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December 4, 2020

The Honorable Chris Frye
Mayor, City of New Castle
230 North Jefferson Street
New Castle, PA 16101

Mayor Frye:

We have statutory responsibilities related to the City of New Castle's budget process according to amendments to the Municipalities Financial Recovery Act (i.e. Act 47 of 1987) in 2014. Under Act 47 as amended, we must review your budget for compliance with the Amended Exit Plan adopted by the City in November 2020. We must then make any modifications necessary to the proposed budget to meet the Plan's objectives and return it to you with those modifications.

We are providing this letter to confirm that your budget as submitted to us on November 20, 2020 complies with the Exit Plan. The rest of the document following this cover letter describes our findings in support of our conclusion.

We understand that the next step in this process is for City Council to adopt the budget in December. Should Council propose any amendments or make any changes to the introduced budget, we will review those changes for compliance as well. As required by law, we will then provide a letter to the Pennsylvania Secretary of the Department of Community and Economic Development reporting whether the final version of the budget complies with the Amended Recovery Plan.

We appreciate your team's responsiveness to our questions during this process, especially Business Administrator Stephanie Dean and her staff. Please let us know if you would like to discuss our findings.

Sincerely,

Act 47 Coordinator
Gordon Mann, Public Financial Management
Joel Lennen, Eckert Seamans
Vieen Leung, Public Financial Management

Cc: C. Kim Bracey, Pennsylvania Department of Community & Economic Development
Terri Cunkle, Pennsylvania Department of Community & Economic Development
Tom Smith, City Council President, City of New Castle
Stephanie Dean, CFO/Business Administrator, City of New Castle

City of New Castle 2021 Budget Review for Exit Plan Compliance

Consistent with the 2019 Exit Plan, the 2020 Amended Exit Plan has four primary objectives that the City must achieve to exit Act 47 oversight.

- Reduce the operating deficits in the Amended Exit Plan baseline projection with some use of fund balance to cover recurring expenditures;
- Keep the City's reserves at an appropriate level;
- Phase out the use of the resident and non-resident earned income tax (EIT) authorized by Act 47; and
- Provide funding to improve the City's existing infrastructure (e.g. road repaving, building renovations) and establish a capital reserve.

These are not the only objectives that the City must meet to comply with the Exit Plan or exit Act 47 oversight, but they provide a useful measure of the City's overall progress toward those goals.

The table below summarizes the City's plans to achieve these objectives as described in the introduced 2021 budget.

Goal	City progress
Reduce projected deficits	The budget balances total General Fund expenditures against total General Fund revenues after using $1,132,680 in fund balance, which is complies with the Amended Exit Plan as explained in more detail below.
Maintain financial reserves	The City replenished the Rainy Day reserve in 2017 as required by the 2015 Amended Recovery Plan and has maintained the reserve level at $2.5 million since then.
Phase out Act 47 EIT	The 2021 budget follows the Amended Exit Plan requirements and reduced its Act 47 levy used for operations.
Fund capital improvements	The budget allocates $1,021,000 for capital improvements and another $510,000 for the capital reserve that will fund capital projects after 2024. The budget also includes $30,000 in CIP fee for the Sylvan Heights golf course and maintains a $25,000 Parking Garage Capital Reserve.

Reduce projected deficits and maintain reserves

At the beginning of the 2020 Amended Exit Plan process, the Coordinator developed a baseline projection of revenues and expenditures for the City's three primary funds through 2024.[1] By definition, that baseline showed the City's projected results absent any corrective action. In that scenario, the City would have experienced annual operating deficits of $1.6 million in 2021 growing to $3.1 million in 2024.

[1] Please see page 4 of the Amended Exit Plan for more information. The primary funds are the General Fund, the Sinking (or Debt Service) Fund and the Pension Fund. The last fund is a checking account that the City uses to pay pension-related administrative costs and hold pension related revenues before they are deposited in the pension plans. The Pension Fund is not the pension plans themselves.

The Exit Plan anticipated the City would need to increase its real estate tax rate by 1.5 mills in 2021 and use $933,000 in fund balance to balance the operating budget.[2] The 2021 introduced budget proposes that the tax rate remain at 15.476 mills and anticipates using $1,132,680 in fund balance to balance the General Fund budget. The Act 47 Coordinator determined that the City's use of $1.1 million in fund balance complies with the Amended Exit Plan for the reasons explained below.

