

STEP II: FINANCIAL TREND ANALYSIS

Performed over a multiyear period, the purpose of this analysis is to project future revenue, expenditure, economic, and demographic trends so that the City can understand its future financial position and take immediate steps to counteract any negative trends. Based on a detailed historical analysis of the City's finances and considering the economic context within which the City operates, the following information is provided relative to projections for years 2010 through 2014.

PROJECTIONS 2010-2014

Based on our review, it is apparent that the City has been operating with a structural deficit for a number of years (when adjusting for proceeds from loans, sale of city assets, and one-time cash deposits from other funds). Specifically, the sale of the sewer interceptor lines, conveyance system, and receivables to the Municipal Authority have provided much-needed funds for cash flow purposes during the past eight years. Unfortunately, these one-time fixes are not available for future revenue generation, and the City must, therefore, examine its core operating revenue and expenses in an attempt to achieve a positive fund balance. The general fund balance is the net worth of a fund when considering its assets and its liabilities. Based on a review of the City's audited financial statements, the fund balances for years 2002 through 2007 are shown as:

TABLE 18 – AUDITED FUND BALANCE 2002-2007

Year	Fund Balance	Inc/Dec in Dollars
2002	\$237,021	
2003	(\$443,122)	(\$680,143)
2004	(\$1,680,980)	(\$2,124,102)
2005	(\$358,261)	\$1,322,719
2006	\$836,215	\$1,194,476
2007	\$715,983	(\$120,232)
2008	974,984	

NOTE: In 2005, the reduction of the negative fund balance from 2004 was a direct result of the proceeds from the bond issue from the refunding of the 1997 Series B bonds. In 2006, the positive fund balance was a result of the sale of the sewer interceptor lines to MACM in the amount of \$2.4 million. In 2008, the increase in fund balance was a result of the sale of the collection and conveyance system to MACM for a \$3 million down payment.

As part of this Step II analysis, an additional review of the fund balance and core operating revenues and expenses was conducted. In this analysis, which is summarized in Table 20 below, the revenue related to bond proceeds, sale of City assets and any other non-recurring revenue was eliminated from the operating revenue. Years 2010 through 2014 are projected based on historical trending and a review of the City's practices and obligations.

TABLE 19 – CORE OPERATING REVENUES AND EXPENSES

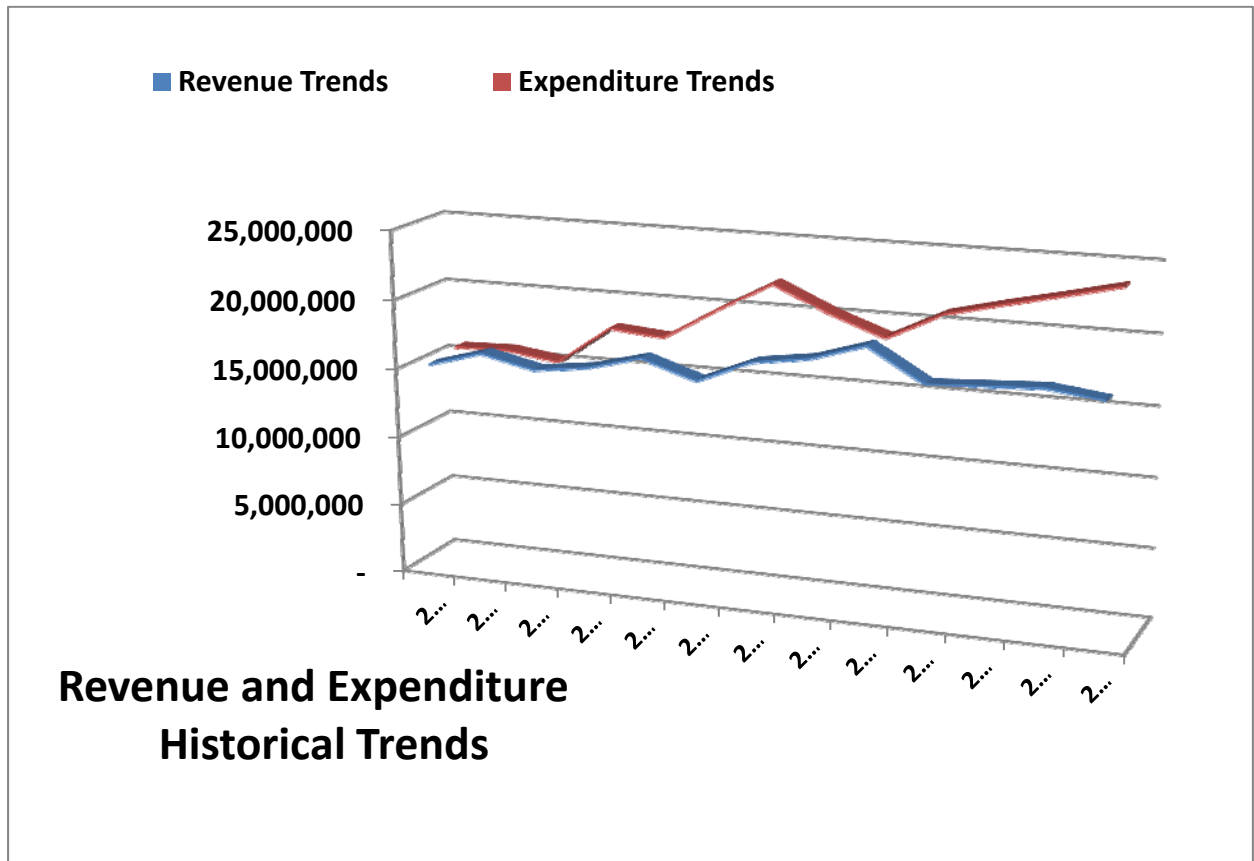
Year	Revenue	Expenditures	Difference
2002	\$15,236,422	\$15,611,311.69	\$(374,889.31)
2003	\$16,344,455	\$15,706,551.46	\$637,903.41
2004	\$15,483,897	\$15,161,351.96	\$322,545.52
2005	\$15,974,541	\$17,929,881.97	\$(1,955,341.03)
2006	\$16,981,498	\$17,588,652.51	\$(607,154.80)
2007	\$15,715,677	\$19,898,206.31	\$(4,182,528.82)
2008	\$17,361,393	\$22,011,032.26	\$(4,649,639.33)
2009	\$17,926,840	\$20,260,273.86	\$(2,333,433.96)
*2010	\$19,159,576	\$18,817,560.66	\$342,015.38
2011	\$16,839,312	\$20,768,364.83	\$(3,929,052.50)
2012	\$17,057,264	\$21,729,775.98	\$(4,672,512.02)
2013	\$17,264,208	\$22,611,274.22	\$(5,347,065.78)
2014	\$16,775,307	\$23,538,236.48	\$(6,762,929.70)

**NOTE: For purposes of this review, budget numbers were used for 2010*

It is obvious, based on this review, that if the City's annual revenues remain at about \$18 million and the operating expenses are estimated to be over \$20 million, there will inevitably be a gap that can no longer be filled with one-time cash deposits or debt restructuring. There will simply be no additional assets to sell and no restructuring of debt to provide loan proceeds for temporary revenue fixes. The MACM has over \$30 million of repairs that must be made to its infrastructure, based on its approved Act 537 Plan. There are no additional assets or cash reserves available for support for the City's operating revenue.

