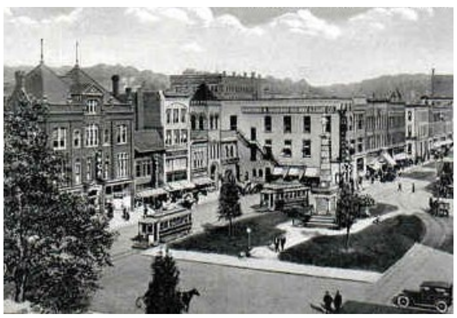
Municipalities Financial Recovery Act

Rescission Recommendation

City of New Castle
Lawrence County, Pennsylvania



Prepared on behalf of the

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

As Filed on October 9, 2023

Public Financial Management
1735 Market Street
42nd Floor
Philadelphia, PA 19103-2770
215 567 6100
www.pfm.com

Table of Contents

Introduction

The City of New Castle (the "City" or "New Castle") has had a remarkable turnaround in its financial performance since entering Commonwealth oversight under the Municipalities Financial Recovery Act (Act 47 of 1987) in January 2007.

The first Recovery Plan filed at that time described a $1.2 million deficit in the 2007 budget as well as millions of dollars in outstanding obligations. The City had not repaid Tax Anticipation Notes (TANs) within the same year and was behind on making its Minimum Municipal Obligation (MMO) payments for the employee pension plans. At that time, the baseline projection calculated the $1.2 million budget gap in 2007 would grow to $4.2 million by 2012 (or more than 30 percent of the projected revenue that year) absent any corrective action.

2007 Recovery Plan Projected Deficits, 2007 – 2012

	2007	2008	2009	2010	2011	2012
Total Revenues	10,412,194	10,475,180	10,601,863	10,734,036	10,872,145	11,006,704
Total Expenditures	11,582,251	12,795,164	13,261,168	13,886,358	14,538,249	15,227,282
Operating Result	(1,170,057)	(2,319,984)	(2,659,305)	(3,152,322)	(3,666,104)	(4,220,578)
Deficit as a % of revenue	11.2%	22.1%	25.1%	29.4%	33.7%	38.3%

The first Recovery Plan adopted by City Council in 2007 had more than 100 initiatives, many of which were focused on revenue enhancement and expenditure control. Other initiatives targeted improving operations and management across City government to stabilize New Castle's financial condition.

The City has spent more than 15 years in Act 47 oversight. Since it entered oversight in 2007, the City now makes its full MMO payments and has not needed short-term financing for cash flow purposes in years. It has built its financial reserves above the minimum threshold recommended by the Recovery Plans and the Government Finance Officers Association (GFOA). It sold its sanitary and storm sewer lines to an authority that can manage these assets on a regional basis and used the one-time windfall to reduce its debt burden and build up its Rainy Day reserves, contributing to its financial stability for years to come. It outsourced its refuse collection function, improved the quality of service, and no longer bears the expense and operational strain of providing this service.

New Castle has also become a Home Rule community, expanding its taxing powers to give the City more financial stability upon exiting Act 47 oversight. Over the past several years, the City has been preparing to exit Act 47 oversight by lessening its reliance on Act 47-enabled taxes. Today, all of the revenue collected from this wage tax goes towards current and future capital projects rather than day-to-day operations.

As we review the City's financial performance in 2023, New Castle is no longer on the brink of being unable to meet its obligations, as it was when it entered Act 47 oversight. The City will continue to face the economic challenges that it did before oversight, but it is now in a much better position both in terms of financial management and fiscal strength to overcome these challenges.

In view of this progress, we are writing this report to recommend that the Commonwealth of Pennsylvania rescind its declaration of financial distress for New Castle. This report confirms that New Castle meets the four statutory criteria in Act 47 that a community must meet to exit oversight.

This report also looks forward. It provides a new "baseline" projection of the City's revenues and expenditures for the next five years, highlights the challenges and opportunities that City officials will face, and provides direction on how to ensure that New Castle's financial recovery is not just remarkable but also sustainable.

History in Act 47

In January 2007, the Secretary of Pennsylvania's Department of Community and Economic Development (DCED) designated the City of New Castle a distressed municipality according to the criteria in the Municipalities Financial Recovery Act (Act 47 of 1987). DCED reviewed the City's financial performance and found that the City met four of the 11 criteria that qualify a community for distressed status under Act 47:

1) The municipality maintained a deficit over a three-year period, with a deficit of one percent or more in each of the previous fiscal years.

2) The municipality's expenditures exceeded revenues for a period of three (3) years or more.

3) The municipality accumulated and operated for each of two successive years a deficit equal to five (5) percent or more of its revenues.

4) The municipality failed to make the budgeted payment of its minimum municipal obligation to the employee pension plans.

In February 2007, the Commonwealth appointed an Act 47 Coordinator team lead by Public Financial Management (PFM) and Eckert Seamans Cherin and Mellott, LLC[1] to develop a financial Recovery Plan and bring the City back to fiscal health. Under this first Recovery Plan, New Castle implemented several difficult measures to bring the City's finances back into balance, including increases to real estate and earned income taxes, increases to trash collections fees, and personnel cost control measures such as wage freezes. The City also worked to retire some of its outstanding obligations through an unfunded borrowing and sanitary sewer line sale in 2010.

On November 21, 2012, the Coordinator filed a comprehensive Recovery Plan amendment in response to the City's ongoing financial challenges and an emerging threat of rising required contributions to the employee pension plans. The 2012 Amended Recovery Plan put a strategy in place for incrementally increasing the City's annual pension contributions to improve the funding level, avoiding costly benefit enhancements for current or past employees, and establishing a more affordable level of benefits for new hires.

On October 31, 2014, Governor Tom Corbett signed Act 199 into law, which limits the amount of time that a municipality designated as financially distressed can remain under Commonwealth oversight with the following provision:

"Municipalities operating pursuant to a recovery plan on the effective date of this section shall be subject to a termination date five years from the effective date of the most recent recovery plan or amendment enacted in accordance with this act…"

New Castle's termination date at that time was December 2019, five years from the effective date of the Recovery Plan amendment adopted by the City in December 2014. On October 21, 2015, the Coordinator filed another comprehensive Recovery Plan amendment, outlining a strategy for the City to reduce its reliance on Act 47-authorized taxing powers and facilitate its exit from oversight.

On April 1, 2019, the Coordinator filed a Financial Condition Report with the City and DCED recommending the City adopt a three-year exit plan. The 2019 Exit Plan provided a strategy to give New Castle a better chance of exiting Act 47 oversight by the end of 2022. That Plan included initiatives related to adopting a Home Rule charter, outsourcing trash collection, and more aggressively funding capital projects.