In the Amended Exit Plan, the Coordinator discussed the importance for the City to maintain reserves in its General Fund for several reasons.[3] Those reserves help the City pay its obligations early in the year without borrowing money for cash flow purposes before tax revenues arrive. They provide a contingency against unanticipated shortfalls and to meet emergency needs, and they bolster the City's credit rating, which allows it to borrow money at a lower cost.

The Amended Exit Plan projects that the City will have to use $3.6 million in unassigned fund balance from 2021 to 2024 to help close the budget gap. The Coordinator acknowledged that this was not an ideal response to the City's structural deficit but would help mitigate the level of tax increases or service cuts that would otherwise be necessary.

Amended Exit Plan Projection (Inclusive of Plan Initiatives)

	2020 budget	2021 proj.	2022 proj.	2023 proj.	2024 proj.
Revenues	19,692,275	19,834,755	20,368,141	20,828,292	19,566,205
Expenditures	20,192,275	20,767,435	21,242,691	21,709,968	20,487,183
Surplus/(Deficit)	**($500,000)**	**($932,680)**	**($874,551)**	**($881,676)**	**($920,978)**
Unassigned Fund Balance	**$4,481,245**	**$3,548,564**	**$2,674,013**	**$1,792,337**	**$871,360**

The projected unassigned fund balance included in the Amended Exit Plan was based on the 2018 financial audit, the most recent information available to the Coordinator at the time when the Plan Amendment was written. Since the filing of the Amended Exit Plan on October 30, 2020, the City Auditor provided the final unassigned fund balance as of December 31, 2019. The City also provided updated projections for 2020 and anticipates only using $50,000 in fund balance this year as opposed to the $500,000 assumed in the 2020 budget.

As a result of the new information, the Coordinator determined that the City can use an additional $200,000 in fund balance to close the budget gap in 2021 while still having $3.5 million in unassigned fund balance at the end of 2021, as shown in the table below.

Unassigned Fund Balance, 2019 - 2021

	2019 Audit	2020 Projected	2021 Projected
Beginning Unassigned Fund Balance	$5,116,024	$4,725,272	$4,674,015
Net Operating Result	($390,752)[4]	($50,000)	($1,132,680)
Ending Unassigned Fund Balance	**$4,725,272**	**$4,675,272[5]**	**$3,542,592**

[2] See the "Surplus/Deficit" line on page 2 of the Amended Exit Plan. It shows a $932,680 negative difference between revenues and expenditures across the three major funds in 2021.

[3] Initiative AD04, pages 39-40.

[4] Note: The deficit in 2019 was in part because of $208,000 in additional paving work that was funded by the positive result in 2018, which complied with the Amended Recovery Plan and advanced a strategic priority.

[5] The actual 2020 ending fund balance will depend on the City's final 2020 net operating result.

The scenario as described above will still bring the City's unassigned fund balance level to $0.9 million in 2024, the same as the Amended Exit Plan projection. Including the $2.5 million in the Rainy Day Reserve as required by initiative AD04, the City will have a total fund balance of $3.4 million at the end of the 2024, equivalent to approximately 17 percent of the City's operating expenditures, the recommended minimum level of reserves for municipal governments by the Government Finance Officers Association ("GFOA").

Updated Projection Based on the Introduced 2021 Budget

	2020 proj.	2021 proj.	2022 proj.	2023 proj.	2024 proj.
Surplus / (Deficit)	**($50,000)**	**($1,132,680)**	**($874,550)**	**($881,677)**	**($920,977)**
Fund Balance	**$4,675,272**	**$3,542,592**	**$2,668,042**	**$1,786,365**	**$865,388**

In addition to using an additional $200,000 in unassigned fund balance to close the budget gap, the proposed 2021 budget includes other actions to close the remaining budget gap, as described below:

- **Wage freezes for selected non-represented employees**: The Amended Exit Plan includes a two-percent wage increases for all non-represented full-time employees. The 2021 proposed budget assumes no wage increases for all full-time non-represented employees except for the Director of Public Works and Code Enforcement Officers.[6] There has also been some turnover within the Code Department, which resulted in additional savings.
- **Elimination of 7 part-time police officer positions**: The 2021 proposed budget reduced the number of part-time police officers from 9 to 2, resulting in savings of $180,000. Over the last several years, because of recruitment and retention issues, the City has only been able to fill between three to five part-time officer positions. The Police Chief noted that the proposed reduction to two part-time officers will not have an impact on overtime because the Department will reduce the number of specialized units and pull resources from the CID (Criminal Investigative Unit), Traffic, or Narcotics Divisions instead.
- **Reduction in parks and recreation and code seasonal staff**: The 2021 proposed budget reduced the parks seasonal staff allocation from $23,000 to $8,000 and code seasonal staff allocation from $20,000 to $10,368. The Parks and Recreation Department noted that with the purchase of new equipment and the implementation of using herbicide to mitigate excess grass growth, it would require fewer seasonal staff to achieve the same desired results.
- **Elimination of Council contingency fund**: The 2021 proposed budget eliminated $20,000 in contingency fund that was included in City Council's 2020 budget.
- **Shifted $50,000 in demolition spending to the capital budget:** The City typically budgets $50,000 in demolition funding in the Code Enforcement Department budget, which is moved to the capital budget and will be funded by the Act 47 capital EIT.

As a result of the use of additional unassigned fund balance and the actions described above to close the budget gap, the total real estate tax rate remains lower than projected in the 2020 Amended Exit Plan.

Real Estate Tax Rates (Mills)

	2020	2021	2022	2023	2024
2020 Exit Plan projection	15.476	16.976	18.476	19.476	20.226
Actual rate	15.476	15.476	TBD	TBD	TBD

[6] The Assistant Solicitor was also provided a wage increase, but the position was considered a part-time position according to the Amended Exit Plan workforce allocation.

Phase out Act 47 EIT

The earned income tax (EIT) is New Castle's largest source of revenue and a portion of that revenue is tied to the City's Act 47 status. The Amended Exit Plan provides that the City will be able to keep the Act 47 authorized portion of the resident and commuter EIT during the Plan period from 2020 to 2024. However, the City will have to gradually shift the Act 47 authorized portion of the EIT out of the General Fund operating budget and completely eliminate the supplemental taxing power it uses to balance annual expenditures against annual revenues by 2024.

Consistent with the Amended Exit Plan, the City maintained the operations portion of the Act 47 EIT at 0.10 percent for residents given that the COVID-19 pandemic will continue to dampen revenue growth. The City at the same time needs to continue making the required progress toward exiting Act 47 oversight, so it reduced the operations portion of the Act 47 EIT by 0.05 percent for commuters and increased the capital portion of the Act 47 EIT by the same amount. The distressed pension EIT, which is the portion of the EIT that funds the City's contribution to employee pension plans, will also drop from 0.70 percent to 0.675 percent to remain in compliance with Act 205.

The end result of all of these changes is that the total EIT rate for residents will drop from 2.10 percent to 2.075 percent and non-residents EIT will drop from 2.0 percent to 1.975 percent. The Coordinator estimates that the Act 47 portion (including both operations and capital) of the resident EIT will be worth $1.1 million and the Act 47 non-resident (commuter) tax will be worth another $0.9 million in 2021.

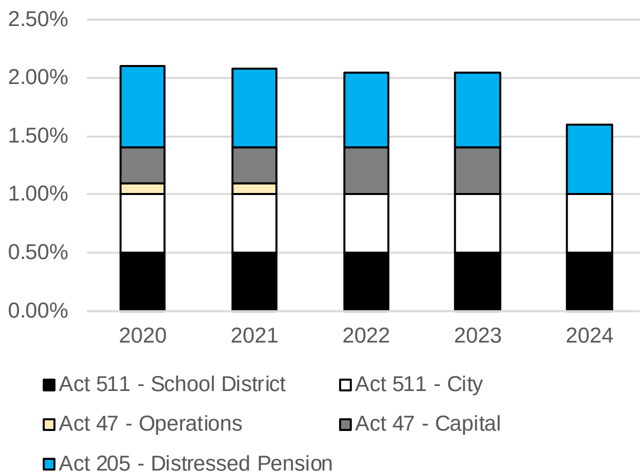
Resident EIT Rate

	2020	2021	2022	2023	2024
Act 511 - School District	0.50%	0.50%	0.50%	0.50%	0.50%
Act 511 - City	0.50%	0.50%	0.50%	0.50%	0.50%
Act 47 - Operations	0.10%	0.10%	0.00%	0.00%	0.00%
Act 47 – Capital (Paving)	0.30%	0.30%	0.40%	0.40%	0.00%
Act 205 - Distressed Pension	0.70%	0.675%	0.65%	0.65%	0.60%
Total	**2.10%**	**2.075%**	**2.05%**	**2.05%**	**1.60%**

