

Pennsylvania Economy League Central PA LLC
Observations on the Financial Case Studies of
Bethlehem, Easton, Lancaster, Reading and York Cities
Submitted to the Urban Affairs and Housing Committee
Gerald E. Cross, Executive Director, PEL Central PA LLC

June 11, 2009

The five cities examined in a recent PEL review were all third class cities, with populations ranging from slightly over 26,000 to just in excess of 80,000. All have suffered from historical population stagnation or declines, although some have recently shown early signs of some rebound in population. The five cities have also seen their tax bases, both as property values and as earned income, stagnate or decline as well. As a generalization, it is not inaccurate to say that the cities are older, smaller, and poorer than they were over the past several decades.

Nonetheless, the five cities remain the economic, social, political, and religious hubs of their particular regions. The cities still provide the focus of economic activity for their regions, and also provide the locus for the educational, governmental, religious, and healthcare institutions that serve both the cities and the surrounding areas. **Therefore, the cities are obligated to provide the level of public safety and infrastructure services that maintains the integrity of the city and the vitality of the region.**

The case studies illustrate the central issue facing the cities: to continue to provide an expected level of public safety and infrastructure services from a declining tax base which is increasingly unable to support these services. **The cities' total revenue streams consist of taxes, non-tax revenues such as fees and charges for services, and a variety of sources of income that range from one time elements such as debt and derivatives or sale of assets to annual recurring subsidies from utility operations.**

Each city depends on the revenue collected primarily from real estate and Act 511 taxes, particularly the Earned Income Tax. For the cities in these case studies, the real estate tax has become an essentially static revenue source. Property assessments, the basis for real estate taxation, have been slow to grow and reflect the limited ability of the cities to achieve significant property appreciation through new development. There is typically little room for new development on vacant land in these cities, for example, the most significant property development in these studies is being built upon the site of a bankrupt steel mill. Politically, the

cities must compete with the school districts and the counties for the real estate tax base, and as such cannot significantly compound the increased tax millage on the assessment base. For the Act 511 taxes, the cities must also share these revenue sources with their school districts. Of the available taxes, the earned income tax (EIT), local services tax (LST), and the real estate transfer tax are the most productive levies.

The EIT has performed with lagging growth in the case study cities, with most cities showing only minimal annual growth in this tax source. Reflecting the demographic changes of the cities, the EIT—levied in Pennsylvania based on place of residence—generates a tax level that is representative of the cities' residents' prosperity, not the overall level of earnings from the people who work within the cities. The LST tax, levied on employees based upon the location of work, does generate significant revenue for the cities, but is limited to the maximum range of \$47 to \$52 per employee per year. The disparity between place of work and place of residence is reflected in the collection totals in some of the cities as the LST revenues approach 60 to 70 percent or more of EIT revenues. Even the home rule cities of Reading and Easton, with the ability to raise the EIT rate above the statutory maximum, do so as a replacement or substitute for increases in the real estate tax, as well as a response to the stagnant earnings base of their residents.

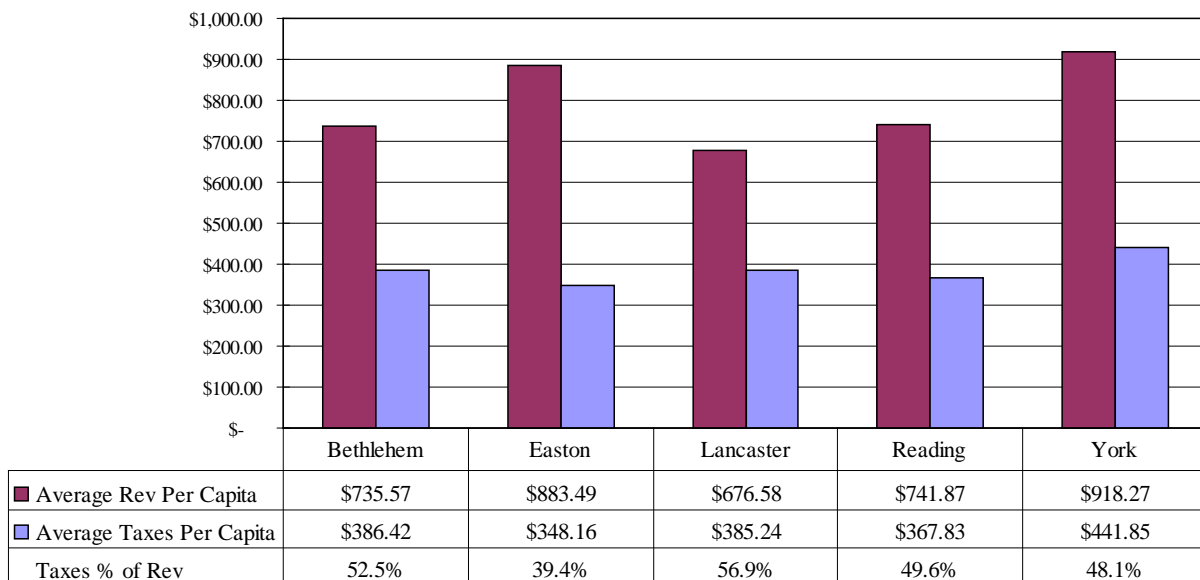
PEL analyzed the cities' ability to pay for the basic elements of municipal services solely from the taxes collected in the cities. Public safety, specifically the provision of police and fire services, was selected as the indispensable service provided by the cities. **In all but one of the case study cities, total taxes collected each year were insufficient to pay for police and fire services. In other words, all the taxes levied within the city do not generate sufficient revenue to pay for public safety, let alone the other basic functions of the government such as general administration, public works, and debt service. No city in any of the case studies could support public safety, general administration, public works and debt service from their existing tax base.**