[1] Because of personnel changes at Eckert Seamans and the changing nature of the engagement, Eckert Seamans phased off the engagement in recent years. They were an integral part of the Recovery effort.

On May 29, 2020, in response to the coronavirus pandemic, Governor Tom Wolf signed Act 23 in law, which provided an 18-month extension for municipalities designated as financially distressed. Pursuant to Act 23 of 2020, the City adopted an amended Exit Plan in October 2020 that set the new deadline to exit Act 47 at February 2024. The City is ready to exit Act 47 oversight ahead of that deadline.

According to Act 47, during the three-year Exit Plan period, the Coordinator may file a report with the Secretary of DCED recommending that the municipality have its distressed status terminated. This report recommends the City of New Castle have its distressed status terminated for the reasons described below.

Factors to Consider

In determining whether the City's distressed status shall be terminated, Section 255.1 of Act 47 requires the Secretary of DCED to consider the following four factors:

1) Operational deficits have been eliminated as evidenced by audited financial statements prepared in accordance with generally accepted accounting principles, and projections of future revenues and expenditures demonstrate a reasonable probability of future balanced budgets absent participation in Act 47;

2) *Obligations issued to finance the municipality's debt have been retired, reduced, or reissued in a manner that has adequately refinanced outstanding principle [sic] and interest and has permitted timely debt service and reasonable probability of continued timely debt service absent participation in this act;*

3) All claims or judgments that would have placed the City in imminent jeopardy of financial default have been negotiated and resolved; and

4) The City is projected to have positive operating balances for the first five years after the termination of distressed status. Projections of revenues shall include any anticipated tax or fee increases to fund ongoing expenditures for the first five years after a termination of distress.

Act 47 states that distressed status shall be rescinded if "the secretary concludes that substantial evidence supports an affirmative determination for each of the [prior] four factors." Substantial evidence is defined as such relevant evidence as a reasonable mind might accept as adequate to support a conclusion.

We present evidence on each of the four factors in turn.

Factor 1: Elimination of Operational Deficits

Operational deficits of the municipality have been eliminated and the financial condition of the municipality, as evidenced by audited financial statements prepared in accordance with generally accepted accounting principles and projections of future revenues and expenditures demonstrates a reasonable probability of future balanced budgets absent participation in [Act 47].

Over the past decade, New Castle's financial audits have shown deficits in some years and surpluses in others across its the three major funds: the General Fund, Sinking (or Debt Service) Fund, and the Pension Fund.[2]

[2] This is the checking account from which the City pays its Minimum Municipal Obligations and pension-related debt, not the pension plans themselves.

Combined General, Sinking, and Pension Fund Operating Result, 2012 – 2021 ($ Millions)

	2012 Audit	2013 Audit	2014 Audit	2015 Audit	2016 Audit	2017 Audit	2018 Audit	2019 Audit	2020 Audit	2021 Audit
Combined Revenues	$18.5	$20.7	$20.5	$21.8	$20.0	$21.1	$20.1	$20.3	$19.1	$18.5
Combined Expenditures	$18.0	$20.3	$19.8	$21.9	$20.8	$20.7	$19.8	$20.8	$19.5	$20.5
Surplus/Deficit	**$0.5**	**$0.4**	**$0.7**	**($0.1)**	**($0.8)**	**$0.4**	**$0.4**	**($0.5)**	**($0.4)**	**($2.0)**
Unassigned Fund Balance	$5.0	$5.0	$5.0	$5.0	$5.0	$5.0	$4.8	$4.4	$4.4	$3.6

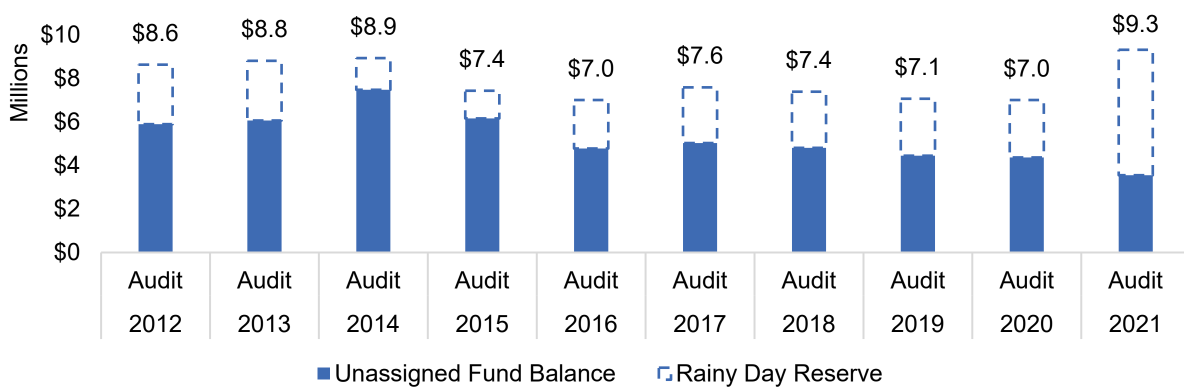
The $2.0 million deficit stands out because of its large size relative to the other results, but that is largely a function of audit procedure. In 2021, the City sold its storm sewer lines to the New Castle Area Sanitation Authority, completing an initiative that had first been considered years earlier, when the City sold its sanitary sewer lines to the same authority. The City used the proceed sales to pay down its debt in accordance with the asset sale provisions in the 2019 Exit Plan.

From an auditing perspective, the sewer sale proceeds are not considered revenues, but the City's additional debt payments are considered expenditures. So, the table above only shows the latter half of the transaction and inflates the operating deficit. Separately, the 2021 audit shows streetlighting expenditures but does not show the liquid fuels revenue that the City uses to pay for these costs. Without these accounting quirks, the deficit in 2021 would have been much smaller.

While the City had operating deficits in 2019, 2020 and 2021, the Exit Plan anticipated this would be the case and allowed deficits in these years to draw down the City's substantial reserves. The City has carried a Rainy Day Reserve and unassigned fund balance equal to or above $7 million since 2012. This level of reserves is above the targets set in the Recovery Plans and above the minimum levels recommended by the Government Finance Officers Association (GFOA).

Instead of requiring the City to increase taxes or cut expenses to avoid operating deficits, the Exit Plan authorized the City to spend down its reserves, so long as they were kept above the target level. In fact, the 2021 asset sale took total reserves above $9 million at the end of that year.

