under the original Recovery Plan to "install professional accounting support" for the Director of Administrative Services. This position has evolved into a Deputy Finance Director position.
- The **Accounting Manager** oversees the six-person unit that handles accounting functions on a daily basis.

When the City adopted the original Recovery Plan in June 2010, it had only two of the four positions filled. The same person held the Managing Director and Director of Administrative Services positions after the Managing Director resigned during the Recovery Plan drafting process. The Accounting Manager position was filled, though that employee left City government soon after the original Recovery Plan was adopted. The Controller position was new and not yet filled.

During the term of the original Recovery Plan (2010 – 2014), the City hired its first Controller and filled the other vacancies. The City had an interim Director of Administrative Services at one point but, unlike more recent situations, the interim Director was someone separate from the Managing Director and Controller. The City had four people to do four jobs.

The City's Director of Administrative Services resigned in 2015 and that position had only been filled on an interim basis until the new Director started work on March 2019. Aside from a short stint, the interim Director was someone who already held one of the other three critical positions. Essentially the City used three or fewer people to do four jobs for years.

43 2010 Recovery Plan, page 96.
44 Most tax collection functions have since been moved to entities outside City government.
45 This is separate from the elected City Auditor position.

During 2018 we publicly and privately communicated the importance of filling the Director position on a permanent basis. We highlighted this as necessary to exit Act 47 oversight in public City Council meetings. We also emphasized it in regular private meetings with the Administration where we first discussed a target date of April 2018 to fill the vacancy, with the understanding that the new Director would need time to settle into the position and work with the other team members before the City could exit financial oversight.

The City changed Managing Directors in September 2018. As of June 2019, there was still a dispute between the Administration and Council as to whether the current position holder is serving in this capacity on a permanent or acting basis. The City hired a new Director of Administrative Services in mid-March 2019, allowing the Controller who had been filling that role in an acting capacity to return to his normal position. The City also shifted the Community Development Director into the Accounting Manager position, giving the City four people for four jobs for the first time in years. In June 2019 the person holding the Controller position announced his departure from City government, which will once again create a vacancy in this area.

Status of Four Key Financial Management Positions[46]

	2010	2011 15	2016 18	January 2019	April 2019	Goal
Managing Director	Yes	Yes	Yes	Yes	Yes	Yes
Director of Administrative Services		Yes		Acting	Yes	Yes
Controller (Deputy Finance Director)		Yes	Yes		Yes[47]	Yes
Accounting Manager	Yes	Yes	Yes		Yes	Yes

Having these positions is not just a matter of "checking a box" or adding names to an organizational chart. The City needs qualified candidates who can help rebuild the financial management capacity and there are tangible negative consequences for not doing so.

During the 2017 year-end auditing process, the external auditor found that the City had to make "material adjustments" in its sewer funds, including $4 million in construction costs not submitted to the Commonwealth for reimbursement until May 2018. The auditor notes, "This led to the City not being reimbursed timely for construction costs incurred." The City's response was, "Due to staffing shortages in the Administrative Services department, the oversight of the project accountant position was not maintained."

In March 2019 the Pennsylvania Department of the Auditor General released compliance audits for the City's three pension plans. The audits review the City's compliance with pension-related provisions in Pennsylvania law, collective bargaining agreements, administrative policies and local ordinances. The Auditor found that the City accidentally paid $47,000 less than its Minimum Municipal Obligation (MMO) to the officers and employees pension plan and $16,000 less than its MMO to the police pension plan. These amounts are small relative to the City's multi-million dollar total pension contribution, but the reason for the mistake was again staffing related: "Plan officials did not comply with the Act 205 requirements because there was a recent turnover of plan officials."

The City acutely felt the absence of the Director of Administrative Services during the 2019 budget process last fall. Because of that vacancy and the timing of the Managing Director transition, the City was not able to finalize its revenue projections for the 2019 budget until a few days before the budget was due for public

[46] Except for a short stint in 2016, the City used people already holding one of the other three positions as the Acting Directors of Administrative Services from 2016-18.
[47] The Controller announced he will leave City government during the summer of 2019.

presentation. That did not leave enough time for the newly appointed Acting Managing Director to review the departmental budget requests and make adjustments so that the Mayor could submit a balanced budget to Council. It also resulted in a proposed budget that did not comply with the Amended Recovery Plan as Act 47 requires.

The submitted budget had a $4.7 million deficit – more than twice the size of the $1.8 million baseline deficit we projected during an interim progress update in April 2018. We were able to work with the Administration and Council toward a Plan-compliant budget, but the City needs to be able to execute this process without Coordinator intervention. Then the City needs to take a more active role in the multi-year planning process in the Spring of 2020, while also resolving the findings in the external audit. The City also has problems related to the efficiency of its procurement process that it needs to resolve.

FM01. Stabilize department leadership

Target Outcome:	Improved financial management
Three-year Financial Impact:	See below
Responsible Party:	Managing Director, Director of Administrative Services

As described above, there are four senior positions within City government that are critical to financial management – the Managing Director, the Director of Administrative Services, the Controller (Deputy Finance Director) and the Accounting Manager. The person holding the Controller position announced he will leave his position over the summer, creating a critical vacancy that the City needs to fill. Since its establishment in 2011 the Controller has been the primary person responsible for financial reporting and coordinating the City's operating budget process.

The City shall fill this vacancy and maintain, fund and fill these four positions going forward. The City is posting the job opening for the Controller position and seeking applications. We recommend increasing the Controller position salary from $75,482 to $81,600 to restore it to the level before the staff transition in 2016. The impact of this recommended salary increase is included in the workforce allocation for non-represented employees.[48]

FM02. Annual operating budget process improvements

Target Outcome:	Improved financial management
Three-year Financial Impact:	N/A
Responsible Party:	Managing Director, Director of Administrative Services, Controller

Reading's Charter requires the Mayor to submit the proposed operating budget and capital program to City Council at least 90 days before the start of the next fiscal year. To comply with that deadline and ensure enough time for the Mayor and Managing Director to review the budget in its entirety and make adjustments before Council submission, the City should follow a budget preparation calendar like the following:

[48] Please see initiative WF10 in the Workforce and Collective Bargaining chapter.

April – May: Using the unaudited results from the prior fiscal year and the current year budget, the Director of Administrative Services[49] prepares a five-year projection of the City's revenues and expenditures in a baseline *status quo* scenario that assumes no changes in tax rates, service levels, headcount or other variables subject to the budget process. The baseline revenue projection is the first look at how much the City will have available to spend in the next year's budget.
June: The Mayor and Managing Director set strategic and operational priorities for the upcoming fiscal year. The Controller prepares budget instructions and worksheets for distribution to the department directors, including any direction on expenditure reduction or investment priorities from the Mayor and Managing Director.
July: Department directors prepare budgets using the instructions and worksheets provided by Administrative Services, including any enhancement requests for additional staff and new or expanded programs or reduction recommendations. The department directors should submit their budgets to the Managing Director, Director of Administrative Services and Controller by the end of the month. The Controller uses the mid-year financial results to adjust the revenue projections for the next fiscal year.
August: The Director of Administrative Services compiles a City-wide expenditure budget, including a separate listing of enhancement requests with their associated costs. The Controller provides an updated revenue projection. Administrative Services meets with the department directors regarding their budget requests and prepares an expenditure budget for the Managing Director's review at the end of the month. The Managing Director and Director of Administrative Services review the City-wide revenues and expenditures to quantify any deficit and identify potential gap closing measures, if needed.
September: The Director of Administrative Services convenes a Revenue Estimating Committee to discuss the projections for major revenues early in the month. The Committee should include at least one member of City Council and the City Auditor. The City uses this process to reach a consensus on the amount available to be spent in the next fiscal year, absent tax increases. The Director forwards the revenue projection and expenditure budget to the Mayor and Managing Director by mid-September for their review, adjustment and message preparation.

The City's most difficult budgets have been those where it has strayed from this process. The City needs to improve its timeliness in completing the steps leading up to budget adoption and improve the accuracy of its departmental budget submissions, particularly with regard to the salary and health insurance allocations.

The City shall reinstitute the Revenue Estimating Committee process and use it going forward. Working with the Coordinator, the City shall also improve the accuracy of its salary and health insurance budgeting processes.

The City shall also adopt a policy that sets the budget calendar for each year so that the roles and timing of the process are clear. The policy adoption does not need to occur by Council ordinance or resolution, but this will facilitate meaningful conversations between the Administration and Council about the budget process before the October 1st submission.

FM03. Enhance multi-year financial planning

Target Outcome:	Improved financial management
Three-year Financial Impact:	N/A
Responsible Party:	Managing Director, Director of Administrative Services

[49] During Act 47 oversight the Recovery Coordinator has led the multi-year projection process for reasons discussed in the next initiative.

Multi-year (or long-term) financial planning is a best practice recognized by the Government Finance Officers Association (GFOA). The GFOA explains[50]:

> *Long-term financial planning combines financial forecasting with strategizing. It is a highly collaborative process that considers future scenarios and helps governments navigate challenges. Long-term financial planning works best as part of an overall strategic plan…*
>
> ***Financial planning uses forecasts to provide insight into future financial capacity so that strategies can be developed to achieve long-term sustainability in light of the government's service objectives and financial challenges*** *(emphasis added).*

GFOA describes a sophisticated multi-year planning process, but a simpler version will help Reading's elected and appointed officials anticipate financial challenges, identify options to address those challenges and quantify the financial impact, take action to improve the financial trajectory, and then measure the impact and adjust accordingly.

The City's Charter requires the Managing Director to "prepare and submit to the Mayor on an annual basis a five-year financial plan." The Coordinator has prepared multi-year financial projections and discussed those publicly with the Administration, City Council and others since Reading entered oversight. The original and Amended Recovery Plan each had five-year projections and this Plan has a three-year projection.

Some communities prepare a multi-year financial projection in conjunction with their annual budget, which helps put the decisions made during the budgetary process within a multi-year context. Other governments do the majority of their multi-year financial planning work early in the fiscal year, separate from the budget process. That allows the Finance Department to use the recently adopted current year budget as the starting point for the projection, review the prior year's unaudited results and then calculate the growth rate projections separate from the pressures associated with the annual budget process. It also provides helpful context to department directors at the start of the budgeting process.

PFM as Recovery Coordinator has generally led the City's multi-year projection process and will continue to do so while the City is in Act 47 oversight. The Recovery and Exit Plans are the primary vehicles for multi-year financial planning while Reading is in Act 47 oversight and only the Coordinator can initiate an amendment to those documents. Having different versions of multi-year financial projections released by different parties throughout the year would create unnecessary confusion.

The Department of Administrative Services shall participate more in developing the multi-year projection and the Managing Director shall take the lead in presenting options for closing any deficit or achieving other financial goals. This will facilitate the transition from a Recovery Coordinator led process to a City-led process once the City exits Act 47 oversight.

[50] GFOA best practice available online at https://www.gfoa.org/long-term-financial-planning-0.

FM04. Resolve high-priority audit findings

Target Outcome: Improved financial management

Three-year Financial Impact: N/A

Responsible Party: Director of Administrative Services, Controller, Auditor

Each year the City's financial records are audited by an external accounting firm and then released as the Comprehensive Annual Financial Report (CAFR). During that process, the external auditors identify the weaknesses and deficiencies in the City's financial reporting and related processes, which are known as "findings." As the auditor explains, "A material weakness is a deficiency, or combination of deficiencies, in internal control such that there is reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis." Less serious findings are called "significant deficiencies."

	Significant Deficiency	Material Weakness	Total Findings
2010	2	14	16
2011	1	12	13
2012	1	12	13
2013	1	11	12
2014	2	6	8
2015	5	5	10
2016	5	3	8
2017	3	4	7

The City has reduced the number of findings and material weaknesses since entering Act 47. The 2017 audit had seven findings with four material weaknesses compared to 16 findings with 14 material weaknesses in 2010. Three of the four material weaknesses in the 2017 audit have been recurring findings.

- **Year-end material adjustments:** The auditor found that the City still needed to make "significant adjustments" to its 2017 year-end financial statements during the audit process to bring accounts within the sewer fund into compliance with generally accepted accounting principles.
- **Pension reporting:** The City submits a form to the Commonwealth of Pennsylvania each year reporting annual wages related to the employee pension plans. The 2017 form had multiple errors, including some related to the City withholding too much or too little from an employee's paycheck.
- **Grant management:** The City is required to prepare a Schedule of Expenditures of Federal Awards (SEFA) and has struggled to file a complete, accurate schedule for years. The 2017 audit found, "No schedule was maintained noting the federal awards received, expenditures incurred, receivables due at year end."[51]

The City was able to clear one of the high-priority findings noted in the 2014 Amended Recovery Plan. As the external auditor noted in the 2013 CAFR, "The City [had] been unable to reconcile the main operating accounting through which most receipts and disbursements flow." The City caught up on its past-due General Disbursement Account (GDA) reconciliations and the finding was removed in 2016.

The original Recovery Plan required the City to improve its responses to the audit findings by establishing an Audit Committee convened by the City Auditor with representatives from the Department of Administrative Services and City Council to discuss the audit findings and the City's corrective action plan. The Committee has not been convened in a while, perhaps partly because of the transition in the Auditor position, but its meetings should be restarted. The Auditor shall reinstitute these meetings to improve accountability and communication around the City's staffing needs and progress to resolve the remaining "material weakness" findings.

One of the new findings in the 2017 audit noted the City's tardiness in filing a form that the Commonwealth requires before it releases the liquid fuels allocation that funds road paving, salting and other activities.

[51] 2017 CAFR, page 132.

Filing the Commonwealth-mandated reports in full and on time is one of the simplest ways to demonstrate improved financial management.

The Recovery Coordinator has been monitoring the City's progress on meeting these deadlines and reconciling its bank accounts during the year and the external auditor reviews the City's work after the year is over. As the City prepares to exit oversight, the City's elected Auditor shall take over these monitoring responsibilities. Please note that the Auditor's duty is to *track the City's compliance* with the deadlines, <u>not</u> to complete or file the forms except where that is already the case.

FM05. Improve procurement process to ensure compliance with City policies and timely project execution

Target Outcome:	Improved financial management; cost avoidance
Three-year Financial Impact:	See below
Responsible Party:	Director of Administrative Services, City Council

The basic elements of government procurement are:

- Project scoping/work definition
- Writing a request for proposal (RFP), request for qualifications (RFQ) or related documents
- Soliciting bids
- Selecting a vendor
- Contracting with the selected vendor
- Executing the contract, including City Council approval where needed

The steps required depend on the type of good or service being purchased, the dollar value of that purchase and other factors. Not all purchases require all of the steps noted above.

The Department of Administrative Services oversees City government's procurement function, which is staffed by a Purchasing Coordinator and a Purchasing Assistant. In reality, multiple parts of City government participate in procurement from the department staff scoping the project to the Mayor's Expenditure Review Committee reviewing vendor bids to the Law Department contracting with the vendor to City Council approving the contracts.

While writing the Exit Plan, the Coordinator heard concerns from several managers that the City struggles to execute this process in a timely manner. Some frustrations cited difficulties writing RFPs or bid specifications that clearly explain the good or service that is needed. If the RFP is not written well, then there is confusion during the proposal review and vendor selection process that results in lost time and higher costs.

In some cases, the City struggles to execute contracts and approve them. For example, the City needs to approve a contract with an actuary as part of the pension board aggregation process. The aggregation process began in 2017 and the City's contract with the last actuary expired at the end of 2018, but there was still not a contract in place as of June 2019. The absence of an actuary means we could not get an updated projection of the City's required pension contributions for this Exit Plan. It also means that the process for producing the next set of actuarial valuation reports is delayed. Those documents are an important component of determining the City's future Minimum Municipal Obligation to the employee pension plans.

In other cases, problems related to procurement surface after the work is already done. Administrative Services noted a couple of invoices that are being held for payment because of questions about how the vendor was initially selected.

Department staff expressed concerns about the difficulty they have finding vendors for certain goods and services because the procurement and associated payment process is so slow. In these cases, the City is vulnerable to paying higher prices as a smaller number of willing vendors mark up their price to offset the risk of late payment.

The concerns expressed by City managers follow our own finding that the City spent far less than budgeted for contracting and consulting services in Public Works the last two years. In 2017 the City allocated $1.1 million for services related to Public Works Administration, Highways (road maintenance), Public Property (facility maintenance) and Traffic Engineering, but only spent $441,000. The City allocated $1.1 million again in 2018, but only spent $565,000. The allocations themselves are not unusually large – the City committed $899,000 to the same four lines in 2016 – and the money is available in the budget. But City government is struggling to execute the work.

When properly executed, the procurement process promotes fairness, accountability and transparency and provides a safeguard against corruption. Where that is not the case, procurement adds unnecessary time, expense and difficulty to daily operations. The process that is intended to increase competition, lower prices and provide more vendor access to City business does the opposite.

The new Director of Administrative Services is aware of these problems and working on potential solutions such as enhanced training for departmental staff involved in procurement. The Coordinator shall support the Director in this effort with the goal of identifying the most common problems that stall project initiation, contract approval and (in cases where relevant) vendor payment and recommending solutions to them.

FM06. Reinstate the confidential secretary position supporting the Director of Administrative Services

Target Outcome:	Improved financial management
Three-year Financial Impact:	($228,000)
Responsible Party:	Director of Administrative Services

The City previously had a confidential secretary assigned to support the Director of Administrative Services with responsibilities such as scheduling and clerical work. There are similar positions assigned to support the Police Chief, the Public Works Director and the Solicitor[52].

After the Director of Administrative Services position became vacant, the confidential secretary retired and the City eliminated the position starting in 2017. Now that the Director post is filled again, the City should bring back the confidential secretary so that the Director can focus on the many duties assigned to that position. It is not efficient or cost effective for the Director to handle administrative tasks that are assigned to secretarial positions in other departments.

The Exit Plan allocates $73,000 for this position in 2020 based on the average salary of employees in similar positions and the City's maximum contribution to the cost of family health insurance. The allocation grows in line with the recommended wage pattern described in initiative WF10 in the Workforce chapter. The cost of this position is incorporated in the Exit Plan's maximum compensation allocation for non-represented employees.

Estimated Financial Impact

2020	2021	2022
($73,000)	($76,000)	($79,000)

[52] The Fire Chief also has an Administrative Secretary, though the position is part of the AFSCME 2763 bargaining unit. The Exit Plan has a separate initiative re-establishing the secretarial position in support of the Community Development Director which was eliminated in prior years.