All of the cities have had to look to other non-tax sources of revenue to provide the resources to pay for government operations. Fees and charges for services are used by all cities to supplement the tax base and cover everything from copies of police reports to charges for water and sewer services. The cities' abilities to generate revenues from fees and charges for services are limited only by state statute or the cities' inability to creatively generate income

from other sources. Even with the cities’ ability to generate non-tax revenue such as debt from derivatives or sales of assets, the case studies demonstrate these revenues, combined with total taxes collected, are still not sufficient to reliably fund ongoing operations on an annual basis. **This report did not examine the public policy question of using debt to be repaid from successive year budgets—debt used to pay for current year operations; this financial technique is a paramount public policy issue that must be addressed by the Commonwealth.**

Based upon the case study data, tax revenue as a percentage of total revenue is not always the main source of revenue for the municipality. While it can be assumed that tax revenue would be the largest portion of the municipal revenue source, that assumption is not always true. Indeed, based on per capita measures, taxes as a percent of total revenue ranges from a low of 34.4 percent to a high of 56.9 percent. Municipalities in the case studies are forced to pay for expenditures from sources that are not generally considered tax revenue, but from fees for services (often services once paid for by taxes) and for transfers of revenues created from fees for services of a specific type, such as water and sewer or parking. (See Graph 1.)

Graph 1
PER CAPITA AVERAGE TOTAL TAXES VS. AVERAGE TOTAL REVENUE
 Bethlehem, Easton, Lancaster, Reading, York
 2003 - 2007



Each of the cities has had to resort to what PEL has termed “operational supplements” to generate enough income each year to fund ongoing city operations. Taxes and non-tax revenues simply do not and cannot support the expected level of services that the cities provide on an annual basis. These operational supplements can take many forms. In all the case study cities, operational supplements in the form of subsidy payments are collected by the cities’ general funds from enterprise funds, primarily the water and sewer funds. These utility operations are structured to generate revenue to provide a fiscal resource each year and to pay for the cost of providing the service. Other operational supplements include: sale of assets; drawdown of fund balances; use of proceeds from debt issues, including refinancing or restructuring of outstanding debt; use of derivative products such as swaps or swaptions to generate up front current year payments; and other creative and risky techniques.

These cities have relied increasingly on these operational supplements to fill the financing gap that exists each year between the revenues generated and the expenditures required to support the provided level of services. Each city uses operational supplements, and has relied on them more each year throughout the review period.

The cities’ dilemma is fundamentally a revenue problem. Expenditures, particularly for public safety, infrastructure, general administration, and debt service are determined by the levels of services that the cities are expected, indeed almost required, to provide in their roles as regional leaders and by their populations. Revenue bases, already restricted by statute and by demographics, are further reduced by the amount of tax-exempt property in each city. These properties house the educational, governmental, health care, religious, and other public service institutions that make up the essential fabric of regional life, and also provide a significant amount of employment for the residents of the cities and for the regions. The cities do not have the flexibility to reach beyond their tax bases to capture the revenue generated by the location and employment of the institutions in the same way that counties or school districts are able to achieve through taxing a regional base. Unlike counties or school districts, the cities, must still provide the essential public safety and infrastructure needed to protect and enhance these institutions. If the cities cannot capture the revenue streams produced as a result of their status as regional economic generators, the cities will be compelled to search for even more creative methods to pay for the services that their citizens have a right to expect from their local government tax dollars.