Unassigned Fund Balance and Rainy Day Reserve, 2012 – 2017



We also note that the City has outperformed the baseline projection (as it should) in all years since entering oversight. While the baseline projections in the Recovery and Exit Plans have shown deficits every year, the City has had surpluses in some years and smaller deficits than expected most other years. This was even true during the pandemic. The 2019 Exit Plan projected a $0.9 million deficit and the 2020 Amended Exit Plan had a $0.5 million deficit. The City enacted furloughs and other cost saving measures and finished with a $0.4 million deficit.

Projected versus Actual Operating Result, 2012 – 2021 ($ Millions)

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
2012 Amended Recovery Plan	($0.3)	($1.5)	($2.2)	($2.8)						
2015 Amended Recovery Plan				($0.1)	($1.6)	($3.7)	($5.2)	($6.5)	($7.1)	
2019 Exit Plan								($0.1)	($0.9)	($2.0)
2020 Amended Exit Plan									($0.5)	($0.9)
Actual Operating Result	**$0.5**	**$0.4**	**$0.7**	**($0.1)**	**($0.8)**	**$0.4**	**$0.4**	**($0.5)**	**($0.4)**	**($2.0)**

The City has also outperformed the Recovery and Exit Plans in terms of tax increases. The 2020 Amended Exit Plan assumed that the City would need to increase its real estate taxes from 15.48 mills in the 2020 budget to 19.48 in 2023. Instead, the City has not increased its millage rate since 2020.

While the City will almost certainly need to increase real estate taxes in the years to come, New Castle was able to keep tax rates flat for the past three years, avoid the multi-million-dollar deficits anticipated in the recovery and exit plans, and grow its reserves. With this additional context, we believe the City meets this criterion to exit Act 47 oversight.

Factor 1 states that the City needs to demonstrate the "reasonable probability of future balanced budgets absent participation in this act." We will discuss this probability within the context of Factor 4 (projected operating balances for the next five years) and discuss principles for New Castle's sustained recovery.

Factor 2: Debt Obligations

Obligations issued to finance the municipality's debt have been retired, reduced, or reissued in a manner that has adequately refinanced outstanding principle [sic] and interest and has permitted timely debt service and reasonable probability of continued timely debt service absent participation in this act.

The City has limited its use of debt and paid down its existing obligations since entering oversight in 2009. After needing an unfunded debt loan in the early years of oversight, the City has repaid that loan, retired obligations due to the U.S. Department of Housing and Urban Development, eliminated the use of short-term cash flow borrowings to support operations early in the year, and reduced other forms of debt to less than a third of what they were at the start of oversight.

Select Long-term Liabilities ($000)[3]

	2007 Audit	2021 Audit
Bonds payable	$41,100	$15,175
HUD Loans	$2,000	$0
Notes and loans payable	$6,015	$0
Capital leases	$0	$153
Compensated absences	$1,089	$1,023
Bond discount	($374)	0
Long-term liabilities	**$49,830**	**$16,351**

Source: 2007 annual comprehensive financial report, page 11 and 2021 annual comprehensive annual financial report, page 10

	After paying down debt
2021	2,613,377
2022	2,609,766
2023	2,617,925
2024	2,597,855
2025	1,234,022
2026	1,227,427
2027	1,229,090
2028	1,233,209
2029	1,235,513
2030	1,230,725
2031	563,281
2032	563,375
2033	562,594
2034	560,938
2035	558,406
Total	**20,637,503**

From 2012 to 2020, New Castle's annual debt service payments for general obligation (GO) and pension bonds were around $2.8 million per year on average, or about 14 percent of the City's total expenses. In 2021, New Castle sold its stormwater lines and used $3.0 million of the proceeds to pay down its debt. The City also dedicated a portion of the sale proceeds toward an escrow account to offset future debt service payments.

Looking ahead, the City's debt is scheduled to drop by $1.4 million (or 52.5 percent) in 2025 when the City retires one of its pension obligation bonds. Just as the recent reduction in general obligation debt allowed the City to direct more of its total real estate tax revenues to fund operations, the scheduled drop in pension obligation debt will allow the City to use more of its resident earned income tax revenue to fund operations or issue new debt that supports capital investments.

In short, the City has made timely debt service payments for years, even paying off debt ahead of schedule when possible, and should be able to continue to do so after leaving Act 47.

New Castle meets this criterion to exit Act 47 oversight.

Factor 3: Outstanding Claims & Judgements

All claims or judgments that would have placed the City in imminent jeopardy of financial default have been negotiated and resolved.

Based on our consultation with the City Solicitor, we do not believe there are any outstanding legal claims or potential judgments that would place the City government in imminent jeopardy of financial default. While the City is involved in legal actions that could potentially result in a cash outlay for City government, the City's reserves provide resources to cover those potential costs, if needed. While noting the inherent uncertainty associated with any current or future legal proceedings, the City meets this criterion based on the information provided.

[3] Source: 2007 annual comprehensive financial report, page 11 and 2021 annual comprehensive annual financial report, page 10 Since 2007, the accounting standards for annual audits have changed to include net pension liabilities and other post-employment benefit (OPEB) liabilities in the calculation of a municipality's total long-term liabilities. In 2021, the City had a positive net pension liability of $0.6 million in 2021. While the City's OPEB liability (mostly for retiree health insurance) is significant at $9.2 million, the City has taken steps to cap this liability, such as eliminating retiree health insurance for employees hired since 2014.

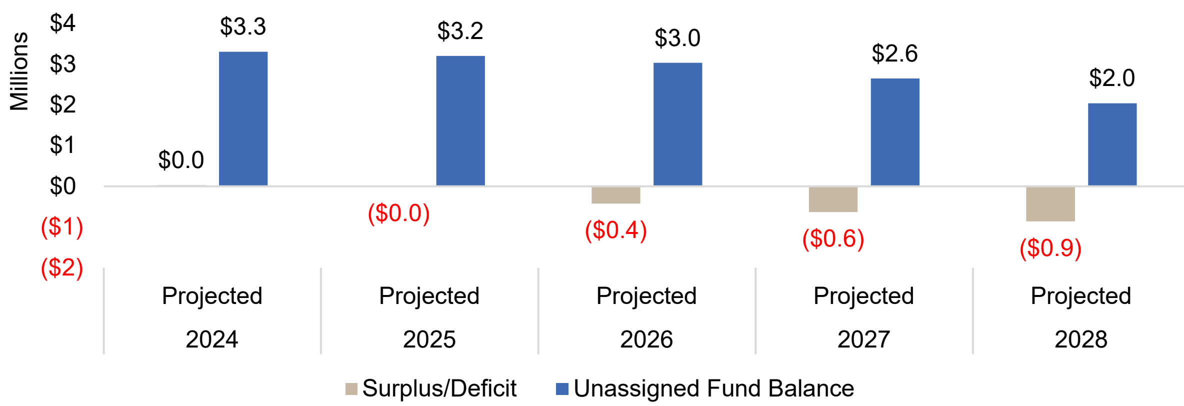
Factor 4: Projected Positive Operating Result

The City is projected to have positive operating balances for the first five years after the termination of distressed status. Projections of revenues shall include any anticipated tax or fee increases to fund ongoing expenditures for the first five years after a termination of distress.

