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Third Class Cities White Paper Outline:

Pensions:

- Authorize municipalities to offer an optional defined contribution plan and encourage municipalities to place all new hires into such a plan.
- Adopt/ensure appropriate actuarial principles.
- Incentivize/encourage the administration and management of plans by the Pennsylvania Municipal Retirement System (PMRS).
- Prohibit benefit enhancements unless the system is 90 percent funded.
- Adopt new benefit levels/rules/contributions/rates for all new hires.
- Prohibit including overtime and/or longevity in salary calculations (anti-spiking).

Binding Arbitration:

- Consider a municipality's "ability to pay."
- Redefine an "impasse."
- Instill "last/best" offer as part of the arbitration process.
- Ensure neutrality of arbitrators.
- Institute a legitimate appeals process.
- Share the cost of arbitration.

Economic Development:

- Create "Urban Redevelopment Areas."
- Expand the Local Economic Revitalization Tax Assistance (LERTA) program to non-profit properties.
- Create a "Strategic Communities Partnership."
- Remove impediments to and support shared services.

Revenue Enhancement:

- Recognize revenue sources and challenges as a real issue.
- *Address revenues after other reforms are in place.*

Metro Chambers for Sustainable Cities

Cities like Reading, York, Lancaster, Harrisburg, Wilkes-Barre, Allentown, Bethlehem and Easton share a similar history, charm and sense of community. But they also share less idyllic characteristics with concentrated poverty, deteriorating property values and red ink seeping into the city balance sheets as tax revenues fails to keep pace with the cost of providing basic services.

The extent of the fiscal predicament was validated by research conducted by the Pennsylvania Economy League (PEL) of five of the cities concluding that financial stability is on very shaky ground due to “systemic problems, not political or personality based problems.”

Municipalities expend their largest share of resources maintaining the most fundamental and much needed services of police and fire protection. Each of the municipal governments in the PEL study has been engaged in using – to varying degrees – operational supplements in order to bring total revenues in balance with total expenditures.” Municipalities have been creatively plugging an existing hole for some time now in order to meet basic needs. The cities have transferred funds from Water and Sewer and the Parking Authorities, sold off assets, and refinanced debt. The plugs ran out for Reading since the report was published and the City filed Act 47 in the hopes of developing a sustainable financial plan with the state’s help. Harrisburg appears poised for the same fate and the others likely a year or two behind.

Ironically, Act 47 provides relief for municipalities from some of the constraints they face due to the systemic or structural problems. So why not address the constraints directly?

On the revenue side of the equation, municipalities only have the authority to tax in areas specifically granted by the state. Act 511 gives Third Class Cities the authority to tax income and property of its residents. Concentrated poverty and deteriorating property values have eroded the base of taxation while City Councils have contributed to the declining revenue stream in their reluctance to increase the rates on the taxes. Cities also host a large proportion of non-taxable property including schools, colleges, hospitals, churches, charitable organizations and government buildings.

Expenditures haven’t been contained very well either. The PEL report pins the blame on contract arbitration awards, skyrocketing healthcare costs and the costs of maintaining fully funded pension plans.

The bottom line: The PEL study concluded that in each of the cities, taxes and non-tax revenue simply do not and cannot support the expected level of essential services that the cities provide on an annual basis. Due to state mandated and demographic constraints, City elected officials will be unlikely able to solve this structural dilemma alone. It will require a regional perspective and modifications of the state legislated framework in which cities operate, including Act 511 (tax authority), Assessment law, Act 111 (binding arbitration), Act 205 (pension requirements), and Act 47.

The revenue side of the equation should be addressed after the expense side of the equation is addressed or the problems our Cities face will only be further fueled.

Pensions

Background

Municipalities, and Third Class Cities in particular, expend their largest share of resources maintaining the most fundamental and much needed services of police and fire protection. The costs however have reached a point where they now exceed the total tax revenues coming into the cities. Using Reading as the example, public safety personnel expenditures grew by \$12 million from 2003 through 2007, while personnel headcount remained fairly constant. Salaries increased 28%, employee benefits rose 81% and pension costs were up 176%.

Obviously, a ranking problem for the Cities on the expenditure side is escalating pension costs. Pennsylvania has over 3000 separate local government pension plans, which is 25% of all such plans in the nation! And two-thirds of the plans have 10 or fewer active members.

While the efficiency of administering 3000 plans is an obvious issue, it is the funding of the benefits that is the bigger problem. During the 90s, healthy investment returns led to decreased employer contributions to Defined Benefit (DB) plans and expansion of benefits. Practices did not change with changing economic realities and a combination of underfunding, investment losses, benefit increases and inappropriate funding assumptions have led to a tipping point. By 2007, there was an estimated \$5.2 billion in unfunded liabilities.