FM07. Improved management of revenue collection for non-tax revenues

Target Outcome:	Improved financial management; revenue diversity; financial stability
Three-year Financial Impact:	See below
Responsible Party:	Administrative Services

As described in the Baseline Projection chapter, receipts from some of the City's largest sources of non-tax revenues have been flat or dropped in recent years. Noteworthy examples include:

- Revenue from **Emergency Medical Service transport fees (or User Fees**) has hovered around $2.9 million with little variation since 2013. While the volume of calls for service has increased and the Reading Fire Department reports a growing amount of time spent responding to them, revenues have not changed. A large percentage of people in Reading using this service do not have private insurance and so their payments are capped at the federal government's reimbursement rates. But limits on the payments per call do not explain why total revenues are flat if the number of calls is increasing.

- Revenue from the City's **permitting and inspection of rental housing** has dropped from $1.72 million in 2013 to $1.62 million in 2017. Falling rental inspection revenue has offset rising rental permit revenue over that period.

- Revenue from **fines** has dropped across several categories. From 2013 to 2017 traffic fine revenue dropped by $136,000 (32.6 percent), quality-of-life fine revenue dropped by $160,000 (48.5 percent) and district court summary offense revenue dropped by $507,000 (56.7 percent).

The revenue trends alone are not proof that the City is mismanaging its non-tax revenues. In some cases the City has made a deliberate decision to change how it manages a program, and the associated revenue dropped as a result. The large drop in District Court summary offense revenue is partly because the City decriminalized parking fines. So that revenue flows to the Reading Parking Authority instead of the City through the court system. Similarly the Property Maintenance Division now issues warnings to property owners in the first instance of some quality-of-life violations, rather than immediately issuing tickets. Fine revenue are intended to deter negative behavior, so the ultimate goal should not be increasing revenue.

But flat and negative trends across a wide range of non-tax revenues raises the question whether the City is doing all it can to collect the amounts billed, some of which are intended to offset the cost of delivering the associated service. If the City is not doing so, then the benefit that one person receives from less stringent revenue collection translates to a cost for all other tax payers.

The key questions that City leaders should ask regarding non-tax revenues are:

- What is the ideal trend for the major sources of revenue? Should revenue rise because the associated activity is positive, like construction permits? Should it fall because the revenue is a deterrent for negative activity?

- What is the actual trend for these revenues?

- What is causing the revenue trend? Is it the result of deliberate policy decisions? What are the factors that drive revenues that City government can influence?

- Is this particular revenue intended to cover the cost of service? If the cost recovery ratio is falling, should the fee be adjusted or the associated expense be reduced?

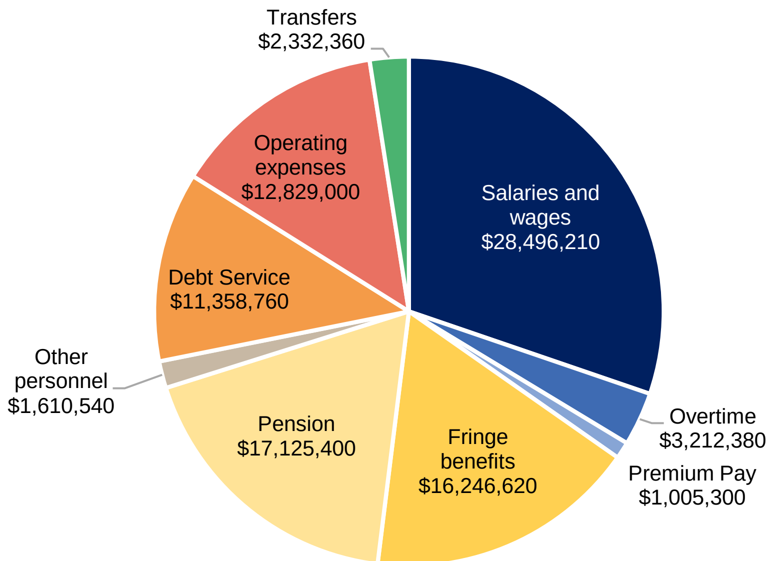
- What is the collection performance for this revenue? Has the amount billed dropped or just the collection rate? What is the plan for pursuing delinquent accounts?

The City recently created a Revenue Manager position as a resource for this kind of analysis and to drive policy discussions and changes. The City currently uses the Revenue Manager to bolster its core accounting capacity and perform critical functions like General Disbursement Account reconciliation. She monitors whether the City is receiving tax revenues from its external collectors, which is critical given their size. Recently she has spent time on special projects, such as analysis of potential payment-lieu-of-taxes from tax-exempt organizations. These may be worthy ventures, but we recommend that the City focus on collecting more of the revenue that it is already due. The remaining time that the Revenue Manager has for these issues should be used to monitor non-tax revenue billing and collection performance and making recommendations to increase revenues where that is desirable and achievable.

Workforce and Collective Bargaining

People who live in, work in and visit Reading depend on the City workforce to maintain safe and clean streets, prevent and investigate crime, respond to fire and medical emergencies, and deliver the other important services of municipal government. Because workforce costs comprise such a large proportion of the City's General Fund, they also play a critical role in City government's financial stability. Like other Pennsylvania cities, Reading spends most of its General Fund budget on its employees. Personnel expenditures – including employee salaries, overtime, other forms of cash compensation, health insurance and the City's pension plan contribution – account for at least $67.7 million or over 70 percent of the City's $94.2 million General Fund expenditures budgeted for 2019. If the $3.6 million in pension bond debt service expenses were shown separate from other debt, the share of City expenditures committed to employee compensation would be even higher.

2019 General Fund[53]
Expenditure Budget ($94.2 Million)



The following table shows the total number of full-time budgeted positions for each fund as recorded in the position ordinance adopted by City Council during the annual budget process. The City has part-time positions which are not shown. Since these are budgeted and not filled positions, the actual number of employees has varied over this period. Also some non-uniformed employees have positions that are listed in one fund, but their compensation is paid by another fund (e.g., an accountant who works on sewer operations is listed in the General Fund but paid from the Sewer Fund).

[53] This chart only shows the personnel related expenditures from the City's General Fund. The City has other employee compensation expenses in its enterprise funds.

Full-Time Budgeted Positions, 2015-2019

Fund	2015	2016[54]	2017	2018[55]	2019
General Fund[56]	502	493	491	489	491
Wastewater Fund	44	44	44	44	44
Sewer Fund	19	19	19	19	19
Recycling & Trash Fund	18	17	17	8	8
Self-Insurance Fund	1	1	1	1	1
Total	**584**	**574**	**572**	**561**	**563**

The total number of full-time budgeted positions has remained relatively stable since the City made reductions under the original Recovery Plan and transferred employees from its Water Fund to the Reading Area Water Authority (RAWA) in 2011. The City had 495 budgeted full-time positions in the General Fund and 565 across all funds except for Water in 2011. It has 491 positions in the General Fund and 563 positions across all funds in 2019. The City reduced the number of positions in the Recycling and Trash Fund when it contracted out recycling collection in 2017.

Most of the City's workforce is represented by one of four public employee labor unions. The Fraternal Order of Police, Lodge No. 9 (FOP); International Association of Fire Fighters, Local 1803 (IAFF); and the American Federation of State, County and Municipal Employees (AFSCME), Local 2763 have the right to collectively bargain with the City subject to the limitations imposed by Act 47. The City must meet and discuss compensation with a fourth union representing first level supervisors (AFSCME, Local 3799), but is not required to collectively bargain with it. The chart below details the number of budgeted positions in 2019 and the respective bargaining unit's contract term, all of which expire at the end of 2019.

City Headcount by Bargaining Unit chart

Employee Group	Covered Positions	2019 Total Employees Budgeted	Contract Term
Fraternal Order of Police (FOP), Lodge 9	All sworn Police Officers with the exception of the Chief and Deputy Chief	167	1/1/2017-12/312019
International Association of Fire Fighters (IAFF), Local 1803	All Fire Fighters with the exception of the Fire Chief, First Deputy Chiefs, and the Deputy Chief/EMS	130	1/1/2016-12/31/2019
American Federation of State, County, and Municipal Employees (AFSCME), Local 2763	All full-time professional and nonprofessional employees, excluding confidential employees, seasonal employees, casual employees, supervisors and management level employees	170	1/1/2017-12/31/2019
American Federation of State, County, and Municipal Employees (AFSCME), Local 3799	All full-time first level supervisory employees	22	1/1/2015-12/31/2019
Non-Represented Employees[57]	Management, professional, and elected	74	N/A
Total		**563**	

[54] The 2016 position count comes from the amended ordinance adopted in early 2016.
[55] The City outsourced recyclable collection work during 2017.
[56] Includes employees in the Shade Tree Fund and employees in Community Development that are funded by US Department of Housing and Urban Development (HUD).
[57] Excludes part-time employees.

Compensation and Benefits

The following table presents the City's General Fund personnel expenditures for 2013 through 2019. The table does not include pension bond debt service or expenditures for employees compensated outside the General Fund. Most expenditures in the Fringe Benefits category are for employee and retiree medical and prescription drug insurance, though the line also includes expenditures for dental, vision and life insurance. The premium pay category covers longevity and holiday pay.

Personnel Expenditures in the General Fund

	2013 Actuals	2014 Actuals	2015 Actuals	2016 Actuals	2017 Actuals	CAGR[58] (2013 2017)
Salaries and wages	26,553,101	27,739,023	27,164,187	27,086,151	27,256,695	0.7%
Overtime	2,995,212	2,939,400	2,987,714	3,486,354	3,608,908	4.8%
Premium Pay	1,031,834	1,032,638	963,991	936,433	913,422	-3.0%
Fringe benefits	10,021,828	11,630,373	12,346,468	13,576,390	13,158,328	7.0%
Pension	9,947,536	9,973,075	13,189,129	14,285,523	14,879,246	10.6%
Social Security	909,153	962,747	948,098	939,275	936,851	0.8%
Uniforms/Clothing allowance[59]	259,607	240,112	214,015	255,206	403,079	11.6%
Unemployment	37,837	55,151	75,409	116,761	81,853	21.3%
Penny Fund	4,117	7,104	(77,620)	0	0	-100.0%
Total Expenditures	**51,760,225**	**54,579,623**	**57,811,391**	**60,682,093**	**61,238,382**	**4.3%**

Total spending on employee salaries within the General Fund was flat from 2013 through 2017, rising by just $0.7 million (or 0.7 percent per year) across all employees. Employees received base wage increases over that period, though they were limited by the terms of the Recovery Plans. Employees who were eligible for tenure-based step increases[60] received them and individual employees received promotion-based raises, so wages for individual employees were not as flat as the overall trend. But turnover-related savings and vacancies kept total growth across all employees below 1.0 percent per year. Overtime expenditures grew more (4.8 percent) but total spending across all major forms of cash compensation was still 1.0 percent.

The City's total compensation costs rose by 4.3 percent per year over this period because of two factors – higher pension contributions and rising health insurance costs, especially for retired employees. Pension costs increased by almost 50 percent from 2013 to 2017 and then grew another $2.2 million in 2018. The City's fringe benefit costs (active and retired employees) increased by 31.3 percent on a gross level.

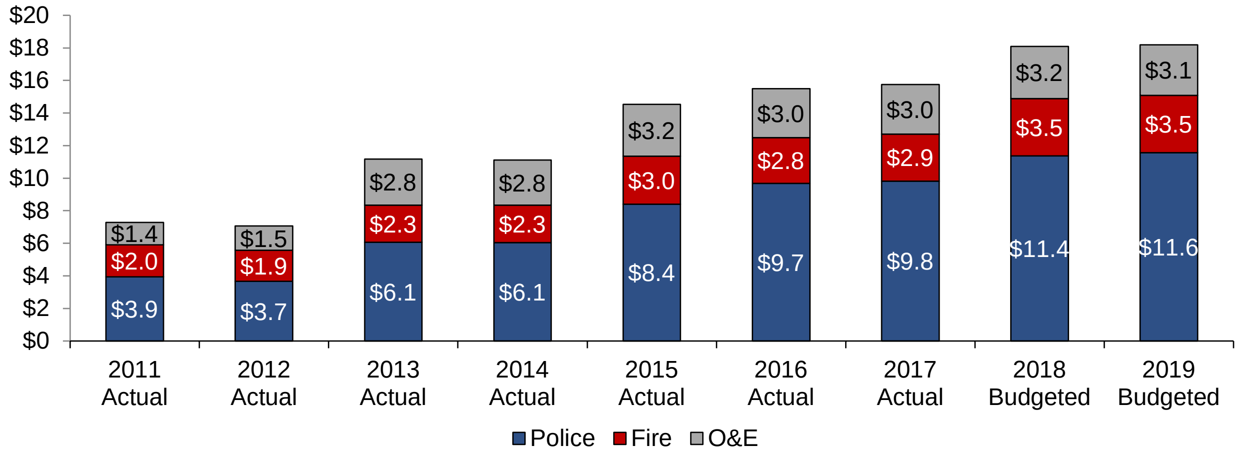
Under the provisions of the 2010 Recovery Plan and the 2014 Amended Recovery Plan, the City's budgeted contribution toward the cost of active employee health insurance could increase by no more than five percent per year[61]. But that cap does not apply to many retired employees who left City employment before the Recovery Plan provisions took effect. Those costs will continue to grow, and the City will continue to shoulder most of the increase, absent any corrective action.

[58] Compound annual growth rate.
[59] This includes the City's spending to replace firefighter turnout gear starting in 2017, which is recorded as part of uniform related expenditures.
[60] This is primarily police officers and firefighters in the early part of the career.
[61] Please see initiative WF24 in the 2010 Recovery Plan, pages 66 – 68, and initiative WF03 in the 2014 Plan Amendment, pages 44 – 46.

Pension

City government's contributions to the three employee pension plans have more than doubled across all funds from $7.3 million in 2011 to $18.2 million in 2019.

City Pension Contributions (All Funds, $ Millions)[62]



As we have noted in prior recovery plans, the 2007 agreement between the City and Fraternal Order of Police, Lodge No. 9 significantly increased pension benefits in excess of what the Third Class City Code permits and contributed greatly to these cost increases[63]. In the State Auditor General's 2010 audit of the City's police pension fund for the period from January 1, 2007 through December 31, 2008, he identified the following police pension benefit provisions unauthorized by the Third Class City Code:

- Pension calculation allows the police retiree to retire with between 60 percent and 70 percent of final average salary instead of up to 50 percent of the higher of the rate of monthly pay at the date of termination or the highest average annual salary during any five years of service.

- Member contribution rate of 6.5 percent of base salary plus $1 per month instead of up to 5 percent of the officer's compensation, plus service increment contributions.

- Ability of employee to buy up to five years of service credit (commonly referred to as "ghost time" since the employee did not actually work during this period) at a rate based upon his or her first year of hire any time prior to retirement.

Under the terms of the original Recovery Plan, police officers hired after 2011 do not have access to these benefits.

Recommendation

Every two years the City's pension plans are required to produce actuarial valuation reports that estimate the City's required contribution or Minimum Municipal Obligation (MMO). In 2017, the Police and Fire Pension Plans adopted assumption changes recommended by the actuary to lower the risk of underfunding. These changes were already adopted by the Officers and Employees Pension Plan (O & E).

The actuary also recommended a change in how pension plan assets are valued. The plans' valuation reports state that the current method "gives results that are biased relative to the market value of assets.

[62] The contribution amounts for 2011 through 2017 cover all funds. The budgeted amounts for 2018 and 2019 exclude small contributions that the City made from its Self-Insurance, Shade Tree and Community Development funds.
[63] This agreement was negotiated by a prior City manager under a prior mayoral administration and prior to the City entering Act 47.

In addition, the current method is projected to take a significantly long period to converge to the market value of assets. Due to this bias and the extended period of deferral of investment losses, the method does not comply with Actuarial Standards of Practice; however, by the passage of Act 44 of 2009, this method is allowable under Act 205."[64] The recommended change in asset valuation was not adopted by either public safety pension plan.

The Coordinator agrees with the actuary and recommends that the Police and Fire Pension Plans adopt an asset smoothing approach that recognizes investment gains or losses over a four to five-year period and complies with actuarial standards of practice. The Coordinator also recognizes that this would likely result in an increase in the City's pension contributions. Given the potential financial implications of adopting this actuarial assumption, it is advised that the City request a cost estimate from the actuary to determine a phase-in period in which the City can gradually implement the recommendation. This will enable the City to mitigate the risk of underfunding while still maintaining resources adequate to fund other vital City services.

Fringe Benefits

The second aspect of retired employee compensation that receives much less attention, but is also a concern, is the cost of "other post-employment benefits" (OPEB). More specifically, the City provides health care to certain retired employees and their spouses until they are eligible for Medicare[65]. The contributions that retirees make toward the cost of health insurance coverage varies depending on their retirement date. For police who retired before 2007, firefighters who retired before 2002, and non-uniformed employees who retired before 2005, there is no regular retiree monthly premium contribution to the cost of health insurance[66].

Like pension benefits, retiree health insurance creates an ongoing liability for the City. The City uses an actuary to calculate the size of this OPEB liability relative to the assets that the City has set aside for them (if any). The most recent valuation provided showed that the City's actuarial accrued OPEB liability was $93.5 million as of December 31, 2014[67].

Unlike the pension liability, which the City is required by Pennsylvania law to fund, there is no legal requirement for the City to prefund its OPEB liability. Consequently, the City pays the annual retiree health care costs that its retirees actually incur which results in the liability growing over time with very minimal assets set aside to counter its growth. In 2018, the City designated $1.0 million from its unassigned fund balance to start an OPEB Trust Fund. Meanwhile the City's expenditures on these benefits rose from $3.3 million in 2013 to $5.2 million in 2017, a compound annual growth rate of 10.9 percent.

Reading must contain these benefit costs to achieve true financial recovery, regardless of its Act 47 status. The remainder of this chapter describes the Exit Plan initiatives, many of which are focused on managing the growth in benefit costs.

Act 47 and Collective Bargaining

Non-represented and unionized City employees have contributed to City government's improved fiscal condition since it entered Act 47 in November 2009. There have been two rounds of negotiated settlements or interest arbitration awards since then.

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[64] City of Reading Police Pension Plan Actuarial Valuation Report, 2017, page 24. City of Reading Fire Pension Plan Actuarial Valuation Report, 2017, page 20.

[65] OPEB Valuation for fiscal year ending December 31, 2014, page 13. The City also provides life insurance to retired firefighters. According to the most recent OPEB valuation provided, life insurance accounts for only $359,000 of the $93.5 million OPEB liability.

[66] This refers to the contributions that employees make even if they do not use the medical care, sometimes called "premium contributions." This does not refer to the payments that retirees make when they receive care (e.g. deductibles, co-payments). Members of the AFSCME 3799 bargaining unit and non-represented employees who retired before 2007 also do not make premium contributions.

[67] Like pension valuations, OPEB valuations are prepared every other year. The valuation covering December 31, 2016 is unavailable. The next valuation will cover the period ending December 31, 2018.