To determine whether the City satisfies this requirement, we developed a five-year baseline projection that shows General, Sinking, and Pension Fund revenues and expenditures in a status quo or carryforward scenario. The projection starts with the adopted 2023 budget and then carries through the end of 2028, assuming no changes in tax rates, headcount, service levels, or debt beyond making timely payments on existing obligations.

The baseline projection shows a balanced budget across the three core funds in 2024, a nearly balanced budget in 2025,[4] and then a structural deficit that returns at $425,000 (or 5 percent of expenditures) in 2026. As shown in a prior table, deficits in the baseline projection are common because they assume "hands off the wheel" (no corrective action). In reality the City will need to take corrective action to balance its budget through measures like tax increases, which we note are not included in the baseline projection. The City has consistently performed better than projected as we discussed in Factor 1.

Projected Surplus/Deficit and Unassigned Fund Balance, 2024 – 2028



	2024 Projected	2025 Projected	2026 Projected	2027 Projected	2028 Projected
Combined Revenues	18,057,035	16,961,909	16,867,090	17,026,334	17,193,656
Combined Expenditures	18,030,193	16,972,040	17,292,557	17,657,896	18,053,574
Surplus/Deficit	**26,842**	**(10,131)**	**(425,466)**	**(631,563)**	**(859,918)**

The reason for the projected deficits after 2025 is a familiar one for New Castle and other Pennsylvania cities. The City's spending on operations, debt, and pensions grows faster than the revenues available to fund those expenditures unless the City takes corrective action to increase revenues and curb the growth in expenditures.

The exit criteria state that revenue projections should include any anticipated tax or fee increases to fund ongoing expenditures for the next five years. While our baseline projection does not explicitly assume any tax increases, New Castle now has legal authority to increase its real estate tax and its resident earned income tax as a Home Rule community. If the City did not take any other corrective actions, the City could close the projected $425,000 deficit in 2026 by increasing its total real estate tax rate by approximately 1.1

[4] The projected deficit is $10,000, or 0.1 percent of projected expenditures.

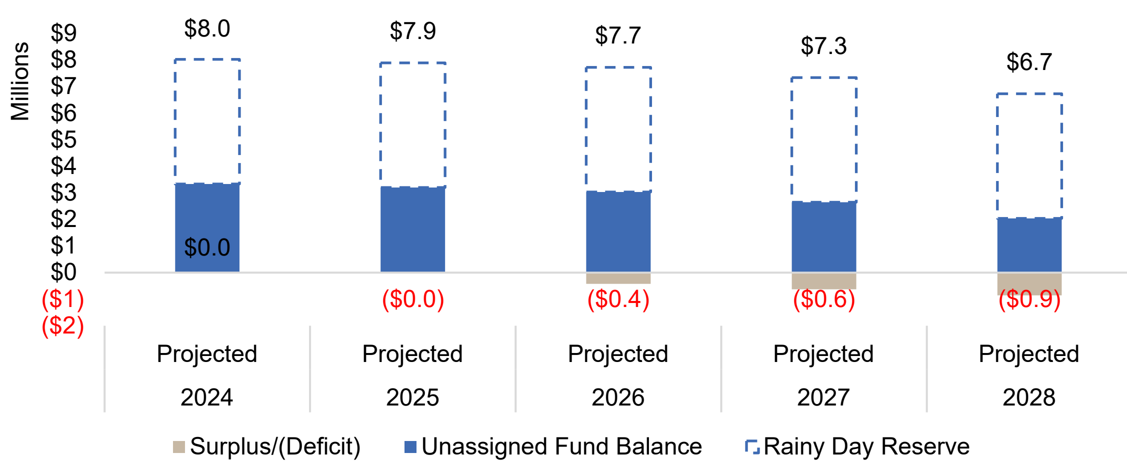
mills (or 6.8 percent). In this scenario, that would be New Castle's first real estate tax increase in six years and equate to a 1.1 percent annual tax increase over that period.

Based on our work with New Castle since 2007, we expect that the City will strive to do more than just rely on tax increases to close its deficits. As noted earlier, the City has a track record of performing better than baseline projections (as it should) and increasing real estate tax rates less than expected.

Revenues may grow less or expenditures more than assumed in the baseline scenario. If this is the case – or if there are emergent needs not included in the baseline – the City is well positioned to weather those events because of its financial reserves.

According to the 2021 audit, the City's unassigned fund balance was $3.6 million at the end of that year. In addition to the unassigned fund balance, the City has built and maintained a Rainy Day reserve. If the City took no corrective action to address the projected deficits, the City would still finish this projection period with $6.7 million in unassigned fund balance and Rainy Day reserves, the equivalent of 37.8 percent of its annual expenditures in the General, Sinking, and Pension funds. This is well above the 16.7 percent target established by the Government Finance Officers Association (GFOA) and provides further validation to the City's case to exit financial oversight.

Projected Surplus/Deficit, Unassigned Fund Balance, and Rainy Day Reserve



We have emphasized the importance of maintaining adequate reserves throughout the Act 47 oversight process and used those reserves to frame our review of most major financial decisions – how would any significant change impact the City's reliance on reserves to fund operations?

Going forward, we urge the City to maintain the Rainy Day Reserve, only use it for true financial emergencies, and then replenish it as soon as possible to the minimum level set by City policy. This reserve is one of the primary reasons the City can now exit oversight and it would be one of the major protections against New Castle returning to oversight in the future.

Exiting Act 47 should not have any direct impact on financial performance in the General Fund because the City stopped using the Act 47 EIT to fund operations in 2022. The City also has labor agreements that provide reasonable salary increases and retain the critical health insurance and pension cost controls through 2027 for most unions (2025 for clerical workers).

The City meets this final criterion to exit Act 47 oversight.