The private sector shift to DC plans actually began in the 1980s and is an international trend. The movement has been due to a confluence of factors including the decline in long term interest rates, the move to market based accounting, increased regulatory burden ... all of which mean uncertainty in long term costs, which is unacceptable as a business practice. DC costs are actual and final where DB costs are simply estimated deposits based upon actuarial assumptions.

The private sector has by and large shifted away from defined benefit plans to defined contribution (DC) plans; government has not. In fact, our cities are required by state law to offer defined benefit pension plans.

Recommendations

We believe there is a need to pursue comprehensive and sustainable long-term pension reform for our cities to be financially sustainable. Pension Reform should be guided by a responsible set of principles and standards, which do not contribute to passing today's cost to future taxpayers.

Steps lawmakers should take to address the pension crisis are:

1. Establish a unified Defined Contribution plan for new members like a 401(k) style plan to curtail open-ended liabilities for taxpayers. Allow by law Third Class Cities to establish such plans as well. While this does not solve the underfunding of the current system, it better manages future risk.
2. Funding of public sector defined benefit plans should be kept current. Benefits should be funded as they are accrued. Require a set of valuation and funding standards (assumptions) consistent with sound actuarial and accounting principles for public sector defined benefit plans. Such reforms are now required of private sector defined benefit plans in The Pension Protection Act of 2006 which requires lower interest rate assumptions, market valuation of assets and shorter

amortization periods. Public sector defined benefit assumptions are currently at roughly 8% (Not all are at 8% – some are higher and many are lower.) which is not practical (Private sector closer to 6%). Amortization periods should conform to the remaining working duration of the active members of the plan. Asset values need to conform to market related values and be compliant with Government Accounting Standards Board (GASB) accounting requirements.

3. Modifying existing defined benefits plans including:

Prohibit benefit enhancements if the fund is below 90% funded

Anti-spiking – prohibit overtime in calculation

Allow municipalities to offer optional defined contribution plans to all employees.

eliminate COLAs and Deferred Retirement Option Programs (DROPs).

Binding Arbitration

Act 111:

Act 111 states how Commonwealth employed police and fire personnel can resolve contract disputes and grievances. In accordance with the law, they cannot strike and therefore have the right of binding arbitration which allows unresolved disputes to be handled by a panel of arbitrators who then make a decision on the dispute. Act 111 authorizes three specific measures: (1) collective bargaining between police/fire and their employers, (2) for arbitration in order to settle disputes, (3) and it requires compliance with collective bargaining agreements and the finds of arbitrators. The overall law is vague on the specifics of the arbitration process and fact-finding provisions.

The Arbitration Process at a Glance:

Collective bargaining becomes binding arbitration when the two parties involved reach an impasse, which then ushers in the need for an arbitration panel. The arbitration panel is composed of three individuals in which one is chosen by the union (the employees), one by the employer (municipality etc.), and the third is a neutrally agreed upon person chosen by the union and employer. It is also very important to note that the decision made by the arbitration panel is final and binding on both parties.

The Need for Reform:

Many studies have concluded that although Act 111 is a safeguard to prevent strikes and contract disputes by police and fire professional employed by the State, there are several reforms that are needed in light of the overall process, as well as, the increasing numbers of municipalities facing Act 47 and possible bankruptcy.

Recommendations

1. *Consideration of Ability to Pay*

Several studies and criticisms of the Act 111 arbitration process focus on municipality considerations and arbitration awards that lead to strong financial stress on a city or municipality. Studies have shown several criteria that focus primarily on market forces to combat this problem: comparison with economically and demographically similar cities to see what their police and fire personnel earn and the benefit package they receive; staffing levels; productivity level changes; hours worked per-week; inflation since the approval of the last contract and projected for the term of the contract; average income growth in the municipality; and financial ability of the municipality. A municipality's ability to pay should strongly be considered as a reform to the system due to the exponentially growing number of distressed cities in Pennsylvania.

2. *Redefine definition An Impasse*

Act 111 states that an impasse exists when the parties don't reach a written agreement within thirty days after collective bargaining proceedings have begun. This raises the question of whether an actual impasse exists between the two parties and the necessity of binding arbitration. Clarification of the law would aid in establishing when a true impasse exists. For instance, under Ohio law the Bureau of Mediation must determine that the following conditions have been met prior to issuing a conciliation order: fact-finding report was rejected timely by at least one party by a three-fifths majority of the individuals who were eligible to vote, the vote of the fact-finding report was served timely upon the State Employee Relations Board (SERB) and the other party, publication of the fact-finding report did occur in which the effective date of publication is stated on the board-issued notice of rejection of the fact-finding report, at least

seven days have passed since the effective date of publication of the fact-finding report and the parties have not reached a settlement. Eliminating 'false' impasses may lead to proactive negotiations between the parties and eliminate costs associated with the binding arbitration process.