Under the 2010 Recovery Plan, current employees took wage freezes (some non-represented employees took wage cuts); increased their contributions to the cost of health insurance; and saw their holidays and vacation accrual reduced. New hires received lower cost pension benefits and lower starting salaries and are not eligible for post-retirement health care benefits. By implementing the original Recovery Plan and taking other actions, City government broke its string of years with operating deficits and started to gain financial stability. The 2014 Amended Recovery Plan had similar provisions for active employee wages and health insurance to help the City manage the rapidly growing cost of pension benefits and health insurance for retired employees. These changes allowed the City to stabilize its finances and maintain services without resorting to more severe measures, such as layoffs.

Employees will likely note that the Exit Plan initiatives are more favorable than previous recovery plans. For example, instead of wage freezes, the Exit Plan's maximum allocations for employee compensation assume across the board wage increases of 2.0 percent, 2.5 percent and 3.0 percent over the respective three years. Additionally, with respect to the growth cap on the City's contribution toward the cost of active employee health insurance, the Exit Plan increases that cap from 5 percent to 10 percent just for 2020 which means that the City will shoulder more of the cost increase in that year.

The Coordinator has decided to take this approach in the Exit Plan for three reasons. First, while the City is not in the clear yet, its estimated pension costs appear to be stabilizing after years of exponential growth. Second, the approach recognizes the sacrifices made by employees in previous recovery plans which helped to improve the City's financial condition. Third, after many years, the City is now able to save money by not having to pay for the health care of retired City police officers who were working for Berks County.

Bargaining Unit Expenditure Limits

Section 252 of Act 47 provides that a "collective bargaining agreement or arbitration settlement executed after the adoption of a plan shall not in any manner violate, expand or diminish its provisions." This Exit Plan therefore sets limits on projected expenditures for individual collective bargaining units that may not be exceeded by the distressed municipality. The initiatives in this section set such limits in the form of maximum annual allocations for employee compensation for each of the employee groups.

In determining the maximum annual allocations, mindful of the projected budget gaps that the City faces and the requirements and limitations described throughout this Exit Plan, the Coordinator began by first reviewing the initiatives from the original Recovery Plan and Amended Recovery Plan that impacted employees and were implemented either through negotiation or interest arbitration. We did so because these initiatives were shown to contribute greatly to the City's improved financial status as compared to when it entered Act 47 and represent the status quo for these bargaining units. The Coordinator used continued application of these initiatives through 2022 as a starting point for the purposes of determining the bargaining unit limit calculations being mindful of the new hires in the fire and police departments who have different pension and retiree health care benefits.

Mindful of the sacrifices that employees have made towards the City's financial condition and recognizing improvements in pension cost growth, the Coordinator declined to follow the previous wage patterns (which included wage freezes) when determining compensation expenditure caps. Rather, the Coordinator assumed wage increases at 2.0 percent in 2020, 2.5 percent in 2021 and 3.0 percent in 2022 when calculating the compensation expenditure cap. Furthermore, the Coordinator also assumed that the City would absorb an additional 5 percent of the healthcare cost growth in 2020 (for a total of 10 percent). This is reflected in the City's maximum monthly contribution for healthcare growing by 10 percent in 2020, as noted in WF02.

Workforce

WF01. Active Healthcare Costs

Target outcome:	Improved budget accuracy and resource re-allocation
Three Year Financial Impact:	$6.1 million (net of employee contributions)
Responsible party:	Managing Director; Director of Administrative Services; Human Resources Director

As described in the Baseline Chapter, the City has routinely spent less than budgeted on health insurance for active employees, and the gap between actual and budgeted expenditures has widened. The actual-to-budget variance in the General Fund has grown from $1.5 million in 2016 to $2.2 million in 2018[68]. This amounts to an increase in the variance of more than $700,000 within three years.

The Coordinator calculated the cost of active employee health insurance on a position by position basis, based on the employee's level and type of coverage at the time and the Third Party Administrator's (TPA) premium equivalency rates. The aggregate cost across all funds indicates the City's estimated actual-to-budget variance is again above $2.0 million in 2019 budget. The 2019 budget is the starting point for the Exit Plan's baseline projection, so that variance is carried through 2022 and grows by 11 percent per year, which drives some of the anticipated increase in employee premium contributions described in the Baseline Chapter.

While it is reasonable for the City to budget conservatively for health insurance given its self-insured status, and position vacancies can reduce spending below budgeted levels, the City is budgeting more than it needs for active employee health insurance. This initiative is a corrective measure and requires the City to readjust its healthcare budget to more realistically reflect actual costs. The City should use estimates made by its TPA when budgeting for health care costs.

Note: Employee contributions are based on the TPA's premium equivalent rates and are not affected by this variance. Therefore, there has historically been no "overpayment" by employees.

WF02. Continue health insurance cost control provisions

Target outcome:	Fiscal stability and service delivery; cost containment
Three-Year Financial Impact:	($1.6 million) (net of employee contributions)
Responsible party:	Managing Director, Director of Administrative Services, Human Resources Manager

The 2010 Recovery Plan and the 2014 Amended Recovery Plan established maximum monthly contributions per eligible employee that the City would make toward the cost of employee health care coverage (medical, prescription drug, vision and dental coverage) for active employees based on premium equivalents for the respective coverage levels (single, dual, family)[69]. Employees are responsible for paying the difference between the monthly premium equivalent cost of the plan and the maximum monthly contribution or "cap" as noted in the Recovery Plans.

The Exit Plan continues the "cap" structure and applies it to all employees. The City shall make the following maximum monthly contributions per eligible employee based on coverage level (single, dual, family) for employee health care coverage for each active employee enrolled in City-provided health insurance with employees responsible for any difference between the "cap" and the premium equivalent cost of the plan as determined by the City's health care consultant. The maximum amount includes

[68] Based on preliminary year-end results.
[69] The premium equivalent costs are developed by the City's health care consultant based on all City health care expenditures.

the City's contribution toward the cost of medical, prescription drug, vision and dental coverage. It includes all payments toward health insurance premiums and benefit costs, as well as any taxes, surcharges, penalties, assessments, and other charges and costs which the City may be required to pay under federal or state laws, including the Patient Protection and Affordable Care Act of 2010 ("ACA"), or any other federal or state amendments, regulations, statutes or regulations[70].

Maximum City Monthly Contribution per Eligible Employee Enrolled in City-Provided Health Insurance

	2019	2020	2021	2022
Single	$667	$734	$770	$809
Dual	$1,351	$1,486	$1,560	$1,638
Family	$1,982	$2,180	$2,289	$2,404

The City's maximum monthly contribution grows by 10 percent in 2020 and 5 percent in 2021 and 2022. Because the baseline projection used a lower cap (5 percent growth in the City's contribution in 2020), the increase to 10 percent in 2019 creates a net cost to the City.

WF03. Restructure City health care plans so that they do not trigger the ACA's "Cadillac Tax."

Target outcome:	Cost containment
Three Year Financial Impact:	See below
Responsible party:	Managing Director, Director of Administrative Services, Human Resources Manager

One provision in the Affordable Care Act is a 40 percent excise tax on the value of health insurance benefits exceeding a certain threshold, sometimes referred to as the "Cadillac Tax." While there has been much discussion about Congress eliminating or amending the tax, as of this moment, the tax is delayed until 2022. The tax also applies to any health insurance coverage, including coverage for retired employees.

As of 2019, the annual premium equivalent cost for single coverage ranged from $8,700 to $10,000, depending on the plan and including options available to retired employees. The annual premium equivalent cost for family coverage was $26,000 to $29,900. Since the excise tax threshold could increase, it is unknown whether any of the City's plans will cross that threshold or by how much. But the estimated cost of family coverage of the most costly City plan is almost 9 percent above from the $27,500 threshold.

Due to these uncertainties, the Exit Plan does not assume any additional costs to the City associated with the Cadillac Tax. Given the baseline projected deficit and other factors described in the Exit Plan, the City will not have the financial capability to cover the additional cost of the excise tax without making further reductions to other forms of compensation for current employees. Therefore this Plan Initiative requires the respective parties to restructure health care plans that would trigger the Cadillac Tax so that they remain under the cap. If the employee group does not want to restructure a health care plan that triggers the Cadillac Tax, or a court or arbitrator does not permit the City to do so, the maximum amounts shown above shall still be applicable and those employees who have selected such a plan will be responsible for the full Cadillac Tax amount allocated evenly among themselves.

[70] The Coordinator explicitly notes that the premium equivalent City "cap" amounts include the ACA's "Cadillac Tax". Any employee who has selected a plan that triggers the Cadillac Tax will be responsible for the full Cadillac Tax amount. The Coordinator's preference would be for the respective parties to restructure health care plans so that they do not trigger the "Cadillac Tax." (See Initiative WF03).

WF04. Continue to use professional assistance for labor negotiations

Target Outcome:	Improved management capacity
Three-year Financial Impact:	N/A
Responsible Party:	Managing Director, Director of Administrative Services, Human Resources Manager, City Solicitor

The City shall continue to use experienced public employment labor counsel for its labor relations activities in negotiations and arbitrations.

WF05. Ensure future collective bargaining agreements remain compliant with the Exit Plan

Target outcome:	Cost containment
Three-Year Financial Impact:	N/A
Responsible party:	Managing Director, Director of Administrative Services, Human Resources Manager

No person or entity, including (without limitation) the City, a union representing City employees or any interest or grievance arbitrator appointed pursuant to Act 111 or Act 195 or otherwise, shall continue in effect past the stated expiration date of any current labor agreement the wages, benefits or other terms and conditions of the existing labor agreement if such wages, benefits or conditions are inconsistent with initiatives made herein. Furthermore, no collective bargaining agreement, reached through negotiations or interest arbitration, shall extend past the expiration of the Exit Plan.

WF06. Fraternal Order of Police bargaining unit expenditure limits

Target outcome:	Fiscal Stability & Service Delivery
Three-Year Financial Impact[71]:	($289,000)
Responsible party:	Managing Director, Director of Administrative Services, Human Resources Manager

The Exit Plan allocates the following maximum annual amounts for employee compensation for active members of the Fraternal Order of Police, Lodge 9. This allocation does not include compensation for the Police Chief or Deputy Police Chief. It also does not include compensation for other police department employees who are not represented by the FOP.

2020	2021	2022
17,270,000	17,962,000	18,606,000

The allocation for FOP members assumes the following across-the-board wage increases -- 2.0 percent in 2020; 2.5 percent in 2021; and 3.0 percent in 2022. Because the allocation assumes a larger wage increase than the baseline projection (2.0 percent each year), the financial impact of this initiative is the City spending $0.3 million more than the baseline scenario.

[71] The three year financial impact is shown for the change in salary pattern only. Please see initiative WF02 for the financial impact of the active employee health insurance initiative.

The allocation includes the maximum amounts that the City shall pay active FOP members for any of the following:

- Salaries including step or tenure-based increases and additional pay for overtime or court hearing compensation
- Holiday pay, longevity pay and shift differential
- Uniform or special assignment allowances and all other new or existing forms of cash compensation
- Active employee health insurance coverage including medical, dental, vision and prescription drug coverage as well as life insurance coverage
- Medicare Tax

The allocation includes an amount for active employee health insurance coverage, including medical, dental, vision and prescription drug coverage, net of the projected employee contribution. The allocation is based on the application of initiative WF02 beginning in 2020. If the City and FOP make any changes to health insurance outside of WF02 through negotiation or an arbitration award, the City and union shall project the cost or savings of those changes and apply them against this allocation.

The allocation also assumes the City will not enact any new forms of compensation. The allocation is based on the budgeted complement and mix of employees by rank as described in the 2019 budget. ***Please note the potential allocation adjustment if the City adds positions as described in initiative WF11.***

The allocation does not include the City's required contributions to the police pension plan and assumes no other changes to the FOP's current collective bargaining agreement except those described herein.

WF07. International Association of Fire Fighters bargaining unit expenditure limits

Target outcome:	Fiscal Stability & Service Delivery
Three Year Financial Impact[72]**:**	($199,000)
Responsible party:	Managing Director, Director of Administrative Services, Human Resources Manager

The Exit Plan allocates the following maximum annual amounts for employee compensation for active members of the International Association of Fire Fighters, Local 1803. This allocation does not include compensation for the Fire Chief, First Deputy Chiefs or EMS Coordinator. It also does not include compensation for other fire department employees who are not represented by the IAFF.

2020	2021	2022
12,238,000	**12,767,000**	**13,319,000**

The allocation for IAFF members assumes the following across-the-board wage increases -- 2.0 percent in 2020; 2.5 percent in 2021; and 3.0 percent in 2022. Because the allocation assumes a larger wage

[72] The three year financial impact is shown for the change in salary pattern only. Please see initiative WF02 for the financial impact of the active employee health insurance initiative.

increase than the baseline projection (2.0 percent each year), the financial impact of this initiative is the City spending $0.2 million more than the baseline scenario.

The allocation includes the maximum amounts that the City shall pay active IAFF members for any of the following:

- Salaries including step or tenure-based increases and additional pay for overtime
- Holiday pay and longevity pay
- Uniform or special assignment allowances and all other new or existing forms of cash compensation
- Active employee health insurance coverage including medical, dental, vision and prescription drug coverage as well as life insurance coverage
- Medicare Tax

The allocation includes an amount for active employee health insurance coverage, including medical, dental, vision and prescription drug coverage, net of the projected employee contribution. The allocation is based on the application of initiative WF02 beginning in 2020. If the City and IAFF make any changes to health insurance outside of WF02 through negotiation or an arbitration award, the City and union shall project the cost or savings of those changes and apply them against this allocation.

The allocation also assumes the City will not enact any new forms of compensation. The allocation is based on the budgeted complement and mix of employees by rank as described in the 2019 budget. ***Please note the potential allocation adjustment if the City adds positions as described in initiative WF11.***

The allocation does not include the City's required contributions to the fire pension plan and assumes no other changes to the IAFF's current collective bargaining agreement except those described herein.

Overtime

According to the current IAFF collective bargaining agreement, the City has the option to reopen the agreement when overtime expenditures reach $850,000 in any year of the agreement in order to "address the issue of how to control overtime costs and maintain such costs below the $850,000 on an annual basis." A reopening of the matter through the collective bargaining process would be both time consuming and expensive for the Union and the City, at a time when expenditures have already exceeded budget allocation. In order to more immediately respond, the City shall have the right to suspend minimum staffing requirements for the remainder of the year should the overtime expenditures surpass $850,000 in any year of the agreement. Upon expiration of the current labor contract in December 2019, this language shall be negotiated into the following contract with IAFF, Local 1803.

WF08. AFSCME 2763 bargaining unit expenditure limits

Target outcome:	Fiscal Stability & Service Delivery
Three Year Financial Impact[73]:	($123,000)
Responsible party:	Managing Director, Director of Administrative Services, Human Resources Manager

[73] The three year financial impact is shown for the change in salary pattern only. Please see initiative WF02 for the financial impact of the active employee health insurance initiative.

The Exit Plan allocates the following maximum annual amounts for employee compensation for active members of AFSCME 2763. This allocation covers all AFSCME 2763 employees, regardless of the fund where their compensation is budgeted.

2020	2021	2022
11,937,000	**12,303,000**	**12,732,000**

The allocation for AFSCME 2763 members assumes the following across-the-board wage increases -- 2.0 percent in 2020; 2.5 percent in 2021; and 3.0 percent in 2022. Because the allocation assumes a larger wage increase than the baseline projection (2.0 percent each year), the financial impact of this initiative is the City spending $0.1 million more than the baseline scenario.

The allocation includes the maximum amounts that the City shall pay active AFSCME 2763 members for any of the following:

- Salaries including step or tenure-based increases and additional pay for overtime
- Longevity pay
- Uniform or special assignment allowances and all other new or existing forms of cash compensation
- Active employee health insurance coverage including medical, dental, vision and prescription drug coverage as well as life insurance coverage
- Social Security and Medicare Taxes

The allocation includes an amount for active employee health insurance coverage, including medical, dental, vision and prescription drug coverage, net of the projected employee contribution. The allocation is based on the application of initiative WF02 beginning in 2020. If the City and AFSCME 2763 make any changes to health insurance outside of WF02 through negotiation or an arbitration award, the City and union shall project the cost or savings of those changes and apply them against this allocation.

The allocation also assumes the City will not enact any new forms of compensation. The allocation is based on the budgeted complement and mix of positions as described in the 2019 budget. ***Please note the potential allocation adjustment if the City adds positions as described in initiative WF11.***

The allocation does not include the City's required contributions to the employee pension plan and assumes no other changes to the AFSCME 2763's current collective bargaining agreement except those described herein.

WF09. AFSCME 3799 bargaining unit expenditure limits

Target outcome:	Fiscal Stability & Service Delivery
Three Year Financial Impact[74]:	($18,000)
Responsible party:	Managing Director, Director of Administrative Services, Human Resources Manager

[74] The three year financial impact is shown for the change in salary pattern only. Please see initiative WF02 for the financial impact of the active employee health insurance initiative.

As noted earlier, AFSCME 3799 is a first-level supervisory unit that does not have the same bargaining rights as the other bargaining units. The Coordinator nonetheless provides a bargaining unit expenditure limit for AFSCME 3799.

The Exit Plan allocates the following maximum annual amounts for employee compensation for active members of AFSCME 3799. This allocation covers all AFSCME 3799 employees, regardless of the fund where their compensation is budgeted.

2020	2021	2022
1,689,000	**1,739,000**	**1,797,000**

The allocation for AFSCME 3799 members assumes the following across-the-board wage increases -- 2.0 percent in 2020; 2.5 percent in 2021; and 3.0 percent in 2022. Because the allocation assumes a larger wage increase than the baseline projection (2.0 percent each year), the financial impact of this initiative is the City spending $18,000 more than the baseline scenario.

The allocation includes the maximum amounts that the City shall pay active AFSCME 3799 members for any of the following:

- Salaries including step or tenure-based increases and additional pay for overtime
- Longevity pay
- Uniform or special assignment allowances and all other new or existing forms of cash compensation
- Active employee health insurance coverage including medical, dental, vision and prescription drug coverage as well as life insurance coverage
- Social Security and Medicare Taxes

The allocation includes an amount for active employee health insurance coverage, including medical, dental, vision and prescription drug coverage, net of the projected employee contribution. The allocation is based on the application of initiative WF02 beginning in 2020. If the City and AFSCME 3799 make any changes to health insurance outside of WF02 through negotiation or an arbitration award, the City and union shall project the cost or savings of those changes and apply them against this allocation.

The allocation also assumes the City will not enact any new forms of compensation. The allocation is based on the budgeted complement and mix of positions as described in the 2019 budget. The allocation does not include the City's required contributions to the employee pension plan and assumes no other changes to AFSCME 3799's current memorandum of understanding except those described herein.