New Castle's readiness to exit Act 47 oversight should not be misinterpreted as a statement that all of its financial challenges are solved. As we noted at the front of this evaluation, the City has had operating deficits in recent years, and there is still a structural deficit created by expenditures growing faster than revenues absent corrective action.

We also note that the baseline projection does not identify a specific source for funding capital projects– road paving, major facility repairs, parks upgrades – beyond the capital reserve that the City was required to build in the final years of oversight. In recent years, the City has used the additional taxing authority provided by Act 47 to collect revenue from commuters and its own residents to fund these projects. Those enhanced taxing powers end when New Castle leaves oversight, and the capital reserve ($2.0 million at the end of 2021) will eventually be exhausted.

City leaders with the support of New Castle's citizens and employees will have to find a way to balance the budget, maintain some level of reserves and fund capital improvements, while living within context of limited growth in its major tax revenues. This will not be an easy task, but it is a common one for Pennsylvania governments and one that New Castle is now equipped to meet without Commonwealth fiscal oversight.

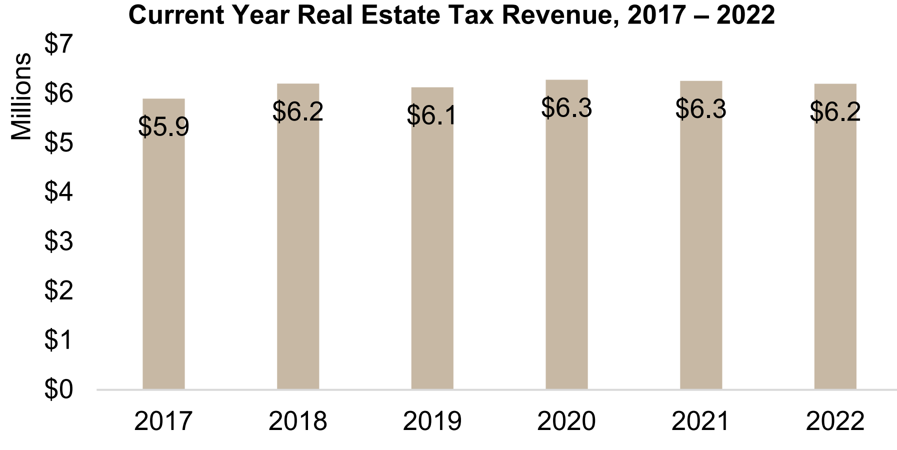
The rest of this report describes the revenue and expenditure trends that City leaders should manage over the next five years and some key principles they should follow to do so.

Revenue outlook

Real estate taxes are the City's largest revenue source, accounting for 37.2 percent of its 2023 budget. Absent a millage increase, the City's real estate tax revenue grows very slowly because the base off of which the tax is levied (the assessed value of taxable properties in the City) stays flat.

From 2017 to 2022, the City's current year real estate tax collections grew from $5.9 million to $6.2 million or at an average annual rate of 1.0 percent. The two years when current year revenues rose had millage increases: one in 2018 from 13.73 to 14.23 and one in 2020 to 15.48 mills. The City has not increased its millage rate since 2020.

Current Year Real Estate Tax Revenue, 2017 – 2022



	2017	2018	2019	2020	2021	2022
Tax Rate (mills)	13.73	14.23	14.23	15.48	15.48	15.48
Current Year Collections	$5,896,298	$6,201,146	$6,127,241	$6,281,036	$6,257,994	$6,197,885
% Increase	N/A	5.2%	-1.2%	2.5%	-0.4%	-1.0%

The five-year baseline projection is a carry-forward or status quo scenario, and therefore it does not assume any increases in the tax rate or tax base. However, it is likely that the City will need a real estate tax increase before 2028 to remain in financial balance.

The projection also carries forward an 83.4 percent collection rate – the average of actual current year collections from 2020 to 2022 – and we discuss the City's declining collection rate under principles for sustained recovery.

New Castle's second largest source of revenue is the **earned income (or wage) tax**, which represents 36 percent of the total 2023 budget across General, Sinking, and Pension funds. The City currently uses three laws to levy the wage tax on its residents and commuters.

- Act 511 taxes are only levied on residents and those commuters whose home municipalities have a resident tax rate less than 1.0 percent.
- Act 205 or distressed pension taxes are tied to pension costs, including pension debt, and levied on both resident and commuter wages.
- Act 47 taxes are also levied on both residents and commuters and are tied to the City's distressed status. Once New Castle exits oversight in 2024, this tax will drop to 0%.

The City has been slowly transitioning its Act 47 taxes away from funding operations to funding capital projects. Since 2022, all current year Act 47 tax revenue goes toward funding current capital projects or the Capital Reserve fund to use when the City exits oversight in 2024.

A large portion of the City's pension debt is also anticipated to be paid off in 2025, reducing the City's total debt as described earlier. While the decreased annual debt service allows the City to dedicate more resident EIT to operating costs, it negatively impacts the total wage tax revenue because the commuter distressed pension tax rate will fall with no offsetting increase in the General Fund.

In 2022, New Castle became a Home Rule community, expanding the City's taxing powers. It can now levy resident wage taxes in excess of 1.0 percent.[5] The City has exercised this power already to keep the total resident wage tax rate level as the Act 205 taxes fluctuate from year to year. Home Rule taxing powers do not apply for non-residents, however, and once the Act 47 tax is eliminated and Act 205 tax decreases, the projected non-resident EIT rate is expected to decrease from 0.88 percent in the 2023 budget to 0.25 percent in 2028.

Budgeted and Projected Wage Tax Rate, 2023 – 2028

	2023 Budget	2024 Proj.	2025 Proj.	2026 Proj.	2027 Proj.	2028 Proj.
Act 511	0.59%	1.08%	1.30%	1.31%	1.32%	1.33%
Act 47	0.40%	0.00%	0.00%	0.00%	0.00%	0.00%
Act 205	0.58%	0.50%	0.28%	0.27%	0.25%	0.25%
Total Resident Rate	**1.58%**	**1.58%**	**1.58%**	**1.58%**	**1.58%**	**1.58%**
Act 47	0.30%	0.00%	0.00%	0.00%	0.00%	0.00%
Act 205	0.58%	0.50%	0.28%	0.27%	0.25%	0.25%
Total Non-Resident Rate	**0.88%**	**0.50%**	**0.28%**	**0.27%**	**0.25%**	**0.25%**

As a result of the declining non-resident tax rate, total wage tax revenues are projected to decrease from $6.5 million in the 2023 budget to $5.3 million in 2028. The City's resident tax base has been growing in recent years, which offsets some of the decline in non-resident tax rate.