3. *Last-Best Offer Arbitration*

This type of arbitration is used in baseball arbitration and requires each party to give their 'best and final' offer. The arbitration panel would then choose one of the last-best offers as the arbitration award. This is a clear cut arbitration style that inhibits an arbitration panel from making additional awards; their choice is only offer A or offer B. This also forces the two parties to make legitimate offers and levels the playing field allowing for an offer that is likely to be acceptable to both parties in the end.

4. *Neutrality of Arbitrators*

These suggestions are examples of how arbitrators could be selected and how they could make a judgment:

- **State Oversight:** A pool of arbitrators would be housed in the Department of Labor and Industry and would be classified as civil servants, free of political pressure. Panels of arbitrators would be appointed from the pool to hear cases around the state.
- **Neutrality:** Arbitrators would have no interest or connection to the dispute. No arbitrator could participate in a case in the county where he or she resides.
- **Professionalism:** Arbitrators would be certified by a professional organization/association and would be qualified to hear cases involving workplace matters for police and fire personnel and their employers.
- **Accountability:** A review panel made up of disinterested senior arbitrators should oversee the arbitrators' decisions and have the final approval on awards.

5. *Institute a Legitimate Appeals or Review Process*

As it stands now, there is no formalized appeals process once the arbitration panel makes an award-both parties are bound by the decision. In all other facets of our judicial system, an appeals process is permitted in order to review decisions and possibly eliminate excessive judgments. Currently courts will only review an award made by the arbitration panel if it is outwardly excessive, however clarification on what 'excessive' means is needed as well as a trigger that municipalities could use if they view the award as excessive in terms of their ability to pay. Amending the law to include the right of appeal and judicial review may handicap the use of excessive awards and further level the playing field during arbitration.

6. *Shared Cost of Arbitration Process*

The Pennsylvania League of Cities & Municipalities (PLCM) notes that in addition to the issues of cost, the Pennsylvania State Association of Township Commissioners (PSATC) supports amending Act 11 to place the cost of the third arbitrator and all other expenses on the party requesting the arbitration and this would therefore make the process more efficient and more fair in terms of cost. As it currently stands, the municipality is required to pay for their appointee arbitrator as well as the third neutrally appointed arbitrator.

Third Class City Alliance – Emphasis on Economic Development

No City can "out-build" the regressive governance and tax structures established for Cities in Pennsylvania Law. Our Cities must be given a new set of development tools designed to encourage commercial investment and residential growth.

- **Create Urban Redevelopment Areas/Development Tax Credit:**
 - Areas are designated by the Cities in planning with DCED and final approval of DCED
 - Areas must have a local 10 LERTA in place provide at least 5 years at 100%, then graduated to 20% in last year.
 - Program goals include development of mixed use, walkable communities with good access to public transportation
 - Expansion or program similar to the Enterprise Zone Tax Credit program that would apply a broader base of tax credits for businesses and residential development.
 - Raise participation rate to 40% (current rate is 20%) Tax credits could be sold for a percentage of value in order to generate capital, or applied directly to tax liability.
 - 20% tax credit would be available to property owners donating property for redevelopment in these areas
 - Add Historic Tax Credit of 20% for both commercial and residential with the ability to capitalize through sale of credits
- **Expand LERTA (Local Economic Revitalization Tax Assistance)** to include previously tax exempt properties (schools, churches, city, county, state, federal buildings, and buildings that paid under PURTA taxes.) to address problem of when an exempt property is purchased by the private sector, it immediately becomes fully taxable based on the assessed valuation when the property is sold, removing valuable capital from a renovation project that could be used for renovations.
- Through a reenergized Main & Elm Street program in partnership with the PA Downtown Center incentivize and financial support for the human capital required to enable a **Strategic Communities Partnership Program** – designed to bring cities, neighboring municipalities, city/county planners, economic development corporations and active urban not for profits together in 3rd Class Cities to work on strategies for redevelopment of major corridors and adjacent residential neighborhoods in 3rd Class Cities and larger Boroughs (over 20,000 population)
- **Neighborhood and small trade area support mechanism** to provide assistance to the "non-downtown" commercial sections of PA core communities. Most cities have their core downtowns, but also have smaller, neighborhood commercial districts as well, some of which may be just a few buildings. These areas serve as cores for residential areas with small groceries, restaurants and other services. They also inspire adjacent residential and other commercial investment. PA's program offerings have for the most part forced communities participating in other programs to "choose" their primary business district at the expense of these very small areas that require substantially less capital, but perhaps more technical assistance and organizing support. The Main Street/Elm Street programs should include a neighborhood commercial component.
- **Remove impediments to /encourage Shared Services** - The efficiency of service delivery could be enhanced if local governments addressed the delivery of services from a regional perspective. Economies of scale would show bottom line benefit and hard investments could be spread over a larger base.