A graphic depiction of the gap between operating revenue and operating expenses is shown in **Figure 5** below.

FIGURE 5 – REVENUE AND EXPENDITURE OPERATING TRENDS



A detailed review of the various categories of revenue and expenses with projections is shown in **Table 20** below.

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TABLE 20 – SUMMARY CORE OPERATING REVENUE AND EXPENSE

Source	Summary Core Operating Revenue												
	ACTUAL	ACTUAL	ACTUAL	ACTUAL	ACTUAL	ACTUAL	ACTUAL	PROJECTED	BUDGET	ESTIMATED	ESTIMATED	ESTIMATED	ESTIMATED
	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Real Estate Taxes	2,489,818	2,416,976	2,345,489	2,245,215	2,255,265	2,297,742	2,241,794	2,263,497	2,387,320	2,253,248	2,264,434	2,275,676	2,286,975
Act 511 Taxes	3,266,346	3,275,291	3,003,484	3,381,224	3,758,964	3,942,606	3,656,730	3,890,907	4,057,825	3,984,289	4,077,829	4,174,478	4,273,437
Licenses & Permits	390,665	368,972	379,797	-	417,641	421,892	517,615	522,980	385,985	408,912	419,134	429,613	440,353
Fines	133,965	95,764	129,167	-	123,699	145,653	135,772	141,483	176,000	145,020	148,645	152,361	156,170
Interest-Rents-Royalties	48,615	30,698	18,417	-	216,596	283,043	156,813	90,480	99,980	101,755	103,573	105,438	107,349
Parking Revenue	367,498	370,074	311,953	-	298,861	260,683	332,198	318,395	335,533	340,503	349,015	357,741	366,684
Intergovernmental	23,164	23,329	19,606	19,275	21,777	22,210	29,805	406,755	705,561	700,649	645,618	581,611	377,429
Loc Payment In Lieu Tax	1,525,451	1,522,635	1,517,737	1,612,138	1,627,724	1,778,829	1,458,697	1,671,924	1,749,626	1,714,472	1,757,334	1,801,267	1,846,299
General Govt. Earnings	2,570,953	2,810,383	4,720,939	3,810,389	1,571,893	2,486,246	2,234,988	2,439,901	2,720,842	2,323,296	2,381,378	2,440,913	2,501,935
Misc. Revenues	365,132	1,130,847	480,700	1,949,618	1,494,093	1,220,489	749,810	1,117,951	1,203,869	541,525	554,395	556,280	-
Other Revenues	4,054,816	4,299,485	2,556,607	2,956,682	2,726,039	2,856,285	5,847,171	3,099,566	3,374,033	2,362,645	2,392,907	2,425,830	2,455,676
TOTAL	15,236,422	16,344,455	15,483,897	15,974,541	14,512,553	15,715,677	17,361,393	15,963,840	17,196,576	14,876,312	15,094,264	15,301,208	14,812,307

*Numbers may vary slightly due to rounding.

Summary Core Operating Expense													
Use	ACTUAL	ACTUAL	ACTUAL	ACTUAL	ACTUAL	ACTUAL	ACTUAL	PROJECTED	BUDGET	ESTIMATED	ESTIMATED	ESTIMATED	ESTIMATED
	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Mayor	222,090.49	233,654.50	237,641.66	201,391.22	213,011.68	214,831.96	235,215.45	201,895.85	199,189.96	188,460.33	194,196.82	200,460.43	207,321.08
Finance	617,803.44	663,426.88	639,855.84	586,858.85	533,230.59	581,024.60	644,786.55	641,029.86	555,471.13	660,987.10	695,996.98	734,343.31	775,466.58
Tax Collection	139,916.71	142,716.48	170,520.45	159,507.66	158,101.03	192,897.14	162,384.23	100,369.85	82,104.60	107,600.31	116,891.38	127,416.52	139,355.33
Law	202,680.08	120,582.63	124,589.48	240,958.73	152,315.64	142,473.04	153,825.74	183,152.06	216,918.72	217,071.75	226,311.66	236,272.48	247,037.03
Other Benefits	196,272.00	299,020.00	945,682.36	526,993.00	488,224.00	881,255.00	911,277.00	1,316,000.00	1,333,730.00	1,464,603.00	1,608,563.30	1,766,919.63	1,941,111.59
Insurances	502,519.66	603,303.00	457,824.15	647,047.56	678,467.31	859,577.41	803,043.21	824,146.50	837,591.20	889,086.46	943,776.85	1,002,279.08	1,064,847.53
Parking and Downtown	258,608.73	258,445.93	241,963.60	250,042.47	243,647.82	284,530.65	393,860.42	384,307.95	394,582.28	402,260.72	418,712.23	434,932.93	423,079.36
Property Maintenance	1,022,920.69	905,687.89	817,390.10	938,300.90	921,719.62	1,105,409.98	1,150,523.49	1,146,340.70	1,095,438.72	1,186,811.60	1,235,297.82	1,288,187.65	1,346,052.88
Police	3,282,662.58	3,331,184.13	3,071,077.58	3,450,460.77	3,296,254.30	3,758,831.19	4,223,964.49	4,189,151.97	4,403,701.61	4,708,253.42	4,993,022.49	5,304,261.71	5,645,274.75
Fire	1,521,685.04	1,635,576.61	1,483,410.12	1,669,064.56	1,562,363.98	1,839,884.48	1,855,359.98	1,974,726.33	2,093,305.70	2,020,970.24	2,002,260.86	2,052,913.05	2,104,965.90
Public Works Administration	221,531.96	205,789.10	174,560.46	116,514.36	117,670.83	177,643.56	243,321.51	265,735.59	233,074.57	238,901.43	244,873.97	250,995.82	257,270.71
Sanitation	862,091.15	713,480.57	735,590.15	875,705.52	819,452.34	912,550.17	1,439,303.42	1,185,567.86	1,064,301.64	1,215,035.19	1,245,411.07	1,276,546.35	1,308,460.00
Streets	1,079,843.74	898,811.51	886,699.95	922,677.67	881,901.36	1,144,143.25	984,725.74	1,085,595.09	1,090,029.76	1,112,734.97	1,347,009.88	1,367,248.39	1,388,041.64
Garage	183,995.64	186,581.98	178,538.89	292,993.73	225,443.20	315,263.55	345,352.97	332,205.13	316,491.45	343,845.69	352,441.83	361,252.87	370,284.20
Traffic Safety	504,235.36	563,969.49	258,862.91	594,076.32	523,322.91	520,796.23	530,239.32	542,322.39	536,400.00	555,880.45	569,777.46	584,021.89	598,622.44
Sewers	253,244.65	219,469.45	204,042.52	188,667.05	206,427.66	215,349.85	249,602.30	103,351.89	-	-	-	-	-
Unfunded Projects	-	-	-	-	-	27,030.04	131,703.81	287,560.27	-	-	-	-	-
5th Ave Mall LLC Partnership	-	-	-	-	-	29,363.11	5,575.00	-	-	-	-	-	-
Recreation	125,799.47	109,381.91	89,019.52	89,437.24	102,542.59	101,910.06	111,684.97	129,653.93	125,966.40	131,070.97	134,347.74	137,706.44	141,149.10
Marina/Palisades-Manager	-	-	152,543.18	202,653.01	13,065.41	140,207.23	214,278.53	191,098.50	48,000.00	80,859.27	82,880.75	84,952.77	87,076.59
Carnegie Library	60,000.00	60,000.00	30,000.00	45,000.00	45,000.00	45,000.00	60,000.00	45,000.00	60,000.00	60,000.00	60,000.00	60,000.00	60,000.00
Civil & Military Celeb	18,417.71	-	229.00	9,554.00	10,158.25	27,999.78	43,285.00	62,460.00	62,400.00	62,400.00	62,400.00	62,400.00	62,400.00
Conservation	30,365.28	28,909.47	30,138.89	34,664.97	29,389.33	37,334.49	37,150.48	81,281.81	84,878.44	83,653.44	85,744.77	87,888.39	90,085.60
Bond Issue / T.A.	2,039,084.73	2,223,658.20	1,754,668.30	1,635,735.72	3,742,739.93	3,289,274.00	4,018,496.10	3,116,178.43	2,397,021.82	3,333,065.82	3,333,065.82	3,333,065.82	3,333,065.82
Intergovernmental Loan	-	-	-	-	291,921.29	(51,264.54)	-	-	-	-	-	-	-
Retiree's Benefits	273,422.21	314,312.23	335,433.31	320,305.82	329,986.52	261,608.60	277,163.61	311,883.25	279,989.52	317,545.02	360,622.78	410,048.35	466,771.05
Misc. Expend.	247,346.05	515,215.25	820,158.33	1,653,075.50	231,046.66	369,687.63	518,654.25	454,417.82	590,000.00	226,000.00	226,000.00	226,000.00	226,000.00
Operating Transfers Out	1,168,422.01	939,201.40	748,932.90	1,616,146.29	1,118,856.38	1,936,371.59	1,678,878.22	436,126.15	-	369,562.00	369,562.00	369,562.00	369,562.00
Community Development	543,178.96	492,093.28	523,823.93	615,446.64	607,085.64	501,386.74	541,663.02	631,565.10	653,604.50	718,831.71	736,802.51	755,222.57	774,103.13
R.D.A. / M.D.C.	33,173.35	42,079.57	48,154.38	46,602.41	45,306.24	35,835.52	45,713.45	37,149.60	63,368.64	72,873.94	83,805.03	96,375.78	110,832.15
TOTAL	15,611,311.69	15,706,551.46	15,161,351.96	17,929,881.97	17,588,652.51	19,898,206.31	22,011,032.26	20,260,273.86	18,817,560.66	20,768,364.83	21,729,775.98	22,611,274.22	23,538,236.48