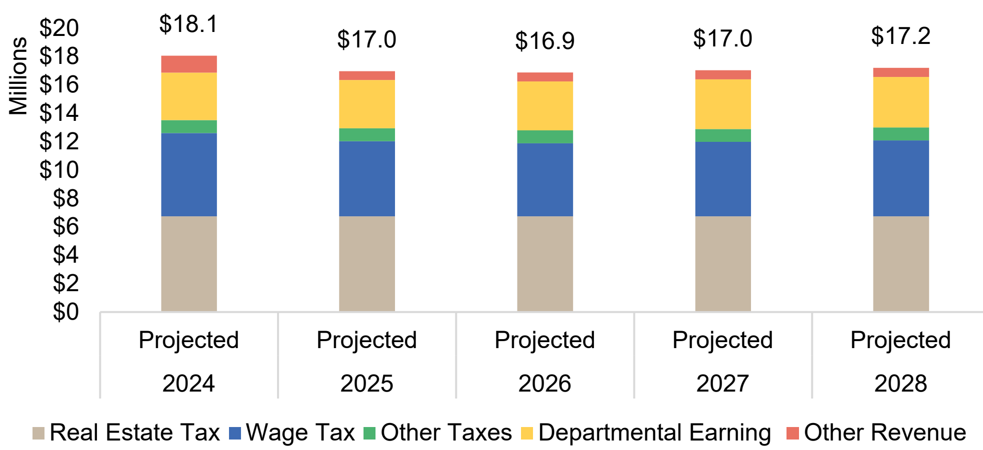
In 2022, the City eliminated its **gross receipts taxes** for businesses (i.e. business privilege and mercantile taxes) in an effort to encourage more businesses to move into New Castle and spur economic growth. Eventually, the City may see the positive economic impacts of this tax incentive in its local services tax (flat

[5] The City splits the first 1.0 percent of its wage tax with the school district, 50/50.

$52 per year paid by anyone who works in New Castle) and earned income tax (currently paid by both residents and commuters). But in the short term, eliminating the tax resulted an immediate decrease in tax revenue of about $500,000 annually.

Many of the City's **other revenues** are assumed to remain flat or grow with inflation from 2024 through 2028. Combined revenue across the General, Sinking, and Pension funds is projected to shrink from the 2023 budget from $18.2 million to $17.2 million absent corrective action due to flat real estate tax revenue and declining commuter wage taxes.

Total Projected Revenues, 2024 – 2028

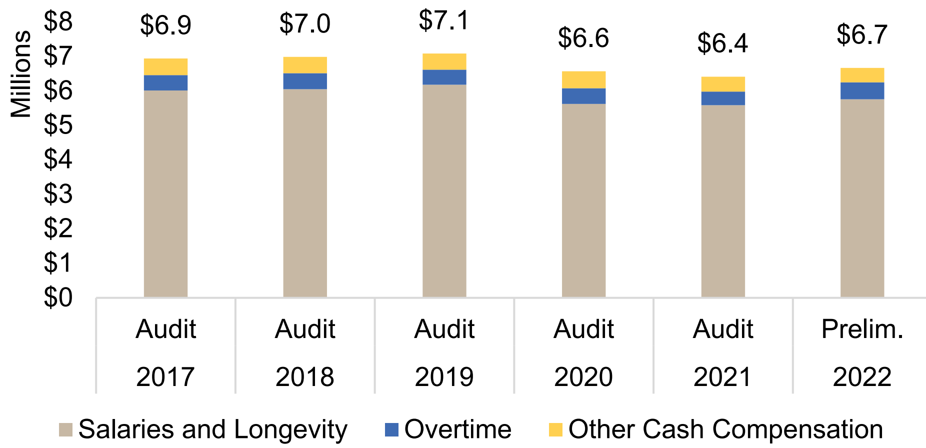


Expenditure outlook

The Act 47 Recovery and Exit Plans set maximum annual allocations that the City could spend on all forms of active employee compensation for each collective bargaining unit. New Castle has four collective bargaining units that represent most of the City's workforce: the Fraternal Order of Police (FOP), International Association of Firefighters (IAFF), the Laborer's Union, and the Clerical Union. The City and its labor unions negotiated new collective bargaining agreements in compliance with the Recovery Plan caps, usually including 2.0 percent annual across-the-board wage increases. Despite those annual increases, the City's total personnel costs actually dropped from $9.2 million to $8.2 million from 2017 to 2022.

Spending on **cash compensation** grew by 1.4 percent per year before the pandemic and then dropped in 2020 because of furloughs and position cuts. Growth in cash compensation has resumed, but turnover offsets some of that growth when senior employees at the top of the wage scale leave and are replaced by new employees at the bottom of the wage scale. The City has also had vacant positions that hold actual spending below budgeted levels.

Cash Compensation, 2017 – 2022



The City's spending on active employee **health insurance** costs also dropped from $1.3 million to $1.2 million over his period, despite rising premium costs. Expenditures fluctuate from year to year, simply due to the types of coverage that employees select. The City had seven fewer employees on family coverage (the most expensive level) in 2023 than in 2020 and two employees dropped off the City's insurance entirely, instead taking a $2,500 in-lieu payment.

The City recently negotiated new collective bargaining agreements with three out of its four of unions that set wage increases for the first couple of years after Act 47 oversight ends. The City is expected to reach an agreement with the Fraternal Order of Police (FOP) that extends through the end of 2027.

Collective Bargaining ATB Increases, 2024 - 2028

	2024	2025	2026	2027	2028
FOP	*$2,000*	*2.0%*	*2.0%*	*3.0%*	3.0%
IAFF	1.0%	4.0%	2.0%	3.0%	3.0%
Laborers	2.0%	4.0%	3.0%	3.0%	3.0%
Clerical	2.0%	4.0%	4.0%	4.0%	4.0%

Blue denotes scheduled wage increases. Grey denotes proposed increases, pending City and union ratification. Yellow denotes assumed increases after the current contracts expire.

With the exception of a one-time adjustment for the FOP[6], across-the-board wage increases will range from 1.0 to 4.0 percent through 2027 for the police, fire, and laborers' unions and through 2025 for the clerical union. The baseline projection incorporates these scheduled increases and assumes no changes in headcount. It does not include any future turnover-related savings. Health care premium costs are projected to rise by 5.0 percent, though larger increases are possible.