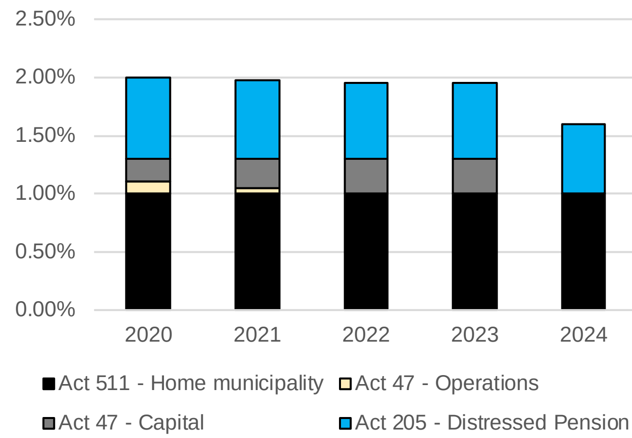
Non-Resident (or Commuter) EIT Rate

	2020	2021	2022	2023	2024
Act 511 - Home municipality	1.00%	1.00%	1.00%	1.00%	1.00%
Act 47 – Operations	0.10%	0.05%	0.00%	0.00%	0.00%
Act 47 – Capital (Paving)	0.20%	0.25%	0.30%	0.30%	0.00%
Act 205 - Distressed Pension	0.70%	0.675%	0.65%	0.65%	0.60%
Total	**2.00%**	**1.975%**	**1.95%**	**1.95%**	**1.60%**

Projected Resident EIT rates[7]



Projected Commuter EIT rates



Setting these rate changes aside, the City also evaluated its tax base growth. There is typically a time lag between when income is earned and when the associated EIT is remitted to the City, so New Castle only started to see the pandemic's impact in its Q3 2020 figures.[8] As shown in the table below, through September 2020, the City's earned income tax revenues have declined by 1.9 percent but there was no change in Q3 revenues relative to last year.

Earned Income Tax Revenues on a Cash Basis, Q1 through Q3 in 2019 and 2020

	2019	2020	Change ($)	Change (%)
Q1	$1,959,346	$1,965,617	$6,271	0.3%
Q2	$1,839,971	$1,726,864	-$113,107	-6.1%
Q3	$1,839,369	$1,840,759	$1,390	0.1%
Q1 thru Q3	**$5,638,686**	**$5,533,239**	**-$105,446**	**-1.9%**

Since the City's revenues in the third quarter were essentially the same as 2019, the City projects EIT revenues in Q4 2020 to remain the same as in Q4 2019. Given the uncertainty regarding the trajectory of the pandemic and the economy at this time, the EIT tax base is assumed to remain flat in 2021. As a result, the 2021 budget anticipates $7.3 million in total EIT revenues.

2021 Introduced budget - EIT Revenues and Uses

	Resident	Commuter	Total
Act 511 EIT	$1,382,570	$0	$1,382,570
Act 47 EIT (Operations)	$276,514	$186,857	$463,371
Act 47 EIT (Capital)	$829,542	$701,129	$1,530,671
Act 205 EIT	$1,887,133	$2,017,396	$3,904,528
Total EIT revenues	**$4,375,759**	**$2,905,381**	**$7,281,139**

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[7] The projected resident and commuter EIT rates do not include assume any changes related to Home Rule as described in the next initiative.

[8] Revenues received during Q2 2020 were based on resident and commuter earnings during Q1 2020, before the pandemic.

	EIT Uses
General operations	$1,845,941
Pension-related purposes	$3,904,528
Capital spending	$1,020,447
Capital reserve	$510,224
Total EIT uses	**$7,281,139**

Funding capital projects

The $7.3 million in projected EIT revenues include $1.5 million designated for capital improvements. The Exit Plan requires that the City dedicate one-third of the $1.5 million Act 47 capital EIT allocation toward a capital reserve, leaving $1.0 million for the capital budget in 2021. It also requires that half of the City's capital budget needs to be dedicated to public infrastructure.

The City's 2021 budget complies with the Amended Exit Plan by allocating $210,000 toward vehicles and equipment and $811,000 toward infrastructure improvements, including $521,000 allocation for paving. The remaining Act 47 capital EIT is dedicated toward a capital reserve that will provide capital funding for the City after 2024.