WF10. Non-represented employees allocation

Target outcome:	Fiscal Stability & Service Delivery
Three Year Financial Impact[75]:	($253,000)
Responsible party:	Managing Director, Director of Administrative Services, Human Resources Manager

[75] The three year financial impact is shown for the change in salary pattern and salary adjustments only. The costs associated with new positions are shown as separate initiatives described elsewhere in this Exit Plan. Please see initiative WF02 for the financial impact of the active employee health insurance initiative.

While Act 47 requires the Coordinator to set a maximum annual allocation for bargaining unit employees, there is not a similar requirement for non-represented employees. To provide consistency in cost control across employee groups and flexibility for the City to reallocate salaries for non-represented employees, the Plan sets the following maximum allocation for all full-time non-represented employees, regardless of the fund from which the employee is being paid.

2020	2021	2022
6,337,000	**6,523,000**	**6,741,000**

The allocation for non-represented employees assumes the following across-the-board wage increases -- 2.0 percent in 2020; 2.5 percent in 2021; and 3.0 percent in 2022. Because the allocation assumes a larger wage increase than the baseline projection (2.0 percent each year), the financial impact of this wage pattern is the City spending $62,000 more than the baseline scenario[76].

The City may reallocate non-represented employee salaries by either reducing current salaries or eliminating budgeted positions so long as the total amount allocated to employee compensation, including the cost of employee health insurance, remains under the cap. This includes eliminating vacant, budgeted positions and reallocating the salary to existing employees.

The allocation accounts for four adjustments[77] to employee base salaries recommended by the Administration and supported by the Coordinator:

- Reinstating the base salary for the Controller (i.e. Deputy Finance Director) position to the level in place before the reduction in 2016. The base salary for this position was reduced as part of the Administrative changeover that year.

- Increasing the base salary for the Solicitor position to bring it into line with those for the City's other major department heads

- Increasing the base salary for the Chief Building Code Official position so the City can fill this high priority vacancy. Lack of capacity at the top of the Building and Trades Division stalls plan reviews necessary for health and safety, economic development and tax base growth (i.e. revenue generation) (see initiative ED01 in the Economic Development Chapter).

- Increasing the base salary for the Community Development Director to avoid salary compression with the Chief Building Official position that the Director supervises (see initiative ED01 in the Economic Development Chapter)

The allocation also accounts for the following new positions described elsewhere in this Exit Plan:

- Reinstating the confidential secretary position in support of the Director of Administrative Services (see initiative FM06 in the Financial Management chapter)

- Reinstating the confidential secretary position in support of the Community Development Director (see initiative ED02 in the Economic Development chapter)

- Establishing a Capital Project Manager position to execute projects funded by the designated earned income tax (see initiative CP01 in the Capital and Debt chapter)

[76] The larger impact amount shown at the beginning of this initiative includes the impact of adjustments other than the wage pattern.
[77] The June 6th version of the Exit Plan recommended that the City increase the base salary for the EMS Coordinator position to match the base salary for the Deputy Fire Chief positions. The City already made that adjustment during the 2019 budget process and it is incorporated in the allocation above.

The City shall not enact any new forms of compensation or increase forms of compensation for non-represented employees. Non-represented employees are subject to the terms of WF02 regarding fringe benefits. ***Please note the potential allocation adjustment if the City adds positions as described in initiative WF11.***

WF11. Additional allocation for optional positions

Target outcome:	Improved service
Three Year Financial Impact:	See below
Responsible party:	Mayor, Council, Managing Director, Director of Administrative Services, various department directors

Act 47 requires that, as part of the City's annual budget process, the Coordinator "shall review the proposed budget to verify that the proposed budget conforms with the [Recovery] plan."[78] During the budget review, the Coordinator carefully analyzes the proposed personnel expenditures for compliance with the maximum compensation allocations. That process will continue during the Exit Plan using the initiatives described above.

The Exit Plan does not explicitly limit the number of budgeted positions. However, because the maximum compensation allocations are based on a recommended compensation package applied to a specific number of employees, the practical effect is that it is difficult for the City to increase the total number of positions without cutting compensation for those that already exist.

As a result, the City's discussions about potential staff additions often focus on the question whether the City is allowed to hire such individuals. Recovery Plan compliance has been and continues to be a statutory requirement for as long as Reading remains in oversight, but that period should end no later than the end of 2022. Once the City exits oversight, discussions about staff additions should focus on whether the City *needs* the positions; whether existing recurring revenues are *sufficient to pay* for the positions; and, if not, whether the City is *willing to increase taxes* or find other recurring revenues to pay for them.

To help prepare the City for these types of discussions after exiting oversight, the Coordinator asked the Administration to identify new positions that would help operations. The department directors identified the positions they needed and forwarded their requests to the Managing Director for prioritization. We calculated the costs associated with each of the requests (cash compensation plus fringe benefits) and provided them to the Administration, so they could determine which positions they would be most likely to propose in the budget.

We made it clear that the City would have to identify recurring revenue to pay for these positions, over and above the revenue in other Exit Plan initiatives. To make the prioritization decision more real, we directed the Administration to think of the potential positions in terms of the question, "Are you willing to propose a real estate tax increase in the budget to pay for these positions?" We also made it clear that these positions are the Administration's priorities and not positions the Coordinator is requesting or endorsing. The positions that we consider priorities are described in separate initiatives.

[78] Section 247.1.

The Administration identified the following positions for potential inclusion in the budget. Based on input that we received during the public comment period, we inserted the option of adding four new police officer positions, subject to the same conditions for all other positions.

Allocations for Optional Additional Positions[79]

<table>
<tr><th>Position</th><th>Department</th><th>Employee group</th><th>2020</th><th>2021</th><th>2022</th></tr>
<tr><td>Telecommunicator</td><td>Police - Special Services</td><td>AFSCME 2763</td><td>$71,000</td><td>$74,000</td><td>$76,000</td></tr>
<tr><td colspan="6">Position would provide increased coverage during the 7:00 pm - 3:00 am "jumper" shift that is the busiest for E911 police dispatch</td></tr>
<tr><td>Firefighter/Medic (4)</td><td>Fire - EMS</td><td>IAFF</td><td>$296,000</td><td>$328,000</td><td>$360,000</td></tr>
<tr><td colspan="6">Four positions would staff an additional ambulance unit as requested by Fire Chief to meet rising calls for service demand. The cost of each position is $90,000 to $99,000 over the three-year period. The Chief has other recommendations to mitigate growth in these calls for service.</td></tr>
<tr><td>Police Officer (4)</td><td>Police - Patrol</td><td>FOP</td><td>$320,000</td><td>$356,000</td><td>$388,000</td></tr>
<tr><td colspan="6">The Coordinator received input during the public comment period on the draft Exit Plan requesting that the City be allowed to consider additional police officer positions.</td></tr>
<tr><td>Crime Analyst</td><td>Police (Unit TBD)</td><td>Non-represented</td><td>$81,000</td><td>$84,000</td><td>$87,000</td></tr>
<tr><td colspan="6">Civilian position to assist with CompStat (crime statistics) gatherings and planning. This position was requested by the Police Chief</td></tr>
<tr><td>Police Evidence Analyst</td><td>Police (Unit TBD)</td><td>Non-represented</td><td>$81,000</td><td>$84,000</td><td>$87,000</td></tr>
<tr><td colspan="6">Civilian position to assist and cover the body camera reviews and redacting for court. This position was requested by the Police Chief</td></tr>
<tr><td>Sustainability Coordinator</td><td>Public Works - Refuse</td><td>Non-represented</td><td>$82,000</td><td>$85,000</td><td>$88,000</td></tr>
<tr><td colspan="6">Position to support the Sustainability Manager in the design and implementation of programs related to waste reduction, energy efficiency and recycling participation. This position was requested by the Public Works Director and would likely be supported by the Refuse Fund.</td></tr>
<tr><td>Youth Academy Director</td><td>Police (Unit TBD)</td><td>Non-represented</td><td>$60,000</td><td>$62,000</td><td>$64,000</td></tr>
<tr><td colspan="6">Civilian position to function as a full-time Youth Academy Director, replacing the current part-time director. This position was requested by the Police Chief</td></tr>
</table>

If the City added all 13 positions, they would cost an estimated $991,000 to $1,150,000 a year during the Exit Plan period, which would require a 4.1 percent increase in the real estate tax, not including the cost of the employees' pension benefits[80].

The Administration will decide which, if any, of these positions to include in the budget and Council has the authority to decide which ones they approve in the annual budget. Our goal is to stimulate those prioritization discussions and resource allocation decisions within the context of the City's total financial picture, while still providing the cost controls required in Act 47.

[79] Consistent with the methodology described in the previous maximum compensation allocation initiatives, the allocations shown here cover all forms of cash compensation plus fringe benefits. The allocations assume the family level of health coverage for each position. The cost allocations do not include the City's required contribution to the employee pension plans associated with these positions.
[80] If the Sustainability Coordinator position is supported by the Refuse Fund, that lowers the additional cost to the General Fund and the associated real estate tax.

If the City adds the positions listed above in the final approved version of the budget[81], and if the City funds the associated compensation costs for those positions with recurring revenue, then the allocations for the affected employee groups shall be increased by the amounts shown above[82]. Please note that any tax increase to fund these positions shall be in addition to the increases described in initiative GP06 of the General Provisions chapter.

If the City does not add the positions in the final approved version of the budget or if it does not identify recurring revenue to fund them, then the maximum compensation allocations shall default to those listed in the previous initiatives. The Coordinator reserves the right to determine whether proposed revenue sources are recurring and adequate to cover the full cost of the positions over the term of the Exit Plan. Because the budget still has to conform to the Exit Plan, the City cannot add more positions than those listed above for any employee group.

If any positions are transferred out of or into an employee group, the portion of the allocation associated with those positions will transfer with them and will impact the cap accordingly[83]. For example, if a non-represented position with $60,000 in total compensation becomes an AFSCME position, the non-represented cap will decrease by $60,000 while the AFSCME cap will increase by $46,000.

Retiree Benefits

To consider the true financial impact of pension and retiree health care benefits, it is necessary to consider both the immediate fiscal impact in terms of dollars required to be spent now as well as the future obligations of the City and its employees. For example, although the City would not incur an immediate pay-as-you-go cost from granting new hires retiree health care benefits (since they are not yet eligible to retire), this action creates a future liability that the City will need to fund (and should actually prefund). New hires soon become incumbent employees and these liabilities continue to grow. It is the Coordinator's specific position that any enhancements to pension or retiree health care benefits (if any) for existing employees or new hires is inconsistent with Act 47's policy objective of relieving the financial distress of the City and would further jeopardize the financial stability of the City.

RB01. No COLAs for pension plans during the term of the Amended Recovery Plan

Target outcome:	Cost avoidance
Three-Year Financial Impact:	See below
Responsible party:	Managing Director; Director of Administrative Services; Human Resources Manager

No pension cost-of-living adjustments (COLAs) shall be provided during the term of the Exit Plan. Currently, no employee pension plan assumes a cost-of-living adjustment (COLA) in its valuation, so this initiative does not have an additional impact on the City's pension costs beyond the level already reflected in the baseline projection. Any pension cost-of-living adjustments (COLAs) granted would cause further deterioration of the financial status of these pension funds and a corresponding increased cost to the City in the form of higher MMO costs.

[81] This also includes the possibility that a newly elected mayor could re-open the 2020 budget in early 2020.
[82] If the City determines that the new positions should be represented by employees groups other than those listed, then the allocation increase will apply to the employee group representing the new positions.
[83] This provision applies to all positions covered by the Exit Plan's maximum annual allocations for employee compensation.

RB02. No pension enhancements during the Amended Recovery Plan term

Target outcome:	Cost avoidance
Three-Year Financial Impact:	See below
Responsible party:	Managing Director; Director of Administrative Services; Human Resources Manager

The City shall not enhance any pension benefit for active employees or new hires during the Exit Plan term. For the same reasons as RB01, any pension enhancement will cause further deterioration of the financial status of these pension funds and a corresponding increased cost to the City in the form of higher MMO costs and future liabilities.

With respect to the Deferred Retirement Option Program (DROP), the City does not receive Commonwealth pension aid for those individuals in the DROP and loses the ability for investment return on those DROP dollars. It is the Coordinator's specific position that providing DROPs to employees who are not eligible for the DROP would be inconsistent with Act 47's policy objectives of relieving the financial distress of the City and would further jeopardize the financial stability of the City. Firefighters hired prior to January 1, 2011, and police officers hired prior to January 1, 2012, may keep the DROP benefit under the current terms of their collective bargaining agreements. These benefits may not be enhanced.

RB03. Defined Contribution retirement plan for new hire AFSCME and non-represented employees

Target outcome:	Cost containment
Three Year Financial Impact:	Dependent upon the retirement plan's terms
Responsible party:	Managing Director; Director of Administrative Services; Human Resources Manager

The City shall implement the Defined Contribution Retirement Plan as soon as possible for new hire AFSCME and non-represented employees. The City bargained the ability to implement a defined contribution retirement plan for new hire AFSCME employees. The City is in the process of implementing this plan for new hire AFSCME employees and non-represented employees.

RB04. Aggregated pension board

Target outcome:	Improved operations
Three Year Financial Impact:	N/A
Responsible party:	Director of Administrative Services

The City shall implement an aggregated pension board as soon as possible for FOP, IAFF, and civilian employees. Prior to the Exit Plan, the City had three separate pension boards for FOP, IAFF, and civilian employees, each with their own administrative and advisory support. In 2017, the City initiated a move toward an aggregated pension board, though to Coordinator's knowledge this process is incomplete. An aggregated pension board serves as a cost-containment measure by having one set of professionals and administrators and reducing the administrative burden to allow for timely reporting of key financial information.

RB05. Elimination of Ghost Time Buy-Back for FOP

Target outcome:	Cost containment
Three Year Financial Impact:	Dependent upon remaining eligible police officers
Responsible party:	Managing Director; Director of Administrative Services; Human Resources Director

As part of the 2007 collective bargaining agreement between the City and the FOP, the parties agreed to allow FOP members to purchase up to five years of pension service credit. This service credit is commonly referred to as "ghost time" since the employee did not actually work during that period. Ghost time is not authorized by the Third Class City Code. No other employee group received this benefit and it has been eliminated for police officers hired on or after December 31, 2011. The Exit Plan specifically requires eliminating the ghost time benefit for any active police officer.

RB06. No retiree health care enhancements during the Exit Plan term

Target outcome:	Cost avoidance
Three Year Financial Impact:	See below
Responsible party:	Managing Director; Director of Administrative Services; Human Resources Manager

The 2010 Recovery Plan eliminated post-retirement health insurance for employees hired after the adoption of that Plan or the expiration of the collective bargaining agreements in place when the City entered Act 47 oversight. Settlements and interest arbitration awards implemented further changes to retiree health care benefits for then active employees.

Retiree health care benefits (if any) shall not be enhanced during the Exit Plan term. It is the Coordinator's specific position that enhancing such benefits (if any) would be inconsistent with Act 47's policy objectives of relieving the financial distress of the City and would further jeopardize the financial stability of the distressed municipality.

RB07. Ensure only eligible retirees receive City-paid retiree health insurance

Target outcome:	Cost reduction and avoidance
Three Year Financial Impact:	Dependent upon the number of retirees with access to other healthcare plans
Responsible party:	Managing Director; Director of Administrative Services; Human Resources Manager

As noted several times in this chapter, retiree health care costs create significant fiscal pressure on the City. Therefore, only eligible retirees should receive City-paid retiree health care. The City shall continue to monitor its retirees (and sometimes their spouses, if eligible) to ensure that they are only receiving City-paid retiree health care if they are eligible. This includes determining whether such retirees have access to other health care plans at their employers that would permit the City to cease providing City-paid retiree health care to them.

RB08. Retiree healthcare savings from arbitration awards

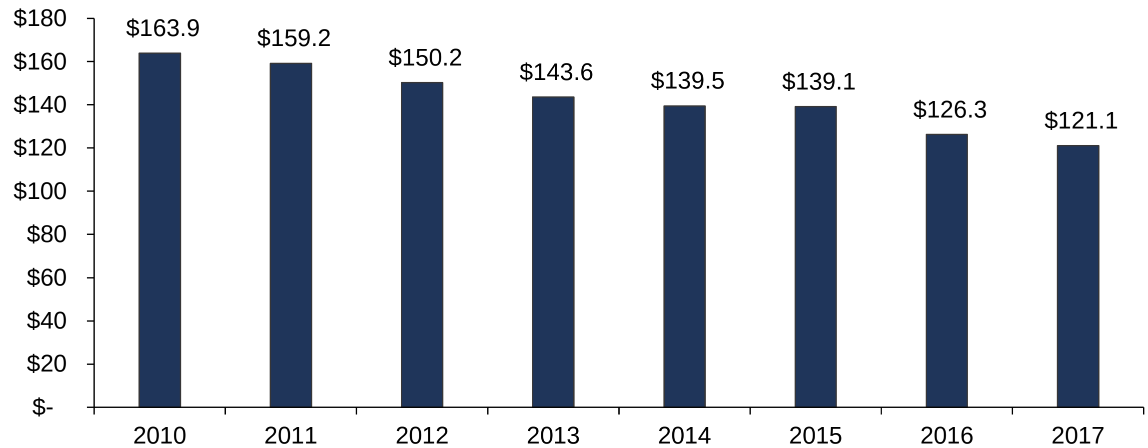
Target outcome:	Cost reduction
Three Year Financial Impact:	$0.9 million
Responsible party:	Managing Director; Director of Administrative Services; Human Resources Manager

In 2018, an arbitrator found that the City did not need to provide City-paid retiree health benefits to former City police officers who were working for Berks County due to the comparability of the health plan offered by the County. The FOP appealed this award to District Court and a judge found in favor of the City. The City anticipates annual savings of approximately $300,000 from not having to pay these retiree health benefits, which are not captured in the budget (and consequently were excluded from the baseline). The savings are now included as an initiative in the Exit Plan.

Capital and Debt

One quantifiable measure of Reading's progress since entering financial oversight is City government's declining long-term liabilities for bonds, bank notes and leases. These liabilities have dropped by $42.8 million (or 26.1 percent) since 2010.