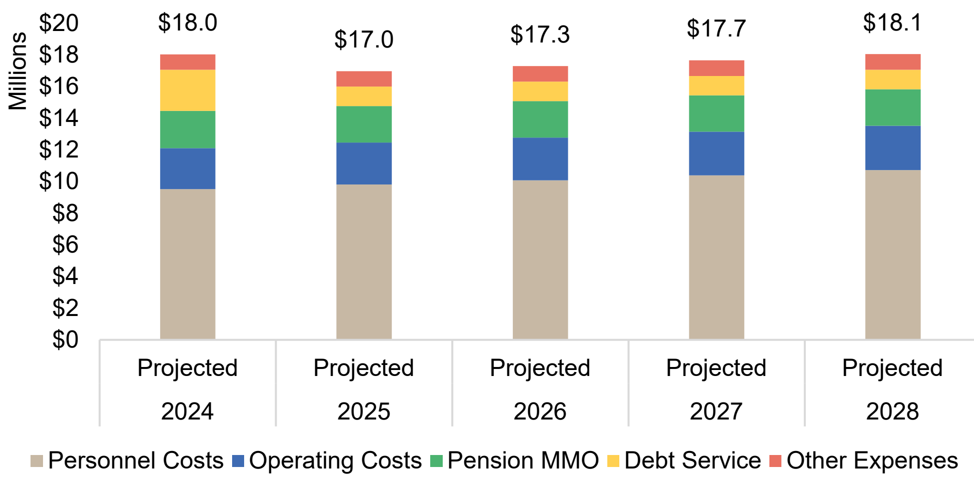
As discussed in Factor 2, New Castle is anticipated to have a drop in its **debt service** payments in 2025, absent any new borrowing, when it pays off one of its pension bonds. Debt service decreases from $2.6 million to $1.2 million in 2025, and then stays relatively flat at this level through 2028.

Many of the City's **other expenditures** are projected to grow along with inflation. Total expenditures across the General, Sinking, and Pension funds are anticipated to drop in 2024 and 2025 due to decreasing debt

[6] Rather than a percent across the board wage increase, police officers will receive a $2,000 increase to the wage scale in 2024. Across the entire department this translates to an approximately 5.8 percent increase, but percent increases by an individual vary.

service. After this, expenditures grow at an average annual rate of 2.1 percent, mostly due to projected cash compensation and health insurance growth.

Total Projected Expenses, 2024 – 2028



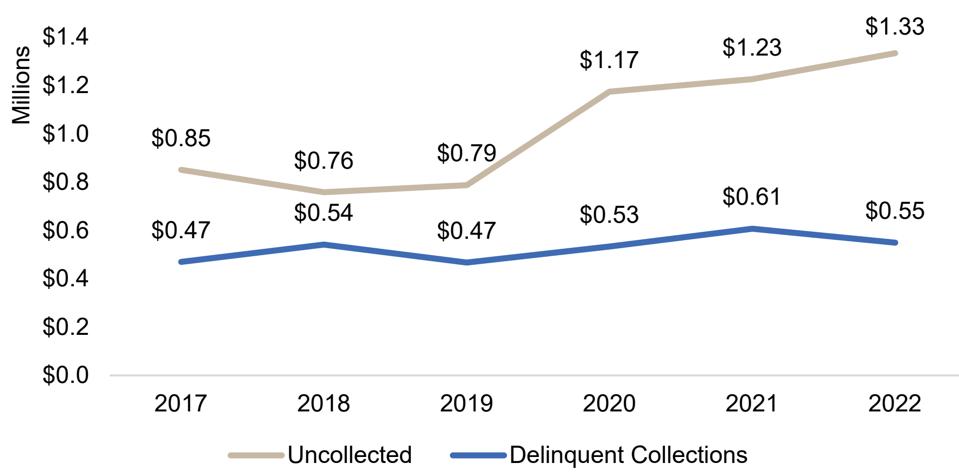
Principles for sustained recovery

Principle 1: Address falling real estate tax collections

When New Castle first entered oversight, it had a very low collection rate for current year real estate taxes. As a result, the City needed larger tax rate increases to generate the same amount of money it would have received with a higher collection rate.

In 2016, the City changed its delinquent real estate tax collector from the County Tax Claim Bureau to a third-party collector. The increased emphasis on collecting back taxes caused the current year collection rate to rise to 82.4 percent in 2018. Prior year revenues understandably dropped because there were fewer delinquent accounts to collect. Unfortunately, the current year collection rate has since regressed back to 82.3 percent in 2022 and delinquent revenues have stayed flat, even though there should be more delinquent accounts again.

Uncollected and Delinquent Real Estate Tax Collections, 2017 – 2022



For its part, the third-party tax collector states that its performance remains strong. Nevertheless, it is hard to explain how the City could have *more* delinquent accounts, the same amount of delinquent tax revenue, and steady success by the third-party collector unless there is some other intervening variable, like the City turning less of its delinquent accounts over to that third-party collector.

We previously helped the City evaluate the connection between these variables and learned that the City was diverting some delinquent tax accounts associated with rental properties to another collector under a "distraint" process. If more delinquent accounts are diverted to the distraint process and that process has a lower collection rate, that could explain the trend.

Whatever the cause, the City should take whatever steps it can to reverse this trend and improve its current and prior year collection rate for its own revenue generating purposes and out of fairness to the majority of property owners who do pay their bill on time.

Principle 2: Use recurring revenues to pay for recurring costs and non-recurring revenues to pay for non-recurring costs.

This has been a consistent requirement across 16 years of oversight and several Recovery Plans. One-time revenues, whether they are generated by asset sales, non-recurring grants or unexpected windfalls, should be used for one-time expenditures such as:

- Replenishing reserves back to the target level;
- Funding capital projects identified through the City's capital improvement program and budgeting process;
- Making an additional contribution to the employee pension plans, above the MMO payments scheduled for the year;
- Making an additional payment on existing debt, beyond the amount of principal and interest due in a particular year.

Following this guideline ensures the City matches non-recurring costs with non-recurring benefits. New Castle followed this principle when it sold its sanitary sewer lines to pay debt ahead of schedule, and then followed it again years later when it sold its storm sewer lines to pay down other debt. It also used this principal to guide its decisions on how to spend federal stimulus money and how to use an unexpected windfall in earned income tax revenue caused by a change in Commonwealth law.

Route to recurring revenue

This principle is straightforward, but not always easy to follow. There will always be temptation to use short-term resources to fund new or existing positions, build new facilities or take other actions that generate recurring costs long after the revenue that funds the initial investment is gone. Similarly, there will be temptation to try to fix a structural problem with a short-term fix "just to get through this year."

Following this principle takes thoughtful review of new revenues and discipline in deciding how to use them.