RECOMMENDATIONS — REVENUE

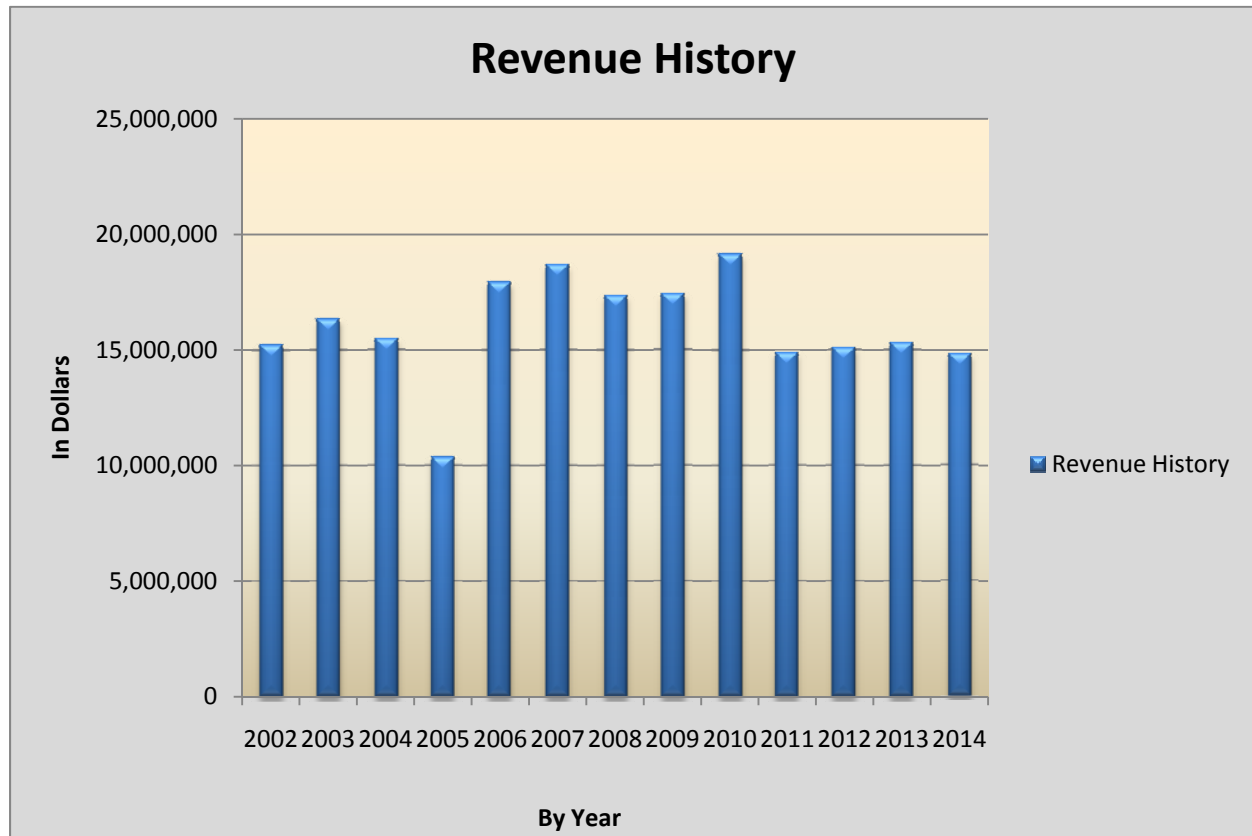
It is imperative that local officials have a thorough understanding of their revenue base and routinely review trends and historical information. One of the most common pitfalls for municipalities is the budgeting of nonexistent and unreliable revenue or overestimating revenue during the budget process. It is important to consider the effects that the local economy can have on the revenue base. Layoffs, an unstable housing market, regional disasters such as floods and storm damage, or significant increases in energy costs can seriously erode revenue potential. By knowing and understanding exactly what the revenue projections are for any given fiscal period, the ability to properly make decisions about levels of staffing, resources, and service delivery is enhanced. Table 22 provides an overview of total City revenue and a five year projection based on prior year and current year trends.

TABLE 21 – GENERAL FUND REVENUE WITH PROJECTIONS

General Fund Revenue with Projections		
Year	Revenue	Inc/Dec
2002	15,236,422	N/A
2003	16,344,455	7.27%
2004	15,483,897	-5.27%
2005	10,348,102	-33.17%
2006	17,931,757	73.29%
2007	18,702,820	4.30%
2008	17,361,393	-7.17%
2009	17,421,100	0.34%
2010	19,166,576	10.02%
2011	14,883,312	-22.35%
2012	15,101,264	1.46%
2013	15,308,208	1.37%
2014	14,819,307	-3.19%

Figure 6 below provides a graphic representation of the trending of the City's revenue over time and includes a projected revenue profile for the next five years. As noted previously, the City's revenue for 2010 was based on the City's adopted budget. However, the budgeted revenue is significantly higher than the actual trended revenue from prior years and projected for future years.