Government Activities – Bonds, Notes and Leases Payable[84] ($ Millions)



Source: City's comprehensive annual financial reports, 2010 - 2017

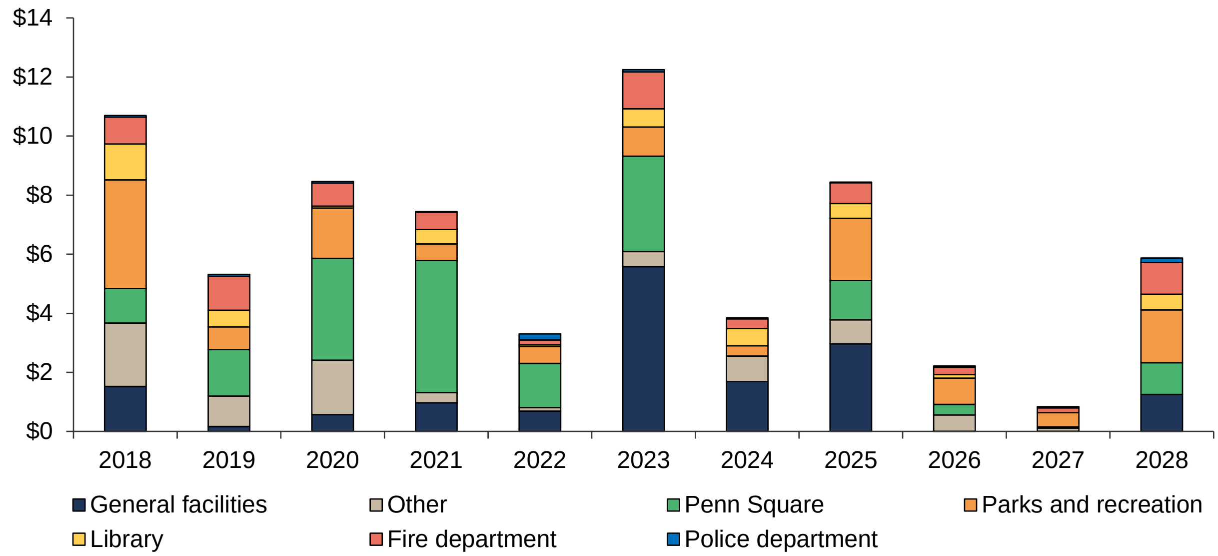
The City has consistently paid the principal and interest due on its debt in full and on time. Occasionally, the City has repaid debt ahead of schedule, reducing the amount that it would otherwise have to allocate in future budgets. The City has generally limited its debt-related activity within the General Fund[85] to refunding loans and bank notes that were issued before the City entered financial oversight. The City received a new bank loan in 2014 to replace some of its information technology equipment and repaid the loan ahead of schedule in 2017. Otherwise the City refunded debt in 2011, 2012, 2014, 2015 and 2017.

This General Fund "debt diet" was necessary as City government worked to bring its budget into balance and meet other growing obligations, like those related to employee pensions. But the debt diet also had a downside. The City has had limited funding for major repairs or replacements of basic infrastructure, like fire stations, parks or City Hall. As a result there is a large backlog of projects that are necessary just to maintain what the City already owns, not to mention any new assets that may be beneficial.

Under the terms of the 2014 Amended Recovery Plan, the City received a grant from the Pennsylvania Department of Community and Economic Development to fund a facility condition assessment. It identified the major repair and replacement needs at most City-owned facilities, ranging from electrical and plumbing work to stairs and roofing, and listed those needs over an 11-year period. Buildings already identified for replacement or closure were not assessed. The graph below shows the identified needs by functional area with the largest concentration in the Penn Square properties[86] and general purpose facilities like City Hall and the Public Works Building.

[84] This is for all Governmental Activities, not just the General Fund. It does not include debt related to "business activities," like the sewer system. It excludes the City's liabilities related to employee pensions, other post-employment benefits and compensated absences.
[85] The City has issued new debt related to its utility functions, like the wastewater treatment plant construction. User fees generally cover that debt in enterprise funds separate from the General Fund.
[86] Please see initiative ED06 in the Economic Development chapter for more information on these properties.

Identified Facility Needs by Functional Area ($ Millions)[87]



Source: 2018 facility condition assessment

This assessment helped prioritize needs related to the City's *facilities* – it was not a comprehensive list of all capital needs including the following:

- The City has a **fleet** of patrol cars, fire engines, ambulances, public works vehicles, generators and other rolling stock that need to be replaced. The Capital Fund covers most, if not all, vehicle replacement costs and the capital budget designates $2.2 million for that purpose in 2019. The 2019 to 2023 Capital Improvement Plan (CIP) includes $11.6 million for vehicles and equipment.
- The City has to periodically replace the **information technology hardware** (e.g. computers, servers) that supports daily operations and provides the platform for further service improvements and efficiency gains. The 2019 capital budget designates $290,000 and the 2019 – 2023 CIP has $5.4 million for that purpose.
- The Capital Budget and CIP have other miscellaneous items that do not fit neatly within the other categories but are still important to daily operations and part of the capital budgeting process – traffic signals and street lighting; security cameras and firefighting equipment. Larger structures like **bridges and dams** require investments, though the City is not using its capital budget to fund that work in 2019.

The City receives a portion of the proceeds from the Commonwealth's taxes on motor fuels and tracks that revenue in a separate Liquid Fuels Fund. The table to the right shows Reading's Municipal Liquid Fuels (MLF) allocation[88] since 2013. By law the City can use its MLF allocation for street paving, road construction, plowing and equipment purchases. The City previously used much of its liquid fuels allocation for street lighting, but has since stopped that practice so there is more available for road paving.

Year	MLF Allocation
2013	$1,402,043
2014	$1,513,088
2015	$1,665,473
2016	$1,947,077
2017	$2,036,946
2018	$2,136,872
2019	$2,186,337

[87] "General facilities" are the buildings that City government uses for its own operations, like City Hall, the Public Works Building and the City Garage. "Other facilities" are those primarily used by other entities, like FirstEnergy Stadium and the Pagoda.
[88] The Pennsylvania Department of Transportation conducts required bridge inspection on the City's behalf and subtracts a portion of the liquid fuels allocation to cover those costs.

The 2014 Amended Recovery Plan required the City to shift a growing portion of its non-resident earned income tax (EIT) and a corresponding portion of the resident EIT from the General Fund to a separate Capital Project Fund beginning in 2016. This was partly intended to wean the City off the extraordinary commuter taxing authority associated with Act 47, but it was also intended to give the City a designated funding source for capital projects. The table below shows the Coordinator's estimates on how much this tax generated for capital projects according to the cash-based figures reported by the City's external tax collector. Projected capital EIT revenue grows to $6.1 million in 2019 with the full 0.3 percent non-resident EIT and 0.3 percent resident EIT designated for capital projects.

Capital Project EIT Revenue

	2016	2017	2018
Non-resident Capital EIT rate	0.1%	0.2%	0.2%
Non-resident Capital EIT revenue (all years)	$726,000	$1,755,000	$2,115,000
Resident Capital EIT rate	0.1%	0.2%	0.2%
Resident Capital EIT revenue (all years)	$654,000	$1,741,000	$2,199,000
Total Capital EIT revenue	**$1,380,000**	**$3,496,000**	**$4,314,000**

Once the City leaves Act 47 oversight, it will lose the non-resident EIT, but the 0.3 percent resident EIT designated for capital projects can and should remain. Even so, City officials rightfully ask how they can make progress against the substantial backlog of capital project needs and continue to fund recurring needs, like fire engine replacement, after the commuter EIT is gone.

Fiscally strong governments use a mix of "pay-as-you-go" funding and debt financing to fund their capital budget. A building or park that will last decades should be funded using debt repaid over several years so all generations that use the facility contribute toward its costs. While Reading's financial limitations have largely precluded the City from doing debt-financed capital projects other than those related to the utilities, there are advantages to both approaches.

	Pay as you go (PAYGO)	Debt financed
Ideal for funding…	Small projects Assets with short useful lives Projects with a local match requirement	Large projects Assets with longer useful lives Projects with a predictable stream of future revenue
Pros	Saves interest and issuance costs Preserves flexibility and borrowing capacity	Provides more money upfront Intergenerational equity (*Distributes the cost of a long-term asset to everyone who will use it)* Easier to distribute spending over time through scheduled debt repayments
Cons	Usually insufficient to fund all needs Uneven expenditures Lack of "intergenerational equity"	Adds interest and issuance costs Limits financial flexibility and reduces borrowing capacity

Source: Adapted from *Capital Improvement Programming: A Guide for Smaller Governments*, Patricia Tigue, GFOA

It is not clear when the City of Reading will be able to afford a large debt-funded capital improvement program. As described in the Baseline Projection chapter, the City's scheduled debt service will drop from $11.4 million in 2019 to $10.7 million in 2020; return to $11.2 million in 2021; and then stay at that level until 2029. The City does not need to wait another decade before it issues debt, but it has to balance any near-term increase in debt service payments with its operating needs and its commitments to other long-term liabilities, like the employee pension plans.

City officials have advocated for the Pennsylvania General Assembly to change Act 47 so that Reading can still levy the non-resident tax after leaving oversight. They note the importance of fairly distributing the cost of providing local government services in a regional employment hub to all the people who benefit from those services, including commuters. We support the continuation of a commuter tax used to fund capital improvements that benefit residents and commuters.

In the interim, this Exit Plan extends the non-resident earned income tax and designates it for capital projects. The best way for the City to demonstrate the importance of keeping the commuter tax after leaving State oversight is to show how they are putting that money to good use while they have it. Successfully doing that involves more than money.

Capital budget process

The City's Administrative Code outlines the following timetable for the capital budget and capital improvement plan (CIP)[89] process.

Due date	Action
First week of May	Mayor provides annual statement of CIP priorities to Council and to the departments funded by the CIP.
First week of June	Administrative Services Department (ASD) issues a formal request to each City department for capital project proposals.
First week of July	Each department submits to ASD its capital project and purchase proposals.
First week of September	The Capital Improvement Program Committee (CIPC) provides its report to the Mayor (see below).
October 1	Mayor submits a five-year capital improvement plan (CIP) to Council.
Mid October	Council holds public hearings on the CIP.
Mid November/December	Council adopts the CIP in conjunction with operating budget and capital budget.

This is a good structure for a capital budgeting process because it is:

- **Coordinated:** The process starts with each department compiling its own proposals, including the cost and the time to execute them, and then reporting back to the Administrative Services Department. This is more effective than tasking one person within Administrative Services with responsibility to gather this information across City government.

[89] The primary difference between the capital budget and the CIP is that the CIP describes the City's planned projects for multiple years.

- **Collaborative:** The Capital Improvement Program Committee members are the directors of the five major departments, the separately selected Auditor and a member of City Council. The Mayor still has ultimate authority for writing the CIP and City Council approves it, but the CIPC provides a useful enterprise-wide perspective on the City's needs.
- **Prioritized:** The CIPC is charged with producing a report that ranks the projects on the extent to which they address health and safety needs; comply with federal or state statutes; reduce expenditures, improve efficiency or improve services; comply with the Comprehensive Plan; and advance economic or community development.

The aforementioned facility condition assessment provides a lot of the information the City needs to identify projects, estimate their cost and prioritize them, at least as it pertains to facilities. That lessens the workload for the Administrative Services Department which is welcome considering the need to focus on improving the operating budget and procurement processes[90]. Department directors will still need to identify and prioritize needs related to vehicles and other items not included in the facility assessment.

We recommend that the City collect the list of non-facility project proposals from department directors and then convene the CIPC to discuss and rank those needs together with those identified in the assessment. That will give the Administration a good head start on its capital improvement program and ensure that process accounts for the backlog of needs at the City's existing facilities.

Project execution

The City's capital budget has grown from $2.5 million in 2016 to $20.6 million in 2019, including grant funded projects. The dollar value of projects funded by the capital EIT grew from $1.4 million to $6.7 million over this same time. In 2018 the City allocated money for $4.4 million worth of projects, which included $750,000 carried over from 2017, and spent $2.8 million. The table below shows the amounts budgeted and spent by category in 2018.

2018 Capital Project Fund Expenditures[91]

Description	Spent	Budgeted	% spent
City Hall projects	$ 286,015	$ 450,000	63.6%
Library projects (Main and branches)	$ 339,890	$ 460,000	73.9%
Other facilities	$ 295,494	$ 60,000	492.5%
Fire station improvements and replacement	$ 104,699	$ 1,070,000	9.8%
Facility subtotal	**$ 1,026,098**	**$ 2,040,000**	**50.3%**
Recreation subtotal	**$ 119,027**	**$ 598,000**	**19.9%**
Vehicle replacement	**$ 1,177,501**	**$ 1,020,000**	**115.4%**
Transportation subtotal	**$ 209,017**	**$ 536,160**	**39.0%**
Information technology subtotal	**$ 243,279**	**$ 250,000**	**97.3%**
Total	**$ 2,774,922**	**$ 4,444,160**	**62.4%**

[90] Please see the Financial Management Chapter for more information.
[91] This table does not include road paving activity, which is paid from the Liquid Fuels Fund, or any work paid form the Community Development Block Grant Fund.

The City is not expected to spend 100 percent of its budget each year. Projects may be delayed or cancelled because the City does not receive the associated grant revenue. Projects that are budgeted for one year can carry over into the next year. The City will have needs or grant opportunities that emerge during the year, so it is good to have some flexibility to shift money. For example, the City needed a pole barn to protect its vehicles from the weather and extend their useful life, so it shifted $250,000 to that purpose last year.

With those caveats noted, the City spent less than 10 percent of the money allocated for fire station improvements and replacement in 2018. Most of the variance between the budget and actual spending is related to the ongoing discussions about where to build two new fire stations. But the City also budgeted $200,000 for Riverside Station, $50,000 for the EMS building and $20,000 for other station improvements and spent just $7,000 total on these projects.

Similarly, the City did not spend any of the $50,000 budgeted for basketball courts at City Park, less than 15 percent of the money budgeted for Schlegel Pool and none of the $135,000 allocated to the Fire Tower. The rest of the expenditures on recreation facilities occurred at FirstEnergy Stadium. The City was able to spend the money allocated for vehicle replacement and information technology upgrades more expeditiously.

The money that the City did not spend is not lost – it remains in the Capital Fund as fund balance that carries over into the next year. But the 2019 capital budget has its own list of projects, including some where the City anticipated launching a subsequent phase for a project that appears to be behind schedule at the end of 2018.

It has taken several years to put Reading in a position where it can start to reinvest in its infrastructure and there is a substantial backlog of work to do. The City needs to increase its capacity to launch and execute projects or those needs will grow, despite having the money available to fund at least some of them.

Initiatives

Capital project management and execution

CP01 Establish Capital Project Manager position

Target Outcome:	Improved stewardship of City-owned assets; improved quality-of-life for residents and neighborhood development
Three-year Financial Impact:	($337,000) (Paid from Capital Project Fund)
Responsible Party:	Managing Director, Director of Public Works

Now that Reading has a source of funding for capital projects, the City needs to execute those projects on time and on budget. Capital project execution can be complicated and time-consuming, particularly when the projects involve coordinating funding from multiple sources; overseeing design or engineering, including the associated procurement process; and overseeing construction work, including the separate associated procurement process.

The City will have close to $7 million in EIT revenue to fund capital projects in 2019, plus funding from federal grants, Commonwealth grants or other external sources. That amount will likely grow, at least until the City exits Act 47 oversight and the commuter tax is eliminated. Management in Public Works has understandably expressed concerns about its capacity to manage and execute these projects.

The City needs to make timely, efficient and effective use of the EIT revenue that has been entrusted to it to improve the quality of life for its residents and maintain core local government services for people who work and visit Reading. The City shall establish a Capital Project manager position that reports to the Public

Works Director but works closely with the Director of Administrative Services whose department manages procurement, budgeting and other relevant financial processes.

The position shall be supported by the Capital Project Fund using a portion of the capital-designated earned income tax. The Manager shall focus on executing the projects funded by that earned income tax. Even if the commuter EIT is eliminated and the capital project funding drops at the end of this Exit Plan, the City will still need someone to manage the projects funded by the resident EIT designated for capital projects.

Estimated Financial Impact (Capital Fund Only)[92]

2020	2021	2022
($109,000)	($112,000)	($116,000)

CP02 Improve capital budget document and progress reporting

Target Outcome:	Improved stewardship of City-owned assets
Three-year Financial Impact:	N/A
Responsible Party:	Managing Director, Director of Administrative Services, Director of Public Works

The City allocates $6.7 million in EIT to capital projects in 2019, which is more than the operating budget for the Community Development Department or the Department of Administrative Services. With grant funding, the capital budget is $20.6 million which is more than the operating budget for every department except Police. Much like the City improved its reporting on financial activity in the General Fund under the original Recovery Plan, it now needs to improve its reporting on the capital budget.

The City shall make the following improvements to its capital budget:

- The ordinance that carried the CIP in 2019 showed the total expenditures for each project over the entire five-year period. Previously, the City showed the spending in each year for each project over a five-year period, which explains when each one is expected to begin and end. The City should return to this format and present the spending for each year in the CIP, and not just an aggregated total for the five-year period.

- The 2019 CIP ordinance shows grant funded projects, which we assume includes those funded by the Community Development Block Grants. This is a good addition because it provides a more comprehensive look at capital projects across the City. The City should also show the paving activity funded by the Liquid Fuels allocation so that residents know what has been allocated and spent on that basic service each year[93].

City Code requires the Director of Administrative Services and the project manager to report to City Council and the public on the progress of each capital project each quarter. The quarterly progress update is supposed to include updated information on the project's cost, status, progress relative to schedule and the cost to operate and maintain the project once it is finished. Regular reporting on capital project activity is a worthy goal, but it would be overwhelming to do so as City Code describes now that the City lists 95 projects in its 2019-2023 CIP[94]. It would be very time consuming to generate quarterly progress reports on each of these projects four times a year and it is not clear how Council would manage and use this information if it

[92] The estimate includes the projected cost of fringe benefits.
[93] Some versions of the City's budget include the Liquid Fuels Fund and others do not. The City can note in the CIP document that a different fund pays for paving.
[94] The CIP ordinance does not specify which projects are active in 2019.

was available. It is also impractical to issue these reports on the last day of each quarter, as City Code states, since the City needs time to finalize the accounting activity up through the last day of each quarter.

The City should start by issuing a quarterly capital budget report with the total amount budgeted and the amount spent through each quarter for each project, similar to the format that the City and Coordinator use for the quarterly financial reports on General Fund activity. The City can then provide a narrative update on the projects where there has been a change in the schedule or funding arrangement, significant progress or those identified as priorities by Council. The City can then adapt and build on this starting point over time, working toward the ideal set in the City code. This will provide accountability and transparency without overwhelming leaders with the preparation, reading or discussion of this report.

We also recommend that the City revisit the Charter provisions for capital projects, some of which are worthy ideals that do not need to be elevated to Charter requirements and others of which are unnecessary or even counterproductive:

- The Charter reads, “Proposed capital projects in the capital programs must be considered on their own individual merits by the Administrative Services Director, the City Auditor, and the proposer of the project.” This does not match the CIPC structure adopted in City Code, nor is it clear what “considered on their own individual merits” means or why these particular individuals would do so when the Mayor is charged with proposing the CIP.
- The Charter describes a preliminary feasibility study which includes important information that the City should gather from departments in the project proposal phase. But it goes further in requiring City Council to adopt the feasibility study by simple majority and then act again on a final proposal with five votes to approve the project. It is not clear whether this would be in addition to Council’s approval of the capital budget and requisite actions associated with the procurement and contract approval process. It is inefficient and unnecessary to require Council to vote at least three times, and potentially more, on the same project, some of which are very basic, like vehicle purchases. Even for more complicated projects, there is a better way to provide transparency and accountability than the Charter describes.