2021 Capital Budget Allocation

	2021 Budget
Vehicles and Equipment	209,581
Infrastructure (including paving)	811,419
Total 2021 capital budget	**$1,021,000**
Capital reserve	**$510,000**
Total Act 47 Capital EIT	**$1,531,000**

In addition to the capital funding provided by the Act 47 EIT, the City also have two additional capital reserves that was created during the 2020 budget process. As required by the 2019 Exit Plan, the City established a capital improvement fee for the Sylvan Heights Golf Course that is projected to generate $30,000 this year. The City also anticipates maintaining $25,000 in parking garage capital reserve in 2021 that will be used to pay for capital improvement projects at the five-level parking garage on North Mercer Street. As of November 30, 2020, the Parking Fund had $35,000 in reserves.

Projected Revenues for Capital Projects at the Parking Garage and Golf Course

	Funding Source	2021 Projected Revenues for Capital
Sylvan Heights Golf Course Capital Reserve	CIP improvement fee	$30,000[9]
Parking Garage Capital Reserve	Projected surplus from parking garage fees and fines	$25,000

Other 2021 Budgetary Highlights

The following lists a few additional highlights from the 2021 introduced budget.

<u>Revenues</u>

The **taxable assessed value** provided by the County for the 2021 budget totals $483.6 million, which is 0.4 percent higher than the taxable assessed value used in the 2020 budget and the first time the City saw

[9] The City plans to use the majority of the Sylvan Heights Capital Reserve in 2021 on vehicle leases and facility maintenance.

an increase since 2016. The increase in assessed value means that the City will collect $29,000 more in current year revenues compared to this year based on the proposed 2021 millage.

Taxable Assessed Values, 2015 - 2020

	2016	2017	2018	2019	2020	2021
Taxable Assessed Value	493,847,820	491,549,500	489,193,500	486,053,114	481,721,847	483,569,489
Change in Assessed Value	0.2%	-0.5%	-0.5%	-0.6%	-0.9%	0.4%

According to initiative ED01 of the Exit Plan, the City is required to outsource trash collection beginning next year. With trash collections having been outsourced on April 1, 2020, the 2021 budget assumes no **refuse collection revenues** in 2021 but at the same time would not incur any blue bags or tipping fees. The City should also see lower vehicle maintenance costs absent the need to maintain and repair its trash trucks. The Exit Plan accounts for the continued employment of the related full-time employees, so the 2021 budget maintains the personnel costs of those employees.

Refuse Collection Fees and Direct Operating Costs, 2019 - 2021

	2019 actuals	2020 budget	2021 budget
Refuse Collection Fee (revenue)	882,136	199,250	0
Refuse Bag Packaging (expenditure)	99,335	23,846	0
Refuse Sanitary Landfill (expenditure)	211,704	45,600	0
Total Net Revenues	**571,097**	**129,805**	**0**

The 2021 budget reduced the projected **building permit revenues** from $318,000 to $300,000. The City collected $339,000 in revenue from building permits last year. This year, with fewer construction and renovation activates, the City only collected $132,000 in building permit revenues through September 2020, although the building inspection expenditure paid to Pennsylvania Construction Inspection (PCI) was also lower. The 2021 budget reduced the building permit revenue target slightly to $300,000 given this year's building activity and maintained the associated expenditure line at $120,000.

Building Permits Revenues and Associated Costs, 2012 - 2020 Q3

	2012	2013	2014	2015	2016	2017	2018	2019	2020 Q3
Building permits (revenues)	80,235	258,590	413,101	233,208	123,096	563,698	701,155	339,296	132,206
PCI Fees (expenditures)	*31,187*	*95,545*	*127,512*	*60,306*	*57,096*	*307,166*	*288,544*	*187,647*	*27,491*
Net revenues	**49,047**	**163,045**	**285,589**	**172,903**	**66,001**	**256,532**	**412,611**	**151,649**	**104,715**

Expenditures

The 2021 introduced budget increased its full-time headcount from 108 to 111 and reduced the part-time headcount from 36 to 29. All the headcount changes were made to the non-represented employee group. The following table shows the number of **full-time and part-time employees** by employee group:

Headcount by Employee Group

Group	Covered positions include:	2020 Budget Headcount
FOP, Lodge 21	All full-time police officers except the Chief	36
Laborers, Local no. 964 – Public Works	Laborers, equipment operators, refuse collectors, tradesmen	23
IAFF, Local No. 180	All full-time firefighters except the Chief	20
Laborers, Local No. 964 – Clerical	Most clerical and administrative support positions	10
Non-represented	Department directors, elected officials, code officers, part-time employees including police and fire	22 full-time 29 part-time
Total		**111 full-time 29 part-time**

The following section describes the headcount changes made in the 2021 introduced budget:

Position Additions:

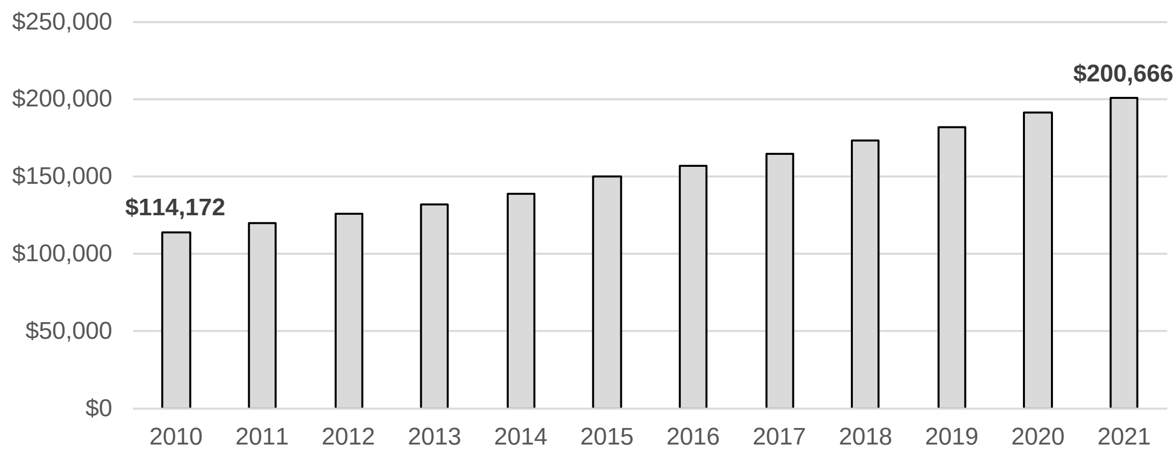
- 3 Administrative Assistants in the Mayor's Office
- 1 Code Enforcement Assistant Supervisor
- 1 Repository Lot Manager
- 1 Golf Course Club House Manager
- 1 Golf Course Manager
- 1 Intern in the Community and Economic Development Department

Position Eliminations/Reductions:

- Mayor's secretary
- 7 part-time Police Officers
- 1 full-time Code Enforcement Officer
- 1 part-time Code Enforcement Officer
- 2 part-time Refuse Collectors
- Full-time Building Inspector hours reduced to 0.5 FTE
- Full-time Assistant Public Works Director hours reduced to 0.5 FTE
- Full-time Meter Enforcement Officer hours reduced to 0.5 FTE

According to initiative AD01 of the Exit Plan, the City is required to work with the County to end the City's **contribution to the New Castle Area Transit Authority**. Because the City already approved the City's 2021 contribution to Authority in June 2020, the Amended Exit Plan requires the City to start working with the County in 2020 with the goal of eliminating the contribution in 2022. The City's 2021 budget therefore projects spending $200,666 in transit contribution, five percent above the City's 2020 contribution.

Contribution to the New Castle Area Transit Authority, 2010 - 2021



The City's 2021 budget projects $2.9 million in **debt service** spending that will be funded by the property tax ($1.1 million) and the earned income tax ($1.8 million). The City's required pension contributions, also called the **Minimum Municipal Obligation (MMO)**, totaled $3.0 million across the police, fire, and non-uniformed pension plans in 2021. Those contributions are funded by the Act 205 EIT ($2.1 million), the Commonwealth pension aid ($0.8 million), and General Fund revenues ($0.1 million).

2020 and 2021 MMO

	2020	2021	$ Change	% Change
Police	1,290,435	1,301,292	10,857	0.8%
Fire	1,014,548	1,014,808	260	0.0%
Non-Uniformed	676,257	637,295	-38,962	-5.8%
Total MMO	**2,981,240**	**2,953,395**	**-27,845**	**-0.9%**

Next steps

By law we are required to review the 2021 budget again after it is adopted in final form by City Council and report to the Pennsylvania Secretary for the Department of Community and Economic Development on whether that version complies with the Amended Exit Plan.