FIGURE 6 – REVENUE HISTORY AND TRENDING



Based on the analysis and trending in Step I and Step II, the following recommendations are made for revenue collection and enhancement.

Real estate taxes are an important revenue source for the City, at 18% of its total revenue base. It is therefore critical for the City to enhance its real estate market values in order to maintain and increase assessment values. It is also important for the City to maintain accurate collection records and to assess the appropriate amount of millage to support City expenses. For this reason, the following items related to real estate tax collection should be implemented by the City:

- Maintain accurate and complete records regarding assessed values, millage rates, delinquent taxes, dollars per mill, and rates of collection. These should be updated and monitored regularly for discrepancies and changes in collection amounts. During the budget process, the strategy should include full utilization of this information in a format that is readily accessible.
- Utilize the above calculations to make conservative estimates of projected revenue collection, including the proper uncollectable rate. It is important for the City to be aware of and to include in its calculations the typical rate of those taxes that cannot be collected in the current year, which may be different than in other communities. Historical evidence over time is the best predictor of future revenue collections.

- Set millage rates at a level that will provide the necessary revenue to cover all expenses.
- Do not avoid tax increases when necessary. Tax rates set at the beginning of the year cannot be changed during the year. Officials who don't face the reality that a tax increase may be necessary during budget season will inevitably cause their municipality to run short of funds by the end of the year and find themselves in the position of spending down cash reserves that may be needed as emergency funds in the future.
- Pursue an aggressive code enforcement program in the neighborhoods and business district. Currently, the City only spends about 3% of its available resources for this important function. In an older community, code enforcement helps to preserve the value of housing stock and increase the value of commercial real estate. The City should consider at least doubling the expenditures for code enforcement and neighborhood preservation activities.
- Continue to explore with the state agencies and the Allegheny County Department of Development the redevelopment of key areas, and continue to be vigilant in introducing housing improvement programs for declining areas. The Stimulus Funds under the American Recovery and Reinvestment Act (ARRA) provide several new tools for neighborhood support programs and economic development for qualifying communities. Specifically, program grant funds are available under the Economic Development Agency (EDA) programs. In addition, infrastructure funds may be available from state and federal sources.
- Continue aggressive activities as they relate to collection of delinquent taxes. The finance department should regularly monitor the delinquent amounts that are collected by the City, in order to ensure that all possible steps are being taken to collect outstanding taxes from prior years.
- Implement and enhance a tax base expansion programs for the commercial and residential properties that includes tax abatement options as a strategy for expanding the tax base for the long-term. These strategies should include aggressive use of LERTA, tax forgiveness, and a vacant property strategy.

Act 511 taxes are another key revenue source for the City. The City has taken steps to enhance collection by its tax office. The City should also consider taking the following steps:

- Implement a comprehensive annual tenant registration application and fee program for all rental properties in the City. With 40% of the City property identified as rental units, it is important for public safety, for the collection of Act 511 taxes, and for the City's ability to govern to have a current list of tenants who reside in all of the properties in the City. A \$20 per unit application fee can also generate additional revenue. With over 5,000 rental units in the City, there is the potential to derive over \$100,000 through this program. It should also be used as an aid to keep the EIT and Business Privilege Tax lists current for collection purposes.

- Provide updated information about taxpayers' addresses, contact information, sales of properties, and permit holders to the City tax collectors on a regular basis. This information should be derived from the rental registration program, permits, licenses, and from sewer bills. It should be collected in a uniform and consistent format that is easily included in future collection activities.

With the exception of the MSF, other fees for services make up only 2% of the City's overall revenue base. This is a lower percentage than any of the comparison communities (see Appendix C – City of McKeesport Financial Analysis: Comparative Communities). It is important that the City maximize revenue through the diversification of the tax base and focus on the establishment of new and existing fees at the appropriate level. The following changes should be considered by the Council and management:

- Adjust fees for services based on comparisons of fees charged by other communities.
- Ensure that the fee charged for every service or item covers the cost of providing that service or item. When calculating the cost, take into consideration the labor, benefits, overhead, and uncollectable fees as identified costs for providing the service.
- Consider adjusting the parking tax to a flat fee based on the number of parking spaces rather than gross revenue. A flat fee is easier to administer and track over time.
- Analyze MSF on an annual basis to determine whether the fee charged to the property owner covers the cost of all personnel compensation and benefits, operating supplies and materials, long-term capital expenditures, and uncollectable accounts. This fee provides 10% of the overall revenue for the City and should be identified for special attention and focus.
- Undertake aggressive investment of excess funds. This is not always possible for two reasons: (1) excess funds are not always available, and (2) the interest rates are not always attractive. However, as interest rates rise, it is important for the City to consider alternative short-term investments such as the Pennsylvania Local Government Investment Trust (PLGIT) and/or shopping banking institutions with Requests for Proposals (RFPs) for the highest rates at the lowest fees.
- Fines and forfeits are consistently about \$145,000 per year. The police management should review and analyze these fines and make recommendations about how to enhance and increase this revenue source through better parking enforcement strategies.
- Vigilantly continue to pursue every possible grant opportunity to supplement City services, especially in the areas of police, fire, recreational facilities, alternative energy initiatives, City programs, and public works.

REVENUE PROJECTIONS DURING THE BUDGET PROCESS

The annual operating budget is the basis for all financial activity in a local government operation. It is important for decision makers to make realistic projections of revenues during the budget process by carefully analyzing historical information and using conservative estimates of future revenue. A common way that revenue estimates become overinflated is to use the current year information to make future year estimates. Revenue trends for several years should be analyzed on a regular basis. Revenue information for fiscal years 2002 through 2009 is captured in detailed and summary formats in Appendix A - Existing Financial Conditions.

During the budgeting process, the City should make realistic projections of revenue by using a spreadsheet that includes at least three years (preferably five years) of prior revenue history in order to make valid predictions about future collections. Currently, the budget format provides for only one prior year and the current year of actual revenue and expenditures. Some of the areas that have been budgeted incorrectly in the past are noted below:

- Real estate taxes are routinely overestimated. In 2006 through 2008, approximately \$2.2 million in real estate taxes were collected. Yet in 2009, \$2.5 million was budgeted.
- Act 511 taxes are routinely overestimated. In 2006 through 2008, approximately \$3.7 to \$3.9 million was actually collected. Yet in 2009, \$4.2 million was budgeted.
- Several budget items were actually budgeted as revenue when they are really deductions to the revenue. For example, real estate tax discounts, Act 77 refunds, senior citizen discount for MSF, and local service tax refunds were budgeted as revenue.
- Revenue that is uncertain or unreliable is sometimes budgeted as actually revenue. For example in 2009 and 2010, there was \$563,000 budgeted from the 2005 “bond surplus” fund that never materialized as a revenue. In 2009, there was \$357,000 budgeted as “MHC Payables” that was never recorded as a revenue.
- In 2010, there was a line item in the budget for “MACM Host Fee” in the amount of \$720,000. This revenue is estimated to be collected should the City sign an agreement with MACM for host fees.
- The “Mayor’s Fund Balance” is routinely included as a revenue budgeted line item but not recorded as revenue in the accounting activity for the year. This may be an accounting/recording error but the amounts should be aligned and reconciled.