The Coordinator is available to support the City and the Charter Review Board in improving this language so it defines a meaningful process that is efficient and practical while also promoting transparency and accountability.

Capital project funding

CP03	**Designate a portion of the resident EIT for capital projects** **Use the non-resident EIT for capital projects**	
	Target Outcome:	Improved stewardship of City-owned assets; improved quality-of-life for residents and neighborhood development
	Three-year Financial Impact:	$21.6 million (resident and non-resident EIT)
	Responsible Party:	Managing Director, Solicitor, Director of Administrative Services

The City shall maintain its resident EIT rate at 2.1 percent each year through 2022, keeping the total resident EIT levy at 3.6 percent assuming the Reading School District levy does not change. For 2020 through 2022, the City shall continue to transfer the revenue generated by 0.3 percent of the EIT to a capital project account, separate from the General Fund, and exclusively designated to fund capital projects.

The City shall also petition the Berks County Court of Common Pleas each year through 2022 to use the additional taxing authority in Act 47 to increase the rate of earned income taxation upon non-residents by 0.3 percent. The crediting provisions of Act 511 provide for the commuter’s home jurisdiction to have first preference on the tax imposed on their residents up to their amount so imposed, which is usually 1.0

percent. The additional amount of tax revenue resulting from the City's non-resident EIT rate shall not be subject to sharing with the Reading School District or any other governmental entity.

The City shall continue to transfer all current year non-resident EIT revenue and the appropriate share of prior year non-resident EIT revenues each year through 2022 to a capital project account, separate from the General Fund, and exclusively designated to fund capital improvements.

This will generate an increasing amount of revenue to fund capital projects as a growing share of prior year revenues are transferred to the Capital Project Fund and the tax base grows.

Estimated Financial Impact (Capital Fund Only)

2020	2021	2022
$6,978,000	$7,199,000	$7,403,000

CP04 Continue to use liquid fuel allocation for road paving

Target Outcome:	Improved stewardship of City-owned assets; improved quality-of-life for residents and neighborhood development
Three-year Financial Impact:	N/A
Responsible Party:	Managing Director, Director of Administrative Services, Director of Public Works

As described above, the City previously used a large part of its Municipal Liquid Fuel (MLF) allocation to pay for street lighting. The 2014 Amended Recovery Plan reported that 65 percent of the City's MLF allocation went toward that purpose from 2010 to 2013. Shifting the street lighting expenses to the General Fund freed more money to pave roads.

The MLF allocation is not enough to cover all of Reading's paving needs. The City has over 150 linear miles of roads for which it is responsible. Assuming pavement has a useful life between 10 and 15 years, the City would have to pave 10-16 miles a year, without accounting for the backlog of paving needs.

Recognizing that limitation, the MLF allocation is the City's primary source for funding this basic need. Road paving has not been included in the capital budget to date and paving related to utility projects is geographically limited to the City streets where that work occurs.

While there is a wide range of street-related projects that can be funded using the MLF allocation, the City shall use as much of its MLF allocation as it practically can to pave roads. Expenditures related to activities like street lighting should be kept out of the Liquid Fuels Fund and expenditures from that fund related to vehicle purchases or road crew salaries and benefits should be kept to a minimum.

Debt management

CP05 Potential debt refunding

Target Outcome:	Reduced expenditures
Three-year Financial Impact:	$115,000
Responsible Party:	Director of Administrative Services

The City's independent financial advisor for debt management reports there is a possibility to refund the City's outstanding General Obligation Bonds, Series C of 2012 and advance refund the General Obligation Bonds, Series of 2014. Both refunding moves would occur in 2022 depending on market interest rates. The estimated net savings at this point are $1.4 million over the 11-year period from 2022 through 2033, or $115,000 per year. With the advice and guidance of its financial advisor, the City shall monitor these refunding opportunities and execute them in 2022 if doing so will improve the City's financial position over the five-year period following the refunding.

Estimated Financial Impact

2020	2021	2022
$0	$0	$115,000

CP06 Potential early debt repayment

Target Outcome:	Reduced expenditures
Three-year Financial Impact:	See below
Responsible Party:	Managing Director, Director of Administrative Services

Since entering oversight, the City has occasionally retired debt ahead of schedule to reduce the total amount paid. At the end of 2019, the City will owe $3.5 million in outstanding principal on the Reading Redevelopment Authority (RDA) lease revenue note, Series of 2015, plus another $450,000 in estimated interest payments. Repaying the note ahead of schedule would reduce the City's interest payments and remove $570,000 from the City's annual budget through 2026.

At this time it does not appear that the City will have enough reserves to repay this note and still keep its fund balance above the $22 million minimum level for the term of this Exit Plan[95]. However, if the City's financial performance exceeds the Exit Plan projections or if the City benefits from a financial windfall, the City shall consider repaying this loan to close the projected deficits.

CP07 Adopt a debt policy

Target Outcome:	Improved financial management
Three-year Financial Impact:	N/A
Responsible Party:	Managing Director, Director of Administrative Services, City Council

The City is starting to have preliminary conversations about whether to issue debt to fund capital projects, so the adoption of a debt policy to guide those decisions is timely. The City shall adopt a debt policy to guide future decisions on the timing, amount and amortization schedule for future debt and to help evaluate refinancing opportunities.

The Director of Administrative Services shall work with the City's financial advisor to identify appropriate debt metrics and goals to guide City government's debt decisions and develop a debt policy for consideration and adoption by City Council. Typical standards that municipal finance officials use elsewhere to evaluate the efficacy of potential debt transactions include: targets for debt service expenditures as a percentage of operating revenues; debt per capita; average maturity of debt; total debt as a percentage of assessed value; and the present value savings of proposed refinancing moves.

[95] Please see initiative GP05 in the General Provisions chapter for more information.

Economic and Community Development

When Reading's potential exit from Act 47 oversight is discussed, one common question is, "How will City government replace the money it loses when the commuter tax is eliminated?"

Since 2010 the City has used the extraordinary taxing powers in Act 47 to tax the earnings of people who work in Reading but live elsewhere. The non-resident (or commuter) tax generated $3.3 million in 2018 which the City split between the General Fund where it paid for daily operations and the Capital Project Fund where it funds projects like public safety vehicle replacement and building repairs. Effective January 2019 the City will use all current year commuter tax revenue for capital improvement projects.

As the law currently stands Reading will not be able to levy the commuter tax after it leaves Act 47 oversight. City officials have advocated for the Pennsylvania General Assembly to change the law so that Reading can still levy the commuter tax after leaving Act 47 oversight. They note the importance of fairly distributing the cost of providing local government services in a regional employment hub to all the people who benefit from those services, including commuters.

We also support the continuation of a commuter tax where the revenue is used to fund capital improvements that benefit residents and commuters. In 2018 the General Assembly's Local Government Commission solicited input on potential amendments to Act 47. In our response we specifically cited the value of enabling Reading to levy a commuter tax to fund capital projects after it leaves oversight.

There would still be a benefit to Reading's commuters if the City could continue to invest in road and bridge improvements and adequate replacement for public safety buildings and vehicles after exiting Act 47 – those are the services the commuters are most likely to use during the work day. But losing the commuter tax after exiting Act 47 means it will be much harder for Reading to make those investments.

As beneficial as the commuter tax is, the City gets far more money from the earned income tax on its own residents. The resident EIT generated $23.3 million in 2018, much of which went to the General Fund where it covers the cost of providing services like police patrol and fire suppression. The rest went to the Capital Fund[96].

If the law is changed so Reading can levy the commuter tax after it leaves Act 47, the resident EIT will still generate far more revenue than the commuter tax. If the law isn't changed, then growth in the resident EIT will be even more crucial since, at the moment, that is the only other source of recurring revenue to fund capital projects.

The primary variables that drive resident EIT revenue levels are the number of employed residents, the amount of income each one earns and the tax collection rate. Two of those three variables are determined in part by having job opportunities available to Reading residents and Reading's ability to attract and retain residents with growing income. So the potential for continued growth in the City's most important revenue depends in part on economic and community development.

The strength of the local economy is also important to City government's other major revenue sources. After the earned income tax, the largest tax revenues are tied to assessed value of property in Reading (real estate tax), the market value of real estate sold in Reading (deed transfer tax), the level of specific types of business activity conducted in Reading (business privilege tax) and the number of people working in Reading (local services tax). Pennsylvania's tax structure for local governments stresses the importance of how much economic activity happens within that particular municipality instead of using a regional

[96] Please see the Baseline Projection chapter for more information on the non-resident and resident EIT.

revenue-sharing approach. So economic and community development is again critical to City government's ability to fund the services it provides.

While officials readily agree about the importance of economic development, there is less consensus about the role that City government itself should play in facilitating it. Some advocate for using local tax policy and incentive programs to attract private sector investment into Reading that produces a benefit that arguably would not otherwise occur. Others are wary about whether these programs are effective and, if so, at what cost and to whom. Much economic development discussions within City Hall in recent years have focused on these types of discussions as they relate to individual large projects.

These discussions are important, but disagreement over City government's role should not paralyze City government's efforts in community and economic development. There are a range of functions that are indisputably City government's responsibility, like zoning, construction permitting, parking regulation and code enforcement. These are also functions that indisputably benefit Reading's residents when they are done well and hurt them when they are not. The benefits of clean, vibrant and attractive neighborhoods extend beyond City government's financial performance to the everyday lives of Reading's residents. The absence of an effective strategy to deal with vacant, blighted or dilapidated properties also has a broad negative impact.

Reading City government will not drive economic and community development on its own and the battle to overcome Reading's biggest economic challenges, like the high concentration of poverty in the City's borders, will continue long after oversight ends. But City government's leaders will determine to what extent their organization will be a constructive partner in larger efforts to overcome those challenges and make Reading a more attractive place to live and work.

The recommendations below focus on a handful of tangible actions the City government should take in the next three years.

ED01. Stabilize department leadership

Target Outcome:	Build capacity to execute the Department's core responsibilities
Three-year Financial Impact:	($98,000)
Responsible Party:	Managing Director

The Financial Management Chapter discusses the City's difficulty in filling four key positions within the Department of Administrative Services and the impact on the City's ability to manage its finances. The same problem exists in the Community Development Department.

As of June 2019 the City has an Acting Director of Community Development; an acting Codes Manager and a vacancy in the Chief Building Officer position. That means three of the Department's four divisions in the General Fund – Administration, Property Maintenance Inspection and Building and Trades -- do not have a permanent leader. The fourth division is led by the Planning Manager who is splitting his time between leading that division and serving as the Acting Department Director. The City has two people to fill four positions.

	April 2019	Goal
CD Director	Split	Yes
Codes Manager	Acting	Yes
Chief Building Officer	Vacant	Yes
Planning Manager	Split	Yes

Just as the City cannot manage its finances effectively without leadership at the top of the Administrative Services department, it cannot manage these functions that are critical to tax base development, quality-of-life and resident safety without stability at the top of the Community Development Department

- According to the City's Administrative Code, the **Department Director** is "responsible for the preparation of short- and long-range planning, economic and community development programs." The Director oversees the Property Maintenance (i.e. Code Enforcement), Building and Trades and Planning/Zoning Divisions and ensures they work efficiently and effectively. The Director oversees Reading's use of federal and state programs, such as Community Development Block Grant (CDBG) funding, to ensure they meet the community's needs and comply with program regulations.

- The **Chief Building Official** manages the eight-position unit responsible for enforcing and recommending changes to Reading's building code; reviewing building plans and permit applications; and conducting inspections to ensure compliance and identify unsafe building conditions. An architectural background is preferred given the nature of the unit's work.

- The **Codes Manager** oversees the 28-person unit responsible for enforcing compliance with the property maintenance code and related ordinances. The Manager administers the City's rental housing permitting and inspection process and oversees health and safety inspections at food-serving establishments.

- The **Planning Manager** position was created by the Scott Administration in 2018 with the support of City Council and the Greater Reading Chamber Alliance. The position oversees the City's land-use planning, zoning and historical architectural review board (HARB) functions.

The City shall fill the vacancies noted in the table above and maintain, fund and fill these four positions going forward. The CBO vacancy is a high priority. Lack of capacity at the top of the Building and Trades Division stalls plan reviews necessary for health and safety, economic development and tax base growth (i.e. revenue generation). The position description requires that the position holder have current certifications as a Building Code Official, Commercial Building Inspector, Building Plans Examiner, and Commercial Accessibility Inspector as required by the Pennsylvania Uniform Construction Code. The Administration noted that architectural experience is preferred, but not required.

At the Administration's recommendation the Exit Plan increases the allocation for non-represented employees so the City has a better chance to fill this vacancy. The estimated financial impact shown below accounts for the salary growth pattern described in the Workforce chapter and the marginal increase for higher payroll taxes.

Estimated Financial Impact

2020	2021	2022
($32,000)	($33,000)	($33,000)

ED02. Reinstate the confidential secretary position supporting the Director of Community Development

Target Outcome:	Build capacity to execute the Department's core responsibilities
Three-year Financial Impact:	($228,000)
Responsible Party:	Administrative Services, Community Development

The City previously had a confidential secretary assigned to support the Director of Community Development with responsibilities such as scheduling and clerical work. The 2016 position ordinance indicates the position was split funded by the General Fund and the Community Development Fund. There are similar positions assigned to support the Police Chief, the Public Works Director and the Solicitor[97].

The City removed the position from the 2017 budget so the Department Director has not had this support in a couple years. The City shall reinstate the confidential secretary position so that the Director can focus on the many duties assigned to that position. It is not efficient or cost effective for the Director to handle administrative tasks that are assigned to secretarial positions in other departments. This additional position will also help the City resolve the backlog of zoning application and appeal reviews described in initiative ED05.

The Exit Plan allocates $73,000 for this position in 2020 based on the average salary of the other employees who hold the Confidential Secretary title and the City's maximum contribution to the cost of family health insurance. The allocation grows in line with the recommended wage pattern described in initiative WF10 in the Workforce Chapter. The cost of this position is incorporated in the Exit Plan's maximum compensation allocation for non-represented employees.

Estimated Financial Impact

2020	2021	2022
($73,000)	($76,000)	($79,000)

ED03. Regularly report key performance indicators related to rental housing

Target Outcome:	Improved quality-of-life for residents; stronger tax base
Three-year Financial Impact:	N/A
Responsible Party:	Department Director, Codes Manager

Most housing units in Reading are renter-occupied and rental units account for a growing percentage of total housing units in the City. More than half of all renters are spending more than a third of their total household income on their rent. So the quality of rental housing in Reading is critical to City as a whole and individual families throughout Reading. The table below shows some of the key statistics for Reading's rental housing stock.

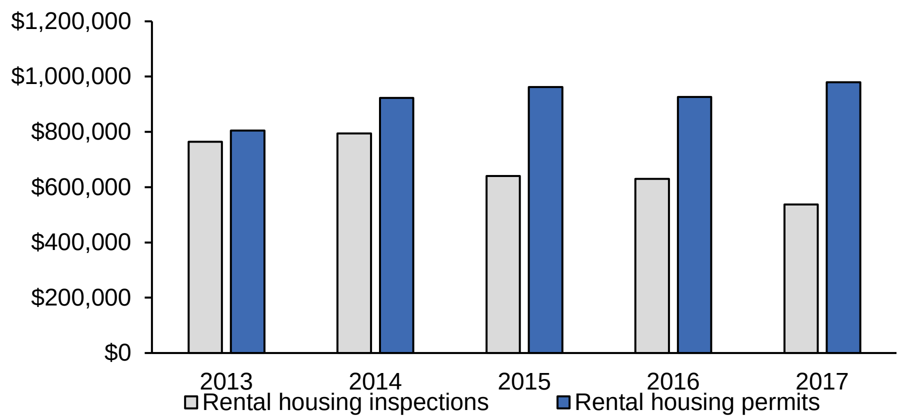
[97] The Fire Chief also has an Administrative Secretary, though that position is part of the AFSCME 2763 bargaining unit. The Exit Plan has a separate initiative re-establishing the secretarial position in support of the Director of Administrative Services.

	2013	2014	2015	2016	2017
Owner-occupied housing units	13,136	13,030	12,617	11,849	11,765
Renter-occupied housing units	17,869	17,405	17,473	17,170	17,215
Rental as percent of total	57.6%	57.2%	58.1%	59.2%	59.4%
Owner-occupied vacancy rate	3.8%	4.2%	4.1%	5.1%	5.1%
Renter-occupied vacancy rate	6.5%	7.7%	9.2%	9.3%	10.3%
Median home value (all owner-occupied units)	$68,200	$67,500	$67,600	$68,400	$69,500
Median gross rent	$722	$732	$731	$752	$770
Percentage of renters who spent at least 35% of total household income on rent	55.1%	56.8%	54.6%	53.2%	50.9%

Source: US Census Bureau, American Community Survey, five-year estimates

In our quarterly financial reports we found a noteworthy trend in the revenues related to rental housing. Since 2013 the City has collected a growing amount of revenue from rental housing permits, but a falling amount of revenue from rental housing inspections. This suggests that there are more known rental units in Reading but less inspections of those units.

Rental Housing Revenues (Current plus Prior Years)



Property Maintenance Inspection (PMI) management explained that the City is doing a better job identifying and registering rental units, which explains the increase in permit revenues even though the census data shows the number of renter-occupied units falling over this period. Management also cited staffing shortages – either vacant positions or employees who were not yet certified to conduct inspections -- hampered the City's ability to conduct inspections. That problem has been largely addressed in the near term and 2018 had more inspection revenue than 2017.

Reading would benefit from more frequent and more public data analysis and discussion of its rental inspection program. This same process helped focus attention and monitor progress on key issues related the City's financial performance and it can work in this area, too.

PFM as Recovery Coordinator worked with PMI on performance measurement during the previous administration and PMI still tracks some of those metrics. While those discussions would often turn to questions about the City's collection rates for certain fines, like the quality-of-life violations, revenue generation should not be the primary concern and may not even need to be part of the discussion. While cost recovery would be ideal, the City's ability to generate revenue from rental inspections and permits is limited to those programs' costs and the primary goal is cleaner, safer neighborhoods, which has its own economic benefit.