It also requires that the City have recurring revenue growth so it can cover recurring costs that will naturally grow over time. Ideally, the City's two primary revenues (real estate tax and wage tax) will grow "naturally," without tax rate increases, when the assessed value of taxable property increases or resident earnings rise. But City government cannot single-handedly control the timing and volume of private sector construction that boosts the real estate tax base or the employment decisions that drive wage tax revenue growth.

So, the City should monitor tax base growth as we have done over the years, reviewing the changes in assessed value on an annual basis and monitoring wage tax performance quarterly. If those two tax bases do not grow adequately, then the City should increase the tax rates themselves or find offsetting expenditure reductions so government lives within its means.

Principle 3: Fund capital projects after Act 47

Since 2022, New Castle has dedicated all current year Act 47 EIT revenue to fund current capital projects and built its capital reserve to pay for projects beyond 2024. The Act 47 EIT will end when the City exits oversight and the associated tax revenue will trail away to zero a year or two later. While the City has built up its capital reserve ($2.0 million at the end of 2021), without a recurring source of funding it will eventually exhaust this resource. Meanwhile, the need to invest in capital projects – road paving, parks improvements, building rehabilitation – will continue.

As noted earlier, the baseline does not assume specific amounts of capital spending because decisions about how much the City should spend and when will be made after oversight ends. The City will need to find alternative sources of funding for its capital needs after Act 47 taking powers go away.

The table below compares two primary methods for funding capital projects: pay-as-you go for smaller, recurring expenses like paving and vehicles and debt financing for larger project with a long useful life

	Pay-as-you-go (PAYGO)	Debt financed
Ideal for Funding:	Small projects Assets with shorter 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 Easier to distribute spending over time through scheduled debt repayments
Cons	Insufficient to fund all needs Uneven expenditures Lack of "intergenerational equity" (i.e., today's taxpayers fund projects that will be used for years to come)	Adds interest and issuance costs Limits financial flexibility and reduces borrowing capacity Cost of borrowing depends on credit worthiness

Now that New Castle is on stronger financial footing, it can and should start looking for ways to fund capital projects on a recurring basis. Below are specific tools that the City has for doing so.

- ***Resident EIT increase dedicated to capital:*** In the final years of oversight, New Castle dedicated its entire 0.4 percent Act 47 wage tax to fund capital projects and build its reserves. The City can continue to allocate a portion of the earned income tax to capital and, now that the New Castle is a Home Rule municipality, it has much more flexibility to raise resident tax rates to meet its capital needs.

- ***Capital projects real estate tax millage:*** Historically, the City has allocated a portion of its real estate tax millage to debt service, which will decrease significantly in 2025. The City could increase its real estate tax rate, which has been flat since 2020, and add a specific millage to fund capital projects.

These first two options allow the City to raise recurring PAYGO dollars through tax increases. While never popular, tax increases that directly fund City projects that residents can immediately see and use (like paved roads or maintained public spaces) may be more palatable.

- **Fund larger projects using debt.** The City reduced its annual debt burden by dedicating one-time revenue from the sale of its sewer system to pay down obligations and in 2025, it will retire one of its pension bonds. Annual debt service costs will drop from $2.6 million to $1.2 million in 2025. In the future, the City should consider issuing general obligation bonds to pay for larger assets with a longer useful life. Decisions about how much to borrow and the repayment schedule should be guided by a multi-year projection, as described in the next initiative.

Principle 4: Use a multi-year perspective to make important financial decisions

Multi-year (or long-term) financial planning is a best practice recognized by the Government Finance Officers Association (GFOA). The GFOA explains[7]:

> *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 the City anticipate financial challenges; identify and quantify options to address those challenges; and act accordingly.

In its role as Recovery Coordinator, PFM has led the City's multi-year planning process. The Administration and Council have used that projection to guide their decisions and should continue to do so especially at the following junctures:

- Before eliminating revenues or adding new services
- During collective bargaining
- During preparation of the next year's fiscal budget
- Before issuing debt

Many key financial decisions occur during the budget process, but the City should also use the multi-year projection when making big decisions off budget cycle. The City should continue to use this important tool and process, internally or with external support. In the latter case, the City should use the Commonwealth's Strategic Management Planning (STMP) program to fund a portion of the costs associated with this work.

Principle 5: Implement an economic development strategy that focuses on blight remediation

While New Castle has made progress towards having balanced budgets and building reserves, in order to have true long-term, sustained financial recovery, the City will need to grow its tax base. The City's taxable assessed value (the base for its largest revenue source, the real estate tax), has historically been flat: over

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

the past eight years, the tax base shank at a rate of -0.2 percent per year on an average annual basis from 2015 to 2023.

Economic development is not merely a strategy for balancing the City's budget, but is important for improving residents' quality of life and neighborhood attractiveness. The benefits of clean, vibrant, and attractive neighborhoods extend beyond City government's financial performance to the everyday lives of residents. The absence of an effective strategy to deal with vacant, blighted, or dilapidated properties also has a broad negative impact.

The City does not have the resources nor capacity to drive economic and community development on its own and the battle to overcome the City's economic challenges will continue after oversight ends. But the City can still be a constructive partner in the larger efforts to overcome those challenges by using the tools that it has: code enforcement and blight removal.

As the City is in the process of hiring a City Manager and drafting its first budget that looks beyond Act 47 oversight, it should have more forward-looking strategic initiatives and prioritize economic development. Without tax base growth, the City will continue in a cycle of cutting expenses and raising tax rates to maintain fiscal balance.

Conclusion

Looking beyond Act 47, the City will have to weather three events that will reduce the amount of revenue available to fund operations and capital projects in the near term:

- In 2024, the City will lose its Act 47 taxing powers that fund capital projects. The commuter portion of that tax will be eliminated, and the resident portion could shift to fund operations.
- In 2025, the City will use more of its real estate tax revenue to cover debt because the escrow funds associated with the sewer line sale will be gone.
- In 2025, the City's pension debt will drop, triggering a reduction in the Act 205 tax. The commuter portion of that tax will be reduced, and the resident portion could shift to fund operations.

The City is positioned to absorb those shocks because of its continued vigilance in controlling personnel costs, as evidenced by the recently negotiated labor agreements, and the healthy reserves it has maintained. New Castle, like other Pennsylvania cities, will need to continue its focus on cost control while doing what it can to grow its tax base. The City will also need to find a way to fund capital projects, but it has options thanks to Home Rule and a smaller debt burden.

New Castle will continue to face financial challenges, but it is better equipped to meet them and ready to do so outside of Act 47 oversight.