RECOMMENDATIONS — EXPENDITURES

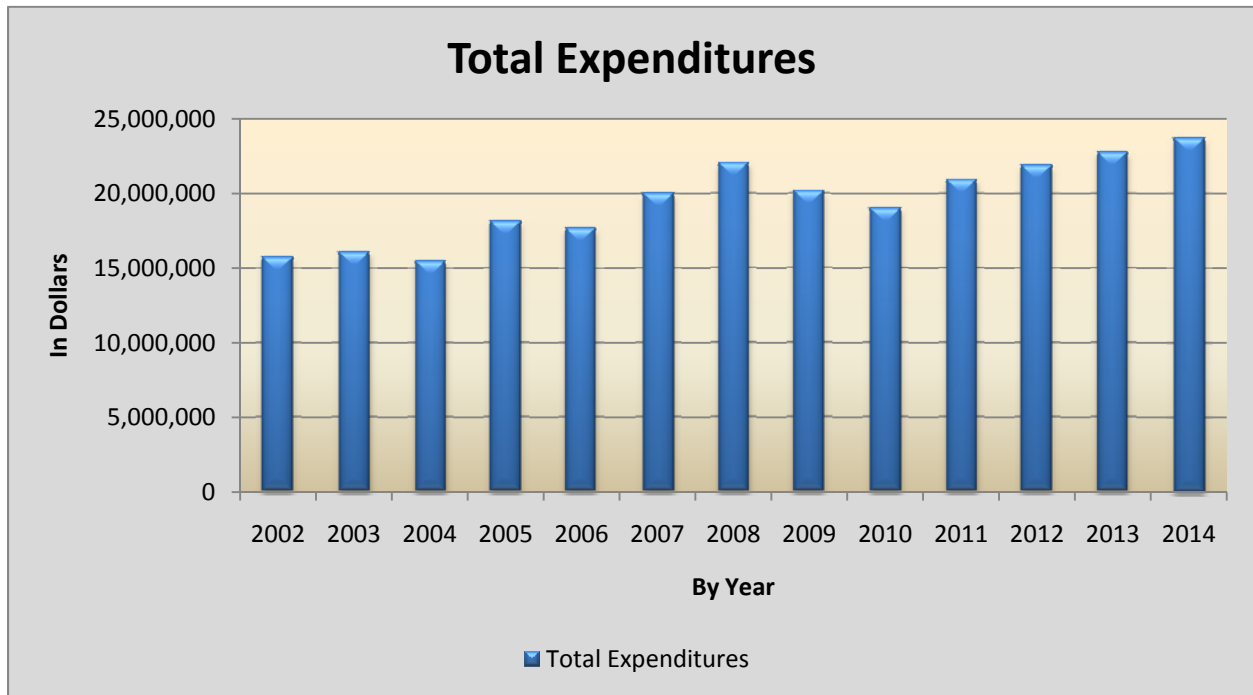
The City must also have a clear understanding of its current operating expenditures and which of them can be controlled and which cannot be easily changed. Many expenses for municipalities are fixed (such as debt service and pension obligation) but expenses related to level of service can be adjusted by adjusting the number of employees who are assigned to carry out any given service. By knowing and understanding exactly what the expense projections are for any given fiscal period, the ability to properly make decisions about levels of staffing, resources, and service delivery is enhanced. Table 23 provides an overview of actual expenditures through 2008 and projected expenditures through 2014. As noted previously, the expenditures for 2010 were based on the City's adopted budget and are much lower than the historical trending and the projected expenditures shown in Table 23.

TABLE 22 – GENERAL FUND EXPENSES WITH PROJECTIONS

General Fund		
Year	Expenditure	Inc/Dec
2002	15,753,375	N/A
2003	16,112,033	2.28%
2004	15,498,240	-3.81%
2005	18,130,997	16.99%
2006	17,735,579	-2.18%
2007	20,033,365	12.96%
2008	22,030,293	9.97%
2009	20,183,232	-8.38%
2010	18,985,615	-5.93%
2011	20,937,093	10.28%
2012	21,904,626	4.62%
2013	22,794,047	4.06%
2014	23,728,231	4.10%

Based on a review of prior years, it is projected that the General Fund expenses will increase at approximately 4% to 4.5% per year (see years 2010 through 2014). This creates a significant problem for the City since revenue increases at a rate of only about 3.1% per year. It will be necessary for the City to develop a strategy for either increasing revenue or decreasing operating expenses in order to support general fund operations over the next five years. A graphic depiction of the general fund expenses is shown in **Figure 7** below.

FIGURE 7 – EXPENSE HISTORY AND TRENDING



Based on the findings above, the City Council and management should consider the following strategies for containing costs in the City departments.

PUBLIC SAFETY

Public safety is overwhelmingly the most expensive function of the City’s local government operation. The expenditures made by the City for police and fire operations leave very few resources for any other department, function, or activity in the City. It is absolutely critical for the City to contain the costs associated with the police and fire departments.

- The City should carefully examine all aspects of the police operation in order to achieve expenditure reductions, especially in the areas of overtime and health benefits. Scheduling recommendations, better training for supervisors, and more efficient deployment of resources could create a much more efficient and less costly operation. This recommendation is discussed in greater detail in Step IV of this report, relative to the management review of the McKeesport Police Department.



- The City should market its police and fire services wherever possible in order to support the expenses of the departments and to utilize excess capacity. The City should take the lead and rigorously pursue a regional approach to the provision of public safety services. Many of the communities that are immediately adjacent to the City have substandard and inadequate services. An ongoing and open dialogue between the City and its neighboring municipalities should be aggressively pursued by the Mayor and City Administrator.



- It is important for the decision makers to analyze every hiring decision, including the filling of vacancies. For every new hire, the appropriate department head should work with the City Administrator to provide justification for the position by identifying the level of service, demand, cost of the hire including benefits, legacy costs, and alternatives to making a decision to hire additional personnel. The use of overtime or the use of contracted services for specialized activities is often a less expensive alternative to hiring additional personnel.
- The police chief and fire chief should be required to explore and execute mutual aid agreements for the police and fire departments, so that extraordinary emergencies can be addressed on a regional basis through a cooperative approach. A single public safety department can never be prepared to address extraordinary disasters or events without assistance.

OTHER DEPARTMENTS

In other departments, planned cuts to personnel have already been made in the code enforcement, community development, administration, and recreation departments. Overall, the salary and benefits for these departments are a much smaller part of the general operating budget. However, it is recommended that the City Council and management consider the following additional actions:

- Analyze every hiring decision, including the filling of vacancies. For every new hire, the department director should provide a complete analysis of the cost of the hire, including benefits, legacy costs, and alternatives to the new hire, such as the use of overtime or the use of contracted services.
- Specifically, a complete analysis of the Treasurer's Office staffing should be undertaken. Two positions were eliminated when the sewer billing was transferred to MACM in 2008. Currently, there are still eight employees in this office. It will be necessary to re-evaluate the staffing needs again prior to 2012 when the countywide collection of earned income tax will be fully implemented under Act 32.
- A complete analysis of the City's recycling operation should be undertaken in order to determine the cost effectiveness of contracting this operation to a private vendor. This

option will be further discussed in Step IV, the management audit and review of the public works operation.