On a quarterly basis the Community Development Department shall provide a report to City Council that shows data and analysis on the following points:

- Number of registered rental properties broken down by structure type (single, multi-family units, etc)
- Number of illegal rental properties identified
- Number of filled/vacant inspector positions assigned to rental inspections
- Number of rental inspections scheduled, conducted, cancelled because of "no shows," etc.
- Percent of known rental properties inspected within a three-year cycle
- Results of the inspection process (e.g. X percent found compliant, X percent found with violations and scheduled for re-inspection)
- Most common violations identified during the rental inspection process

The Department Director and Codes Manager shall present this information to Council publicly in a Committee of the Whole meeting and answer questions from Council. The Department Director and Codes Manager can add or replace data points as needed. The overall goal is to create a deliberate, data-driven dialogue that helps improve transparency and identify necessary amendments to the City's ordinances, fee and fine schedules and related documents.

ED04. Finalize and execute blight reduction strategy

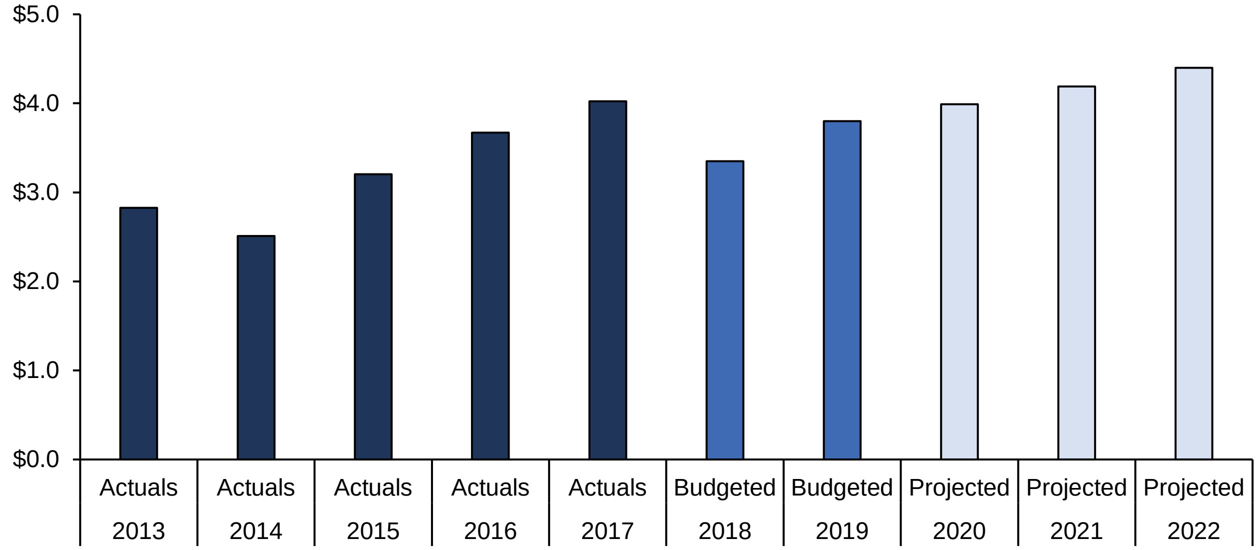
Target Outcome	Improved quality of life for residents; stronger tax base
Three-year Financial Impact:	See below
Responsible Party:	Managing Director, Department Director

In 2017 the City began working with an external subject matter expert on a Housing and Blight Strategy. The strategy is scheduled for release and presentation to City Council and other parties later this year. Considering the length of the process and the urgency of the subject matter, the City should review, adopt and begin to take action on this strategy before the end of this year.

The City assigned $1 million of its General Fund balance (i.e. prior year reserves) to housing issues which the City should use to execute this strategy. The City also allocated $440,000 for sidewalk repairs in the 2018 budget, which was not spent and can be used to execute this strategy.

These allocations coupled with some of the City's federal CDBG and HOME funding will help the City start to execute this strategy. Eventually the City will need to identify more funding to implement any recommendations related to increased or targeted demolition activity; short-term code enforcement "sweeps" or "surges"; or technology upgrades. The City shall consider allocating a portion of its real estate transfer tax revenue to this purpose if the revenues continue to grow at a rapid, uneven pace. As described in the Baseline Projection chapter, transfer tax revenues grew rapidly but unevenly from 2013 to 2017 and they are subject to further swings whenever large property sales occur. The baseline projection assumes 5 percent annual growth.

Real Estate Transfer Tax Revenue ($ Millions)



The transfer tax's volatile nature makes it a problematic source for funding predictable, recurring expenditures but a useful one for funding special projects. For example, the City could adopt a policy such that, if transfer tax revenues grow by more than 5 percent in any year, the City will take the difference and use it for initiatives identified in the blight reduction strategy. So, if the transfer tax grows by 10 percent in 2020 instead of the five percent projected in the baseline, the City would have additional funding to execute this strategy. There are potential variations on this concept including setting a cap on how much can be diverted to blight reduction (i.e. revenue growth from 5 *to 10 percent* assigned to blight reduction).

ED05. Clear zoning application and appeal review backlog

Target Outcome:	Improved quality-of-life for residents; stronger tax base
Three-year Financial Impact:	See ED02
Responsible Party:	Department Director, Planning Manager

The Reading Zoning Ordinance of 2010 is intended to "establish a precise set of policies and regulations for the use of land and structures in the City…to promote and to protect the public health, safety, comfort, convenience, and general welfare of the people." The Reading's Zoning Ordinance should be consistent with the Pennsylvania Municipalities Planning Code and the City's comprehensive plan.

When a person or organization wants to begin new construction, change how property is used or alter a building's structure, they apply for a zoning permit that is reviewed by the Zoning Administrator. The Zoning Administrator can also initiate an investigation into whether someone violated the zoning code and begin enforcement proceedings that potentially include fines. The violation recipient can appeal it to the City's Zoning Hearing Board.

The City's current zoning staff inherited a backlog zoning/housing permit applications submitted between 2014 and 2016 that were never reviewed or resolved. Zoning does not have a fulltime administrative assistant which would maintain a continuity of processes, retain institutional knowledge and avoid additional backlogs due to staff turnover. Current zoning enforcement is hindered by the lack of resolution.

While the zoning ordinance prohibits people from beginning their project until they receive a zoning permit, it is likely that some applicants have interpreted this silence or a lack of response as approval of their project. Unresolved permits leave applicants and the surrounding neighborhood in limbo as to whether there is a problem that needs to be corrected.

This backlog is disheartening because the City made substantial progress toward eliminating a different zoning backlog as part of the 2014 Amended Recovery Plan. That Plan required the City to resolve 2,700 "reconciliation cases" in which there were disputes regarding the accurate number of allowable rental units in a property[98]. The City developed a process and cleared much of that backlog in 2015. Now there is a different backlog in the same functional area.

The City needs to resolve this backlog and ensure there is sufficient capacity to avoid falling behind again. Initiative ED02 provides a position to help with this objective.

ED06. Return the Fifth and Penn Properties to productive use

Target Outcome:	Increased tax base for the City; reduce facility maintenance workload and eliminate potential draw on limited capital project funds
Three-year Financial Impact:	See below
Responsible Party:	Managing Director, Department Director

The prior recommendations have intentionally focused on the regular "nuts and bolts" aspects of the Community Development Department's work instead of addressing individual projects or potential development sites. There is one exception worth highlighting as a high priority for the City – returning the five properties on the northwest corner of Fifth and Penn Streets, sometimes called "Penn Square," to productive use.

In 2013 the City purchased these five properties. In 2014 the City entered into an agreement with Our City Reading (OCR) to redevelop them and in 2015 the parties entered an agreement for OCR to manage the properties, with the City retaining ownership. In early 2017 the City and OCR agreed to dissolve that agreement and the City issued requests for proposals (RFPs) seeking bids to redevelop the properties. The City reviewed and rejected the small number of bids eventually received. The Greater Reading Chamber Alliance is now helping the City with the RFP process.

As the *Reading Eagle* noted, the properties are in a pivotal location downtown:

It is crucial to downtown Reading's future for this work to be done right…The north side of the 400 block of Penn Street is devoid of commercial activity except during the weekly Penn Street Market. Penn Square is the heart of downtown Reading, yet a big portion of it is empty[99].

Returning these properties to the tax rolls would do more than generate additional tax revenues, though that is one objective for redevelopment. A successful project would turn a long-vacant, highly visible site

[98] See Amended Recovery Plan initiative CD01, pages 233-234.
[99] *Editorial: Plans for five downtown buildings hit a snag when project bids are deemed insufficient.* June 20, 2017.

into a vibrant block within a compact geographic area where other organizations are also working to bring new economic activity.

Just as there is potentially large upside for redeveloping these properties, there is large downside for failing to do so. Because the City owns the properties, it is responsible for maintaining them. If an urgent maintenance or repair need arises at these properties, City government is responsible to fund that work, just as it does at City Hall or City Park, even though the Penn Square properties do not serve a public purpose in the same way these other facilities do.

In 2018 the City conducted a facility condition assessment to identify the major repair and replacement needs at most City-owned facilities[100] over an 11-year period, ranging from electrical and plumbing work to stairs and roofing. The Penn Square properties account for four of the six largest properties of need and the combined need across the five properties ($18.2 million over 11 years) is larger than any other category of properties reviewed. If the City allowed the Penn Square properties to deteriorate, that would set a bad example for other property owners and exacerbate concerns about downtown's lack of vibrancy. But there are too many other City-owned properties that need capital improvements to treat Penn Square as an investment priority over the long term[101].

Identified Needs by Facility, 2018 through 2028

Rank	Facility	Total
1	City Hall	$11,181,605
2	Fifth and Penn - Building 1	$7,529,293
3	First Energy Stadium	$4,965,149
4	Fifth and Penn - Building 2	$3,877,590
5	Fifth and Penn - Building 3	$3,687,228
6	Fifth and Penn - Building 5	$2,377,434

According to the facility assessment, the price of waiting to redevelop these properties is steep. More than half of the $18.2 million estimated needs occur from 2020 through 2022, and that excludes $2.7 million in projects identified for 2018 and 2019. The Administration and Council should treat the redevelopment of Penn Square as a high-priority, time sensitive matter and push it to a successful conclusion.

[100] The assessment did not address buildings already identified for replacement or closure.
[101] Please see the Capital and Debt chapter for more discussion of the needs identified in the facility condition assessment.

General Provisions

Section 256 of Act 47 states that this Exit Plan "shall contain such elements as may be necessary to ensure termination of distressed status after three years, including, but not limited to" the following:

1) The sale, lease, conveyance, assignment or other use or disposition of the assets of the distressed municipality.

2) Functional consolidation of or privatization of existing municipal services.

3) The execution, approval, modification, rejection, renegotiation or termination of contracts or agreements of the distressed municipality, provided, however, that the provisions of section 252 shall apply to any exit plan adopted in accordance with this subchapter.

4) Changes in the form of municipal government or the configuration of elected or appointed municipal officials and employees as permitted by law.

This chapter addresses those concepts and then finishes with two initiatives that will improve Reading's chance to have its distressed status terminated after three years.

Sale, lease or disposition of Reading's assets

When the City of Reading first entered Act 47 oversight, the question was raised whether it should sell its water system or lease it under different terms than those provided to the Reading Area Water Authority (RAWA). This issue was discussed again in the months leading up to the Amended Recovery Plan's release in 2014. That year Reading voters approved an amendment to the City Charter that requires City Council to get voter approval before selling or leasing for longer than 10 years any city asset worth $10 million or more, unless it is sold or leased to a City-created municipal authority.

The City and RAWA adopted an amended lease agreement in 2017 that established a $9,275,000 payment from RAWA to the City for that year. The lease increases RAWA's payment to the City by 2 percent each year in 2018 and 2019 and 1.5 percent each year in 2020, 2021 and 2022. The Exit Plan baseline projection includes those payments.

The lease also requires RAWA to pay the City 25 percent of the net annual revenues generated when it enters into a contract to "supply new commercial customers with water in an amount in excess of ten percent (10%) of the current permitted capacity."[102] RAWA reached an agreement in 2018 to provide water to a new power plant in Birdsboro. RAWA anticipates $500,000 in revenue from this new customer in 2019, a quarter of which will go to the City's General Fund.

The City received $50,000 in the first quarter of 2019, which translates to $200,000 a year, even though the power plant was yet not fully functional. The baseline projection shows $200,000 in revenue from the Birdsboro Power Plant in 2020 and assumes revenue will increase to $500,000 a year by 2022 as the power plant comes fully online and its water usage increases.

Parking system

The parking system is the other large City-owned asset operated in part by a municipal authority. City ordinance empowers the Reading Parking Authority (RPA) to administer the on-street parking system (i.e. parking meters), in addition to the RPA's own garages. As described in the Baseline Projection chapter, the RPA's total payments to the City ranged from $1 million to $5.2 million in recent years, excluding items that the RPA receives and passes through to the City, like traffic fines.

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[102] 2017 Amended Lease Agreement. Section 6.03.

The City's elected officials sought higher contributions from the RPA In 2010 and 2014 to offset the level of real estate tax increases initially shown in the original and Amended Recovery Plans. The RPA contributed the amounts included in the Recovery Plans until 2017. The City budgeted $1.5 million for RPA contributions that year and received $1.0 million. The City budgeted $1.9 million in 2018 and received $400,000 according to the preliminary unaudited results. The RPA explained that it cannot afford the higher levels of contributions because of its own financial needs, including paying for repairs and renovations at its garages.

In November 2018, the RPA's solicitor sent the City a letter stating the RPA would pay the City $850,000 in 2019. The Exit Plan baseline carries that amount forward through 2022 in a *status quo* scenario, even though there is no agreement in place between the parties that guarantees that payment. The lack of a written agreement has created tension and uncertainty for both parties. Both parties would benefit from a lease arrangement that provides more certainty and stability for their own budgeting and multi-year planning purposes.

GP01. Negotiate multi-year contribution agreement with the Reading Parking Authority

Target Outcome:	Stability for multi-year financial planning purposes
Three-year Financial Impact:	TBD
Responsible Party:	Managing Director

The City shall seek to negotiate a written multi-year contribution agreement with the Reading Parking Authority that sets the terms of the RPA's total contribution to the City. The agreement shall set the Authority's payment amount for at least the term of this Exit Plan.

The RAWA lease provides a good template for such an agreement. It describes RAWA's initial payment amount and then sets a manageable growth rate for future payments. The RAWA lease also provides a good template for describing how revenues related to system expansion or new large customers will be split between the Authority and the City. The RPA lease should also set a schedule for the Authority to remit traffic fines and similar revenues to the City where RPA serves as a pass through.

Previous Recovery Plans assumed a higher RPA contribution as part of the City's deficit closing strategy. This Exit Plan does not assume any revenue above the $850,000 per year in the baseline. If the parties agree to a higher contribution amount or one that grows over time, that amount can offset some of the potential real estate tax increase described in initiative GP06. We caution both parties, though, to avoid the mistakes made during the 2014 Recovery Plan amendment process and agree to a stable contribution level that is clearly described in writing ahead of time.[103]

Sewer system

The City owns and operates a sewer system that includes a wastewater treatment plant, storm and sanitary sewer lines, and an industrial pre-treatment program. The City records revenues and expenditures related to these functions in separate enterprise funds. The Sewer Fund makes an annual payment of $3 million to the General Fund, and that amount is capped by a federal consent decree settlement executed in November 2005. The Sewer Fund also reimburses the General Fund $1.2 million for the cost of services provided by Human Resources, Accounting and other City departments budgeted within the General Fund.

The City received input from an external subject matter expert on what the appropriate transfer payment would be, absent the consent agreement. The expert recommended that the City calculate the transfer

[103] On June 10, 2019, the Reading Parking Authority Executive Director told City Council that the RPA was willing to work on an agreement through which it would contribute $850,000 a year for five years. There was no written agreement in place at the end of June 2019.

payment based on a combination of a franchise fee and a payment-in-lieu-of-taxes (PILOT). The franchise fee would be 5.0 percent to 10.0 percent of the sewer system's gross receipts. The PILOT would be calculated by applying the General Fund millage rate to the value of the sewer system.

The initial estimate for this recommended transfer payment was not significantly higher than the $3.0 million transfer that the City currently receives under the consent decree. But this recommended methodology allows the transfer payment to grow when the value of the system does, as will be the case when the wastewater treatment plant upgrade is completed. It also allows the transfer payment to grow as system revenues do. Meanwhile the consent decree caps the transfer payment at $3 million.

The City may be able to increase the transfer payment once the City satisfies the terms of the consent decree and the $3 million cap is lifted. We note that possibility here, but have not assumed it will occur during the term of this Exit Plan.

At this time, we do not anticipate that the City will execute a long-term lease or sale of these major assets during the Exit Plan term. But the following provision governs the use of any such asset monetization proceeds or other windfalls occurring while the City remains in Act 47 oversight.

GP02. Direct windfall proceeds to Exit Plan priorities

Target outcome:	Financial stability; preserve City infrastructure
Three-Year Financial Impact:	See below
Responsible party:	Mayor; Council; Managing Director; Director of Administrative Services

During the period covered by this Exit Plan, the City may benefit from financial windfalls – unexpected, significant, short-term increases in revenues above budgeted or projected levels or reductions below those levels. By their nature, these windfalls cannot be predicted, but the City should have a plan for their use in case they arrive.

With the Coordinator's guidance, the City shall use any financial windfalls of at least $2,000,000[104] for the following priorities, if the City does not need it to address a decrease in revenues or increase in expenditures within the same year:

- Funding capital projects identified through the asset condition assessment described in the Capital and Debt chapter;
- Making an additional debt service payment beyond the amount of principal and interest due in a particular year; or
- Making an additional contribution to the Other Post Employment Benefit (OPEB) Trust Fund.

Other assets

As described in the 2014 Amended Recovery Plan, the City has smaller facilities and parcels that it leases to individual organizations. This Exit Plan carries forward the related initiative from the Amended Recovery Plan.

[104] This is a non-recurring increase in revenues that is at least $2,000,000 above the levels projected in the Exit Plan or a non-recurring decrease in expenditures that is at least $2,000,000 below the levels projected in the Exit Plan.

GP03. Share facility responsibilities with lessors

Target outcome:	Improved stewardship of facilities, net cost reduction
Three-Year Financial Impact:	N/A
Responsible party:	Law Department, Public Works

The costs of operating facilities owned by the City but used by other entities include utilities, maintenance and repairs, and capital costs. For the City to ensure that it can properly care for its facilities over the long term, the City would need to budget for preventive maintenance and unexpected repairs. It would also establish a reserve to accumulate funds that will periodically be needed for capital projects. Since lessees are benefiting from the use of City facilities, it would not be fair for Reading's taxpayers to bear all of these costs.