- Cross-train all DPW streets, parks, and recycling employees so they can be transferred to the area that is most in need of attention and where resources should be most heavily deployed.
- Determine what expenses can be attributed and charged to funds other than the general operating fund. Administrative expenses for services related to the sewer fund and the community development fund should be charged to these areas. Enterprise funds can provide a buffer to raising taxes because the fees for services are distributed to a much broader base of rate payers than the levies for property tax.
- Establish a moderate level of borrowing based on a fully developed capital plan for improvements to streets, sewers, bridges, and facilities so that capital project expenses are well planned and properly funded. According to the Fiscal Management Handbook, borrowing for capital projects, including economic



development activities, makes sense for the following reasons:

- As per capita income increases over time, debt repayments in the future will represent a smaller share of income.
- Postponement of projects because funds are not available may severely hinder the full and proper development of the community infrastructure and tax base.
- Since capital projects are used over time, future generations should contribute to their share of the cost of the project.
- In a community where there is a high transient population, residents will pay a share of the cost of the project that benefits them during the time they are living in the municipality.
- Utilize part-time summer employees for low-level laborer activities that can supplement the regular workforce. Also, use professional interns through the universities and the Local Government Academy to undertake professional-level projects. This creates significant capacity in departments without the long term liability of salaries and benefits.
- Continue to utilize cooperative purchasing and state contracts for supplies and purchases in order to contain costs.

RECOMMENDATIONS — PERSONNEL AND BENEFITS

For the next **police and fire collective bargaining** session, in order to contain costs and provide maximum management capability, the City should include the following items:

- The City reserves the right to explore the consolidation of police and/or fire services with neighboring communities in order to better manage and more efficiently provide police and fire services for its residents.

Although this benefit is promoted by employees as a “no impact” benefit, in fact, there a number of problems and expenses that municipalities incur when they adopt a DROP.

- The City proposes a one-year probationary period for new police and fire employees, as provided in the City Code.
- The overtime rate should not be paid for hours in excess of eight hours in a workday. The overtime rate should only be paid for work performed in excess of 40 hours in any work week as required by the Fair Labor Standards Act.
- The City reserves the right to utilize health insurance plans that are offered through municipal employee programs that provide a cost savings to the City as long as the benefit structure remains substantially the same. In fact, the City should consider a “cafeteria style” benefit plan so that employees can select the benefits that make the most sense for their specific situation within a fixed dollar amount. This type of plan can be very effective for containing costs in the future. However, for union employees, this strategy must be a subject of negotiations in order to implement it for the future.
- Until a cafeteria style benefit plan is negotiated, the City should propose that all employees pay 20% of the premium cost of health benefits.
- The City should propose to eliminate the ability of retirees and part-time employees to participate in the City’s health insurance programs, except to the extent that state and/or federal law requires the provision of benefits. In return, the City would agree to establish a Health Savings Account (HSA) program for employees. This is important because beginning with the 2008 fiscal year, the City is required to calculate the liability for post-retirement health benefits. This will probably require an actuarial study in order to determine the true liability of providing these benefits over time.
- Employees hired after December 31, 2010, should have unlimited accumulation of sick days for purposes of serious illness but no buyback at retirement.
- Employees hired after December 31, 2010 should be required to meet the Act 600 normal retirement age of 50 with 25 years of service as a minimum for retirement.
- Employees hired after December 31, 2010, should be entitled only to the minimum pension benefits that are provided in Act 600. Specifically, the City should carefully consider the impact for every request for enrichment or improvement of benefits for employees because improvements in benefits can create significant liabilities in a very short timeframe. This caution should be particularly observed for the Deferred

Retirement Option Plan (DROP). Although this benefit is promoted by employees as a “no impact” benefit, in fact, there a number of problems and expenses that municipalities incur when they adopt a DROP. Some of these liabilities include:

- The City no longer receives the unit value in state aid for an employee in a DROP since that employee is no longer considered to be an active employee. In 2009, the unit value was \$3,128 per unit and police and fire employees are each allotted 2 units. This can quickly become a significant loss of revenue to the plans.
- The employee who has elected a DROP no longer pays contributions into the plan because they are “retired.”
- There is typically a guaranteed interest rate applied to the pension funds that are escrowed for the employee. If the interest rate is not achieved by the City, the City is still obligated to pay the interest rate that is in the DROP ordinance.
- The DROP encourages higher salaried employees with more expensive benefits to continue their employment while simultaneously drawing their pension funds.

For the next **non-uniform employees’ collective bargaining** session, in order to contain costs and provide maximum management capability, the City should include the following demands:

- The City should propose a one-year probationary period for all new hires.
- The overtime rate should not be paid for hours in excess of eight hours in a workday. The overtime rate should only be paid for work performed in excess of 40 hours in any work week as required by the Fair Labor Standards Act.
- The City should reserve the right to utilize health insurance plans that are offered for municipal employee programs that provide a cost savings to the City as long as the benefit structure remains substantially the same. In fact, the City should consider a cafeteria style benefit plan so that employees can select the benefits that make the most sense for their specific situation within a fixed dollar amount. This type of plan can be very effective for containing costs in the future. However, for union employees, this strategy must be a subject of negotiations in order to implement for the future.
- Until a cafeteria style benefit plan is negotiated, the City should propose that all employees pay 20% of the premium cost of health benefits.
- The City should propose to eliminate the ability of retirees and part-time employees to participate in the City’s health insurance programs, except to the extent that state and/or federal law requires this benefit. In return, the City will agree to establish an HSA program for employees. This is important because beginning with the 2008 fiscal year, the City is required to calculate the liability for post-retirement health benefits. This will probably require an actuarial study in order to determine the true liability of providing these benefits over time.
- Employees hired after December 31, 2010, should be included in a defined contribution plan ONLY rather than the existing defined benefit plan. A defined contribution plan

(such as a Section 457 Plan) eliminates the City's liability for future pension benefits for newly hired employees.

In the event that the defined benefit plan is continued for non-uniform employees, the City should carefully consider the impact for every request for enrichment or improvement of benefits for employees because improvements in benefits can create significant liabilities in a very short timeframe. This caution should be particularly observed for the Deferred Retirement Option Plan (DROP). Although this benefit is promoted by employees as a "no impact" benefit, in fact, there a number of problems and expenses that municipalities incur when they adopt a DROP. Some of these liabilities include:

- The City no longer receives the unit value in state aid for an employee in a DROP since that employee is no longer considered to be an active employee. In 2009, the unit value was \$3,128 and this can quickly become a significant loss.
- The employee who has elected a DROP no longer pays contributions into the plan because they are "retired."
- There is typically a guaranteed interest rate applied to the pension funds that are escrowed for the employee. If the interest rate is not achieved by the City, the City is still obligated to pay the interest rate that is in the DROP ordinance.
- The DROP encourages higher salaried employees with expensive benefits to continue their employment while simultaneously drawing their pension funds.

EXPENDITURES DURING THE BUDGET PROCESS

It is extremely important in the budgeting process that all costs for programs, services, projects, and purchases are included as proposed expenditures. The City should develop the budgeting process by utilizing spreadsheets with at least three prior years (and preferably five years) of actual expenditures and with input from the department directors and City staff. Budget requests based on incremental increases over the prior year's costs are not sufficient for producing a realistic spending plan. Department heads should use the budget process to plan and manage the services they provide to the community. Departments should be charged with the responsibility to review operations to determine if things could be done more efficiently. Requests for any additional funds should be required to be supported by convincing justification based on budget goals and program mission and guidelines.

- In the past, large expense items such as health insurance, legal fees, and police and fire department overtime have been substantially and routinely under-budgeted. This has caused budget overruns in these areas. When there is a planned reduction in these areas, it is important that the reduction is based on real budget cuts — not optimistic projections or wishful thinking. When the budget reductions don't materialize (whether in staffing, overtime, or reduced legal fees), revenue is spent that the City had not planned to generate. Proposed budget cuts that are not supported by historic information will force the City to spend funds that do not exist.

- To assure legality of operation, and as a good management practice, budgeted expenditures should be controlled through individual budget accounts that are reported on a regular basis to management, department heads, and to the City Council. The department directors should get timely budget information and should be required to stay within the budget parameters that are set during the budget adoption process.
- The Act 205 pension activity for the City is included in the budget as intergovernmental revenue and as an expense to the City's general fund. This is in accordance with Act 205. However, this pass-through of state aid in the budget does not entirely support the pension expenses. A separate report should be prepared, issued, and reviewed regularly by City officials to determine the annual liability that must clearly be paid by the City general operating funds. There should be a quarterly meeting of the City with its pension advisors and investment managers in order to carry out the fiduciary responsibility of the City over its pension funds.
- Budget line items are routinely over-expended. The City's accounting system has the ability to preclude departments from over-expending their appropriations through the purchase order system. The purchase order system thresholds should be rigorously enforced so that these items are identified in a timely manner.

COMPARATIVE DATA — PA COMMUNITIES

An analysis was made based on a review of similar communities in Pennsylvania, in order to draw comparisons regarding revenue generation and the level of spending for various operations in the City. Ten communities in the Commonwealth were identified for comparative purposes based on population, service delivery, and budgets as reported on the DCED Municipal Statistics Web site for 2008 (the most recent year for which statistics are fully available). Six are cities, three are boroughs, and one is a Home Rule Municipality. All have populations ranging from 19,000 through 36,000.

- | | |
|----------------------|-------------------------------|
| • City of Chester | • Municipality of Monroeville |
| • City of Easton | • Pottstown Borough |
| • City of Johnstown | • West Mifflin Borough |
| • City of Lebanon | • Wilkinsburg Borough |
| • City of New Castle | • City of Williamsport |

Appendix C provides a complete comparison of actual revenues and expenses for the selected communities.

OBSERVATIONS

Based on a review of the revenue generation by category for the comparison communities, the following observations can be made:

- McKeesport's overall revenue collection is most similar to Monroeville, Pottstown Borough, and Williamsport. Although New Castle and Lebanon are also cities, the revenue collection is much less than McKeesport's.
- With the exception of Lebanon City, all of the comparable communities have significantly higher real estate tax collections than McKeesport. In fact, Johnstown and New Castle collect twice as much real estate tax as McKeesport. The typical millage rate (when prorated for common level ratio) is between 7 and 10 mills.
- Chester, Easton, and Johnstown have exceptionally high millage rates. This is due to the outdated property tax assessment systems in Delaware, Northampton, and Cambria counties and the relatively recent reassessments in Allegheny, Lawrence, and Lycoming counties.
- The collection of Earned Income Tax (EIT) in McKeesport is similar to New Castle, Easton, Lebanon, and Pottstown. It is significantly higher than Williamsport, Johnstown, and Wilkesburg.
- McKeesport has the same collection of real estate transfer tax as many of the comparable communities. Specifically, Williamsport, New Castle, Easton, Lebanon, and McKeesport all reported between \$200,000 and \$282,000 in annual collections.
- McKeesport had about the same total Local Services Tax (LST) as Easton and Pottstown but significantly lower than Chester, Williamsport, Monroeville, New Castle, Lebanon and Johnstown. This is a direct reflection of the loss of employees and industry in McKeesport over the past several years.
- Likewise, McKeesport, at \$554,000, is one of the lowest in the collection of business taxes. Chester, Williamsport, Monroeville, and West Mifflin had significantly higher collections of business taxes, while Johnstown and Wilkesburg collected significantly less.
- McKeesport receives as much or more federal, state, and county intergovernmental revenue as the comparable communities.
- Of the Allegheny County communities identified, McKeesport generates about the same revenue from its sewer fees as both Baldwin Borough and Wilkesburg Borough.
- McKeesport collects revenue that is typical for those communities that levy a garbage collection fee — about \$1 million. However, Easton and Pottstown generate about twice as much in garbage fees as McKeesport.
- The communities with large commercial districts collect much larger revenues from parking meters and lots. Generating the most revenue is the City of Johnstown with about \$1.5 million in collections.

- Lebanon, McKeesport, West Mifflin, Baldwin Borough, and Wilkinsburg collect very little revenue from recreation and culture. Both Monroeville and Pottstown collect over \$500,000 annually from this source.
- McKeesport was about average in the collection of departmental charges and fees for services. Easton and Chester were the highest at about \$5 million.
- McKeesport's collection of licenses and permits (primarily the cable TV franchise fee), is consistent with other communities with a similar population and budget.
- The fines collected in McKeesport, while similar to Allegheny County communities of Monroeville, West Mifflin, Baldwin, and Wilkinsburg are relatively low compared to other communities. Chester, Lebanon, Easton, and Pottstown were substantially higher than McKeesport's collection.
- Interest generated from short-term investments compares favorably with the comparison communities. Of course, higher fund balances allow for more investment of idle funds.

Based on a review of the expenditure outlays by category for McKeesport and the 10 comparison communities, the following observations can be made:

- For most communities, police services are, by far, the highest expenditure in the budget, with the exception of debt service. Chester, at \$11 million, and Monroeville, at \$9 million, spend the most on police services. New Castle, Wilkinsburg, and Johnstown, at about \$2.8 million, spend the least.
- Of the communities with paid professional fire service, McKeesport and New Castle spend the least at about \$1.8 million. Chester spends the most at about \$5.7 million, and Williamsport and Easton spend about \$4.7 million.
- McKeesport, at \$4.5 million in debt service, is the only community that spends more for debt than for police services. Chester, Easton, and Johnstown are the only other communities with significant debt service payments. Monroeville and New Castle pay about \$2.5 million per year for debt, and all other communities spend less than \$1 million.
- McKeesport, Johnstown, Baldwin, and Wilkinsburg all spend about \$2.8 million for solid waste collection.
- McKeesport, Chester, Williamsport, Easton, and Johnstown spend similar amounts for recreation, at between \$1.3 million to \$1.8 million annually.
- Of all the communities included as comparables, Johnstown, Pottstown, Baldwin, and Wilkinsburg spent the least for public works, highways, and streets.



- Of the Allegheny County communities, McKeesport, Baldwin Borough, and Wilkinsburg each spend about \$2.8 million annually for sewage treatment.
- McKeesport, Lebanon, New Castle, and Johnstown spend less than other communities for library services.

SUMMARY AND CONCLUSIONS

In 2002, 2003, and 2004, the City experienced core operating shortfalls as high as \$1.9 million. This shortfall is calculated as the difference between the core operating revenues and core operating expenditures (i.e., adjusted by eliminating grant funds, proceeds from borrowing, sale of assets, and other nonrecurring revenue). In 2003, the City's accumulated fund balance deficit was (\$443,122). By 2004, the City's audited financial statements reported an operating deficit of (\$1,237,858) and an accumulated fund balance deficit of (\$1,680,980).