In some cases City officials deliberately decided to provide these services or cover these costs as a subsidy to support the organization's mission. Given the City's financial limitations and the poor condition of many assets that are solely City government's responsibility, the City should continue to re-evaluate these arrangements. In instances where the City decides to continue the subsidy, it should be transparent, quantified and capped or reduced over time. In all instances, the City needs to be aware of the cost implications of the lease terms and accountable for any use of limited City resources for the benefit of lessees.

First, the City shall ensure that there are current lease agreements in place for all facilities used by other entities. The City should standardize the terms of lease agreements where appropriate to simplify administration and make lease terms more equitable.

Second, the City shall develop a policy regarding how costs are shared between the City and lessees. The policy may differentiate between the cost-sharing obligations under leases that would result in some public benefit and those that would only have a private benefit. The goal is to ensure that respective financial responsibilities of City and lessees are shared in a manner that is fair and transparent.

Operational changes: Consolidation, privatization and contract modifications

The next two potential Exit Plan provisions explicitly suggested in Act 47 relate to government's daily operations:

2) *Functional consolidation of or privatization of existing municipal services.*

3) *The execution, approval, modification, rejection, renegotiation or termination of contracts or agreements of the distressed municipality, provided, however, that the provisions of section 252 shall apply to any exit plan adopted in accordance with this subchapter.*

The City has used consolidation and outsourcing to reduce costs, improve service or gain efficiency since entering oversight. Some of those moves include:

- Transferring tax collection duties to other entities.
- Consolidating functions in the Citizens Service Center and reducing headcount.
- Eliminating the Fire Department's non-emergency medical transport function in view of other existing service providers.
- Transferring water system employees to the Reading Area Water Authority.

Initiatives in the original and Amended Recovery Plans drove some of these changes. The City undertook other initiatives on its own, such as outsourcing recycling collection after bringing the function in-house for a couple years and transferring some billing duties to RAWA.

While we do not consider further consolidation or privatization as “necessary to ensure termination of distressed status,” the City should still identify opportunities to reduce its expenditures through functional consolidation or privatization. The City should regularly review whether there are alternative providers that can provide the same or better service at the same or lower cost.

We do note one function where the current arrangement is not cost effective for Reading tax payers.

As described in the original and Amended Recovery Plans, Reading has an unusual system for dispatching emergency 911 (E911) calls. In most Pennsylvania communities, County government handles E911 dispatch and funds that service at no charge to the municipalities. Counties receive Commonwealth phone surcharge revenue to fund these services, and the General Assembly changed the law to provide counties with more revenue for this purpose in 2015.

The Berks County Department of Emergency Services handles E911 dispatch for most municipalities in its borders, but it also charges them a portion of the cost of service. For example, the City of Reading allocates $180,000 in its 2019 budget to pay the County to dispatch E911 calls for fire and emergency medical services (EMS). Reading has its own police E911 dispatching unit, separate from Berks County, within the City’s police department. So Reading retains a large part of the E911 dispatch duties and gets none of the Commonwealth surcharge revenue that pays for that function.

The City has traditionally resisted recommendations to consolidate its police dispatch functions with the County, including those made in the 2010 and 2014 Recovery Plans. Prior police department leadership cited the difference between Reading’s dispatch needs, as a densely populated urban community, and those of the smaller rural and suburban municipalities that Berks County serves. Fire department leadership mentioned the County’s dispatching approach as a potential contributor to the Department’s high overtime costs in that area. In both cases, the City public safety leaders’ preference is to keep (or bring) the function in-house.

The financial reality is there is a mismatch in Reading between the entity delivering the service (at least in terms of police E911 dispatch) and the entity that receives the money intended to pay for the service. And this mismatch does not exist in other Pennsylvania cities, which also have different dispatching needs than their smaller suburban neighbors.

The Exit Plan does not require the City to resolve this issue to exit Act 47 oversight, and the best solution would likely require County participation, which this Plan cannot mandate. But this remains an opportunity for improvement.

We have noted elsewhere in this Exit Plan instances where the “execution, approval, modification, rejection, renegotiation or termination of contracts or agreements of the distressed municipality” are important to the City’s ability to exit Act 47 oversight. In terms of service contracts, our primary focus is on the City’s ability to procure the services for which it has allocated money in its budget, particularly related to the execution of capital projects, and then pay those vendors in a timely manner. We addressed those concerns with initiatives in the Capital and Debt and Financial Management chapters respectively.

Compared to the original and Amended Recovery Plans, this Exit Plan has fewer recommendations requiring the City to consider or make changes to the daily operations of its Police, Fire or Public Works Departments. This is intentional since this Exit Plan is primary focused on the changes necessary to “ensure termination of distressed status after three years” and those that will bolster City government’s chances to have stable financial performance after Reading exits oversight. Most of those priorities involve duties assigned primarily to the Administrative Service and Community Development departments.

If the Administration or City Council wants guidance and support from the Coordinator in addressing operational challenges not specifically covered by Exit Plan initiatives, like the aforementioned issues related to E911 dispatch, the Coordinator remains committed to helping Reading in those areas.

Change in the form of government

The fourth potential Exit Plan provision refers to changes in the form of government

4) *Changes in the form of municipal government or the configuration of elected or appointed municipal officials and employees as permitted by law.*

Some Act 47 communities have adopted a Home Rule Charter to gain more local control over their tax rates. Depending on the charter's provisions, Home Rule municipalities can increase certain tax rates above the level otherwise permitted by Pennsylvania law. Some municipalities in Act 47 oversight have gone through the Home Rule process or are currently doing so they can retain the extraordinary resident taxing powers that Act 47 provides.

Reading is already a Home Rule municipality and has flexibility under its Charter to change levies like the resident earned income tax and per capita tax. Home Rule does not expand a community's ability to tax non-residents. So City government cannot do anything on its own to retain the non-resident earned income taxing power it has while in Act 47 oversight.

A change in Reading's form government is not "necessary to ensure termination of distressed status." There are cities that have exited Act 47 oversight with a similar "Strong Mayor" form of government (Pittsburgh, Nanticoke) and those that exited with a Council-Manager form of government (Altoona, Clairton).

We do recommend the City consider two sets of changes to the Home Rule Charter that are also not necessary to exit Act 47, but would improve the Charter document or government itself. The first set of changes relates to the Charter's counterproductive language regarding capital projects, as explained at the end of the Capital and Debt chapter. The second set relates to the City's residency requirement.

GP04. Consider changes to the City's residency requirement for select positions

Target outcome:	Improved efficiency in filling key vacancies
Three-Year Financial Impact:	N/A
Responsible party:	Mayor, Council, Charter Review Board

Section 705 of Reading's Home Rule Charter has the following residency requirement:
All such heads of departments, offices and agencies need not be residents of the City at the time of appointment, but after appointment, shall reside in the City. City residency shall be required within 12 months of being appointed.

While the Charter does not list all the specific positions to which this residency requirement applies, we assume it covers the Managing Director, the City Clerk and the department directors for Administrative Services, Community Development, Fire, Law, Police and Public Works.

Reading's residency requirement is not unusual. Among comparably sized Pennsylvania cities, Allentown and Scranton also require their department directors to live within their city limits. Bethlehem repealed its requirement in 1988, and Erie gives its employees the flexibility to live within a 15-mile radius of Municipal Hall, which covers multiple suburban municipalities.

Residency Requirements for Department Directors

Reading	**See above**
Allentown	"All such heads of departments, offices and agencies, need not be residents at the time of appointment, but after appointment shall reside in the City. City residency shall be required within twelve (12) months of being appointed. The City Solicitor shall either be a resident and/or a taxpayer of the City of Allentown prior to their appointment."
Bethlehem	Residency requirement repealed in 1988
Erie	"All persons appointed to any office or position of employment by the City in any of its departments, bureaus and offices shall maintain a residence within a 15-mile radius of the Municipal Building during the term of such employment."
Scranton[105]	Any employee hired after March 1980 "shall have six months from the time of commencement of employment to acquire a bona fide residence within the corporate limits of the City."

The arguments in favor of residency requirements often focus on loyalty (people are theoretically more familiar with, loyal to and invested in the place where they live); equity (people whose jobs depend on city taxes rates should be subject to those tax rates); and economics (governments receive most of their revenues from residency-based taxes so it is better to have these relatively high paying jobs located within city limits). We understand the logic and appeal of these arguments.

However, there is also a cost associated with applying these type of residency requirements to senior positions where specialized, professional expertise is required. The residency requirement was cited as one of the reasons that the Administrative Services Director position was vacant for so long, and the inability to fill that position had financial repercussions for Reading.[106] City Council had difficulty filling the Auditor position – which is an elected position and should be held to a higher residency standard – because of a lack of interest among residents qualified for that position. There is a risk that Reading will have this problem again when it fills the Solicitor position on a permanent basis.[107] The pool of candidates who are certified attorneys, qualified to be the senior legal advisor for a complicated public organization, interested in doing so *and* Reading residents is likely to be small.

The practical effect of this residency requirement is that it puts Reading at a competitive disadvantage with other organizations seeking the same professional expertise without requiring candidates to change their residency. It gives City government a smaller pool of candidates to consider and prioritizes residency over other relevant factors, like their experience and qualifications for a position. It makes it harder to fill key vacancies, which translates to less capacity in critical areas and diminished effectiveness for the organization overall. It requires Reading City government to adhere to a more restrictive set of rules than other businesses or residents themselves would likely use to choose the lawyer, financial manager or engineer who works for them.

We recognize the sensitivity and complexity of this issue and are not recommending that the City initiate the charter amendment process that would be necessary to change the residency requirement. But we

[105] Employees who lived outside Scranton before March 1980 were not required to move into the city unless they changed residence, in which case the residency requirement applied.
[106] Please see the Financial Management chapter for more information.
[107] At the time of this report's release Reading has its second in a series of acting Solicitors.

encourage the Mayor, City Council and the Charter Review Commission to have a thoughtful discussion about whether there are particular positions where the residency requirement should be changed for the benefit of the organization and the tax payers it serves.

Meeting the criteria for successful exit

During the term of this Exit Plan, the Secretary of the Department of Community and Economic Development (DCED) may issue a determination that conditions within Reading warrant a termination of its financial distress status and that the City can exit Act 47 successfully before the end of 2022. Act 47 empowers the Secretary to make this determination if the City adopts the Exit Plan and the Coordinator makes a written recommendation that Reading's distress status be rescinded.

For PFM as Coordinator to recommend that Reading should exit oversight before the three-year Exit Plan is complete, the City would have to clearly demonstrate that it meets the four criteria that Act 47 sets to evaluate a municipality's readiness to exit oversight. The first criterion requires "reasonable probability of future balanced budgets absent participation in this act" and the fourth criterion requires that "reasonably projected revenues of the municipality are sufficient to fund ongoing necessary expenditures." So demonstrating the ability to balance revenues against expenditures now and ***into the future*** will be critical.

The next two initiatives are specifically written to put Reading in the best position possible to successfully exit Act 47 oversight.

GP05. Maintain an unrestricted fund balance in compliance with the City's policy

Target outcome:	Financial stability
Three-Year Financial Impact:	N/A
Responsible party:	Mayor; Council; Managing Director; Director of Administrative Services

The original Recovery Plan adopted in 2010 required the City to "seek to build and maintain an undesignated fund balance equal to 5.0 to 15.0 percent of annual recurring General Fund revenues."[108] The Government Finance Officers Association (GFOA) now recommends a higher minimum level of fund balance:

> *GFOA recommends, at a minimum, that general purpose governments, regardless of size maintain unrestricted fund balance in their general fund of no less than two months of regular general fund operating revenues or regular general fund operating expenditures.*

Fund balance helps the City pay its obligations early in the year before tax revenues arrive, without having to issue Tax Revenue Anticipation Notes and paying interest on borrowed money that funds basic operations early in the year. Fund balance provides a buffer against unexpected revenue shortfalls or unbudgeted expenditures. It is also one of the criteria that creditors and rating agencies use to determine the City's creditworthiness, which directly impacts the interest rates the City pays when it issues debt.

In recognition of those objectives the City adopted an ordinance requiring it to retain a minimum fund balance of 20 percent of regular General Fund operating expenditures or $22 million, whichever is higher. The table below shows the levels of unrestricted fund balance shown in the City's year-end audit since 2014.

[108] Initiative FI07, pages 101-102.

Unrestricted (i.e. Unassigned + Assigned) Fund Balance

	2013	2014	2015	2016	2017
Next year budget appropriations	$0	$2,500,000	$957,000	$850,000	$1,250,000
Other post-employment benefits	$0	$0	$1,000,000	$1,000,000	$1,000,000
Street paving/Liquid Fuels	$0	$0	$0	$1,500,000	$1,500,000
Capital projects - Fire Station	$0	$0	$0	$2,000,000	$4,400,000
City housing improvements	$0	$0	$0	$0	$1,000,000
Demolition	$0	$0	$0	$0	$1,000,000
Property acquisition	$0	$0	$0	$0	$1,000,000
Early debt retirement	$0	$0	$6,570,000	$0	$0
Assigned GF Balance	***$0***	***$2,500,000***	***$8,527,000***	***$5,350,000***	***$11,150,000***
Unassigned GF balance	***$20,175,069***	***$20,661,218***	***$21,508,604***	***$24,202,454***	***$22,266,397***
Unrestricted GF balance	**$20,175,069**	**$23,161,218**	**$30,035,604**	**$29,552,454**	**$33,416,397**

The unassigned fund balance has ranged from $20 to $24 million over this period. The City has allocated money above that amount to long-term cost reduction (other post-employment benefits, early debt repayment); capital improvements (street paving, fire station construction); and neighborhood stabilization (housing improvements, demolition). The unrestricted fund balance is the sum of the assigned and unassigned fund balance.

The City finished 2017 with $33.4 million in unrestricted fund balance. The City transferred $1.5 million for street paving and $4.4 million for capital projects out of the General Fund in 2018. We assume those transfers will reduce the assigned fund balance shown within the General Fund by $5.9 million.[109] The City also estimated that it ended 2018 with a $2.3 million surplus in the General Fund. Taking these moves together, the City's unrestricted fund balance would be $29.8 million at the end of 2018.

The 2019 budget uses $2.3 million of the unrestricted fund balance to cover this year's expenditures. The City should also move the $1.0 million assigned to OPEB into the associated Trust Fund, removing that from the assigned fund balance. Assuming no other changes, those moves would drop the unrestricted fund balance to $26.5 million at the end of 2019.

We support the City's policy requiring a minimum fund balance of $22 million or 20 percent of the General Fund budget, whichever is higher. Meeting that minimum fund balance threshold will demonstrate the City's ability to comply with sound fiscal policy and improve its case for exiting Act 47 oversight. So the City shall maintain a minimum unrestricted fund balance of $22 million or 20 percent of the General Fund budget, whichever is higher, for the term of this Exit Plan.

There is clearly value in assigning portions of the fund balance to offset the large OPEB liability, increase paving activity or reduce the amount that the City would have to borrow for capital projects like the fire station construction. There is potentially value in setting aside money for housing improvements, demolition and property acquisition that leads to redevelopment – all of which would help stabilize the City's neighborhoods and the City's tax base. But there is only value in making those assignments if the associated work is actually executed and, to date, there is no agreement between the Administration and Council on how to use that money. A draft version of the City's Housing and Blight Strategy designates

[109] Even if the audit continues to show this $5.9 million as assigned fund balance within the General Fund, the money should eventually be spent and not considered part of the City's reserves going forward.

$1.0 million in assigned fund balance to execute that strategy[110], plus another $440,000 that was budgeted but not spent in 2018 on sidewalk repairs at City-owned properties. We encourage the Administration and Council to find agreement on this allocation and complete the transfer as soon as practical.

GP06. Real estate tax increases in 2020 and 2022

Target outcome:	Financial stability
Three-Year Financial Impact:	$5.1 million
Responsible party:	Mayor; Council; Managing Director

The Baseline Projection chapter describes a baseline *status quo* projection in which the City's General Fund expenditures exceed the General Fund revenues by $2.3 million to $3.5 million a year through 2022. Without corrective action, the City would use its unassigned fund balance to close those deficits. As described in the prior initiative, the City will also use $6.9 million in assigned fund balance for its OPEB liability, street paving and capital projects and will potentially designate $1.4 million to execute the Housing and Blight Strategy.

Some Exit Plan initiatives increase revenues or reduce expenditures and reduce the fund balance draw. Others increase expenditures. The net effect of these factors is that the City would draw its fund balance down below the threshold set by ordinance and have a level of structural deficit that puts the City's ability to exit Act 47 at risk.

So the City shall increase its real estate tax by 1.0 mill in the 2020 budget and 1.0 mill in the 2022 budget to keep the City in compliance with its fund balance policy and close the remaining part of the structural deficit. A 1-mill increase in 2020 translates to a 5.7 percent real estate tax increase, which would be the first tax rate increase since 2016. The 1-mill increase in 2021 translates to a 5.4 percent real estate tax increase.

Estimated Financial Impact

2020	2021	2022
$1,279,000	$1,285,000	$2,571,000

The table below shows the City's projected operating results and whether the City complies with its reserve policy for three scenarios: the baseline projection; the baseline plus all initiatives except this one; and the baseline plus initiatives including this one.

		2019	2020	2021	2022
Baseline	Surplus / (Deficit)	($2,300,000)	($2,874,000)	($2,925,000)	($3,506,000)
	Reserves comply with City policy?	YES	YES	NO	NO
Plan w/out GP06	Surplus / (Deficit)	($2,300,000)	($1,682,000)	($1,874,000)	($2,667,000)
	Reserves comply with City policy?	YES	YES	NO	NO
Plan w/ GP06	Surplus / (Deficit)	($2,300,000)	($403,000)	($521,000)	$45,000
	Reserves comply with City policy?	YES	YES	YES	YES

[110] This is the $1 million assigned to City housing improvements in the prior table. For more information, please see initiative ED04 in the Economic and Community Development chapter.

The City may identify alternative sources of recurring, sustainable revenue or expenditure reductions to reduce the real estate tax increase provided in this initiative. Any alternative must result in recurring, sustainable revenue or expenditure reductions that are within the authority of City government to enact. The alternatives also must have a quantifiable impact above the levels projected in the Exit Plan.

As described in the Baseline Projection chapter, one potential replacement for at least a part of these real estate tax increases is continued strong growth in the resident EIT revenues. For example, resident EIT revenues through May 2019 were 7.8 percent higher than through May 2018. If resident EIT revenues grow by 7.0 percent in 2019 instead of the 5.0 percent assumed in the 2019 budget and nothing else changes,[111] then the City's EIT revenues would be $558,000 higher than the baseline projection shows in 2020. In that scenario, the City would need a tax increase closer to 0.5-mill next year instead of the 1-mill increase described above. The Coordinator will continue to evaluate the City's performance in this area and provide an updated projection during the 2020 budget process.

[111] This is a simplifying assumption to demonstrate the impact of higher EIT growth.