In 2005, the City was able to address the shortfall in operating revenues by undertaking a massive restructuring of its General Obligation debt. The 2005 General Obligation borrowing allowed the City to refund existing bonds and to restructure its pension bonds which were used to address large pension liabilities in the City's pension plans. It was done in two separate issues: Series A in the amount of \$13,275,000 was used to advance refund the City's 1997 bonds and to undertake capital improvements; Series B, which were taxable bonds, in the amount of \$21,585,000 was used to advance refund the City's 1997 pension bonds and to refund additional unfunded actuarial accrued pension liability in its four pension funds. The result of these transactions was \$1,322,719 excess revenue over expenditures that resulted in the reduction of the fund balance to (\$358,261) and a cash balance of \$232,023.

In 2006, the City again found a way to address the shortfall in operating revenue by undertaking a sale of its sewer interceptors to MACM for \$2.4 million. Part of this sale was used to address a (\$702,931) shortfall in operating funds while the remaining funds were reserved for future use. This transaction brought the accumulated fund balance to a positive \$836,215 which was the first positive fund balance since 2002.

When the operating funds from 2002 through 2008 are adjusted by eliminating the cash generated from the proceeds of debt restructuring and sale of City assets, it is apparent that the City has experienced a deficit in its core operating balance since 2003.

However, the City began to experience core operating shortfalls again in 2007 and continued to operate in a deficit position through 2008 and 2009 as the City spent down the reserve funds. However, in 2008, once again the City was able to sell City assets in the form of the sanitary sewer collection and conveyance system to the MACM for approximately \$3 million down and \$1.9 million annually for the next 20 years. In conjunction with this sale, the City also transferred several City employees to the Municipal Authority for maintenance and upkeep of the lines thereby reducing its operating budget.

Overall, the City has taken a number of steps to reduce expenses and to enhance revenue collection. Many of the strategies that have been employed, however, are one-time "fixes" that will not continue to provide additional revenue for future fiscal years. When the operating funds from 2002 through 2008 are adjusted by eliminating the cash generated from the proceeds of debt restructuring and sale of City assets, it is apparent that the City has experienced a deficit in its core operating balance since 2003, and that this deficit has

rolled forward to deplete cash reserves and become larger with each fiscal period. (See Appendix A for summary and complete detail information relative to the core operating revenues and core operating expenditures.) Based on a review of the City's audited financial statements and an analysis of its 2009 and 2010 operating expenses, the forecast for 2009 is that the City ended the year with a \$250,000 cash balance, which is down from a high in 2006 of \$836,215. In fiscal year 2010, assuming that the City uses its last reserves, there would still be a projected shortfall of at least (\$950,000) because the City's expenses are expected to rise to \$20 million, while the revenue would have grown to only \$18.5 million.

Without intervention, the City, having exhausted all reserves, will begin calendar year 2011 with at least a (\$950,000) deficit. One of the strategies outlined by the City is the execution of a Memorandum of Understanding with the MACM for "host fees" in the amount of \$720,000 annually from MACM to the City. This will help to address the projected shortfall for 2010. In addition, the City has the option to restructure its debt from the 2005 General Obligation Series A bond issue since it included a five-year call provision.

However, it is important that the City take prompt and significant remedial action at the earliest possible date to avoid a potential financial crisis for 2011 and future years. The City should initiate an early budget process and spend the necessary time to develop a strategy that will avert the projected shortfalls that could contribute to severe curtailment of programs and delivery of basic services for its residents.

It is important that the City take prompt and significant remedial action at the earliest possible date to avoid a potential financial crisis for 2011 and future years.

- The City Council will need to consider increases to the real estate tax levy and to fees for MSF, and other services to cover the costs of providing basic services to residents during the 2011 budget process. Specifically, accurate calculations and at least three years of prior year budget experience should be utilized when making projections. The Council should then make informed decisions about whether to continue to spend down any carryover balance to meet revenue needs in future budget years or to raise taxes MSF fees, and other user fees. Although increases to taxes and fees are not politically popular, small increases from year to year to retain adequate fund balances are more acceptable than a "hold-the-line" approach for several years that results in a significant increase that can pose a problem for households with tight budgets during economic downturns.
- When estimating costs during the annual budgeting process, carefully include all "true" costs for overtime, legal fees, and fringe benefits. These items have been routinely under-budgeted in the past and as a result have caused budget overruns in department categories. When new capital projects are completed (e.g., park projects, business district improvements), make sure that maintenance costs to support those projects are also included in the budget.
- Consider a goal-oriented approach to the budget process. Begin the process early enough in the fiscal year to incorporate a goal-setting session that establishes the level

of services and specific programs that will be included in the budget. The goals should address long-term and short-term objectives and should be specific enough to be relevant to the annual budget process. For example, goals might include items such as replacing street signs or improving traffic signal maintenance over a specific time frame. Once items are identified, the department directors should be charged with exploring the best method and the best schedule for meeting goals and detailing the costs in labor and material that must be included in the budget to achieve them. A goal-oriented process would include the following steps:

- Review current year’s fiscal condition
 - Examine basic services and levels of service
 - Determine whether there are programs that are of lower importance
 - Identify demands for services that are not being met
 - Decide the importance of the services that the municipality provides
- It will be important over the next several months to freeze positions and refrain from any hiring decisions in order to contain current expenditures. Any position that becomes vacant should remain vacant through year end in order to reduce operational costs in all departments.
 - The City currently does not include a planning component for identifying “capital outlays” as part of its budget process. In general, these are items that include high-cost, nonrecurring expenses that are related to public facilities, roads, sewers, and large equipment purchases. The capital improvement process is generally done separately from the operating budget process and much earlier in the calendar year. There are two parts to designing an effective program: (1) development of a capital improvement plan that identifies capital items, schedules, and costs over a multiyear period, generally five to ten years at a time; and (2) an annual capital budget that includes a few items from the capital plan that will be included for completion or purchase during the next fiscal year.
 - The City should make an annual appropriation to the capital project fund from the general fund to meet the future needs of the capital improvement program. Annual transfers should be as consistent as possible from year to year in order to avoid a burden for any single fiscal year. This important transfer requires self-control by decision makers so that the temptation to skip the budget transfer in tight budget years is avoided and the transfer to the capital fund is regarded as an important and necessary expenditure in every budget year.
 - Good financial reports are a primary requirement of a good accounting system. The finance department should provide detailed monthly budget reports by the fifteenth of each calendar month, with a detailed balance sheet report that reconciles the bank account balances to ledger activity. The monthly reporting should also include a cash flow report that projects cash position on a monthly basis and also for year-end. It is important for the Council to know what has been received and/or expended from each line item and how the bank balances relate to the ledger balances. By calculating a

cash receipts projection by month and an expenditure projection by month, it is possible to identify a cash position summary based on actual and projected data in the current fiscal period.

Monthly financial reports are the cornerstone of good decision making by elected officials and must be viewed as the highest priority for the organization. Financial reports should be useful both internally for management, staff, and the City Council, and also for the public. The following characteristics should be goals for the financial reports:

- Complete — showing all of the funds and balance sheets for each fund
- Detailed — enough detail to provide support for summary information but not so much information that the facts are buried and difficult to discern
- Summarized — information that is in a useful format so that officials and the public can access the data in an informative way
- Standardized — across funds and consistent with other local governments so that outside users of the information find the reports to be concise and useful

Monthly financial reports are the cornerstone of good decision making by elected officials and must be viewed as the highest priority for the organization.

Additional strategies and recommendations for enhancement of revenue and cost containment for expenditures are included in Step III: Emergency Plan for Current Fiscal Year.