City of Pittsburgh
Allegheny County

Municipalities Financial Recovery Program – Act 47

Rescission Report

November 8, 2012

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Introduction

The City of Pittsburgh has structurally balanced its budget with recurring revenues consistently outpacing expenditures. It has adopted a series of financial management tools that will guide the decision-making of future leaders on fiscal issues to ensure budgetary stability. Pittsburgh has implemented a strategy to address its legacy costs of retiree pensions, retiree health care, workers' compensation and capital needs with funding and management tools to moderate growth. After weathering a deep recession while preserving a strong operating balance, the financial outlook for the City of Pittsburgh is positive. The City's Act 47 Coordinator recommends that the Commonwealth of Pennsylvania rescind its declaration of financial distress for Pittsburgh.

This report reviews the City's financial and operational achievements since 2003 and confirms that Pittsburgh has met the requirements for exiting Act 47 oversight. In addition, the report articulates ongoing challenges that the City must continue to tackle after Act 47 oversight has ended, and recommends ways that the City can continue to meet its future obligations while maintaining a sufficient fund balance and positive annual operating results. The Coordinator is hopeful that the Administration and Council will continue to adopt best practices for municipal governance, and encourages future leaders of the City to do the same. Because the Intergovernmental Cooperation Authority for Cities of the Second Class (ICA) will remain in place if the Commonwealth rescinds the Act 47 designation, external guidance and support for continued progress is assured.

Financial Crisis & Recovery

After nearly a decade of papering over underlying structural deficits through a series of asset sales, debt extensions, and accounting maneuvers, the severity of Pittsburgh's financial condition emerged in sharp relief in the summer of 2003. The City laid off 446 full and part-time employees, including nearly 100 police officers and 24 EMS personnel. City recreation centers were shuttered, public swimming pools closed, and services from police mounted patrol to salt boxes were eliminated. In October and November 2003, the City's credit rating was downgraded repeatedly, leaving Pittsburgh as the nation's only major city to hold below-investment-grade "junk bond" ratings. Absent corrective action, Pittsburgh would have strained to pay its bills through the end of 2004 as it exhausted its remaining cash reserves. Mounting annual deficits would have grown from approximately $72 million in FY2005 to nearly $115 million for FY2009 alone.

After a petition from the Mayor and a hearing by the Commonwealth of Pennsylvania, in late December of 2003 the City of Pittsburgh entered the state's Municipalities Financial Recovery Program, known as Act 47. The depth of the City's financial problems were described in the independent auditor's report: "The City's general fund has suffered recurring losses from operations and has negative net assets that raise substantial doubt about its ability to continue as a going concern." With flat revenues and recurring growth in payroll and benefit costs, combined with a significant debt burden, the City's finances were structurally unbalanced.

After consultation with hundreds of stakeholders, the state-appointed Act 47 Coordinator drafted a broad-based, multi-year financial recovery plan that was adopted by City Council and signed by the Mayor in June 2004. Prior to the adoption of the Recovery Plan by City Council, the state legislature adopted Act 11 of 2004, which created the Intergovernmental Cooperation Authority for Cities of the Second Class (ICA). The legislature declared that the ICA and the Act 47 Coordinator were to “operate concurrently and equally”.[1] The ICA was charged with fostering the fiscal integrity of the City by ensuring that the City pays the principal and interest owed on its debts, meets financial obligations to its employees, and executes proper financial planning procedures and budgeting practices. Later that year, the ICA successfully spearheaded state legislative approval of a suite of tax revisions based in part on options from the Act 47 Recovery Plan. The combination of expenditure control and tax reform provided a strong platform for the City to reverse years of financial decline.

Since adoption of the 2004 Recovery Plan, the City has recorded recurring positive annual operating results in place of the large deficits originally projected. The City successfully balanced its annual budgets and achieved a short-term financial recovery with revenues consistently outpacing expenditures. The success of the Recovery Plan in stabilizing the City’s current finances was due in part to the successful execution of the following Plan initiatives:

- Improving financial management to make the City’s budget decisions more transparent and monitoring the City’s progress relative to its budget on an ongoing basis.

- Right-sizing City services in areas like public safety and parks and recreation, taking into account the City’s resources and lower population in recent decades.

- Reaching new collective bargaining agreements with all City unions, incorporating major Plan initiatives, including freezing all employee wages for two years with subsequent 2.5 percent annual increases, and preserving key gains while addressing some goals of labor in a second round of bargaining beginning in 2009.

- Restructuring benefits to establish or increase employee contributions to health, vision and dental insurance coverage.

- Giving management greater flexibility to direct its workforce more efficiently by changing work rules and collective bargaining agreements.

- Encouraging intergovernmental cooperation between the City and Allegheny County and the City and its neighboring municipalities in areas ranging from shared services to the transfer of selected duties to the County and the private sector to City provision of services to Wilkinsburg.

- Contributing funds toward capital projects on a “pay-as-you-go” basis while paying down hundreds of millions of dollars in legacy debt.

- Using technology and private sector resources to gain efficiency in emergency medical transport billing, fleet maintenance, and other areas, while challenging in-house services to operate more cost-effectively.

- Controlling expenditure growth across multiple departments.

- Receiving credit rating upgrades from all three major rating agencies.

- Improving the presentation and quality of financial reporting.

[1] *See*, Act 11 of 2004, § 102 (b)(3).

The combination of external restrictions reversing poor financial practices and strong fiscal stewardship from the Administration, City Council and the Controller made Pittsburgh one of the few large American cities to make it through the recent recession with its finances largely intact, generating positive net annual operating balances in all but two years since 2005.[2]

Before these changes fully took root, in late 2007, Pittsburgh's Mayor and City Council petitioned Pennsylvania's Secretary of the Department of Community and Economic Development (DCED) to review whether the City's Act 47 distressed status could be rescinded and, if not, asked for a "blueprint" to complete its financial recovery. In 2008, the Secretary of DCED acknowledged Pittsburgh's considerable progress in turning projected multi-million dollar deficits into positive annual operating balances, but also acknowledged the City's need to address the legacy costs that threaten its future financial stability.

Those legacy costs – retiree health care, pensions, workers' compensation and debt – represent hundreds of millions of dollars in liabilities that the City shoulders for services rendered in the past, but which consume a large and growing portion of the City's current annual budgets. To be financially healthy, Pittsburgh needed to address the financial threat to the current employees and retirees who depend on these benefits and to the residents, businesses, and others who must pay for them in lieu of receiving current services.

Therefore, in response to the City's 2007 request for rescission, the Secretary determined that:

> "Pittsburgh needs an amended recovery plan that would provide a blueprint for it to exit Act 47 and address pending legacy costs of debt, pensions, post-retirement benefits, workers compensation along with a long-term capital plan, while maintaining positive operating budgets well into the future."

The Secretary directed the Act 47 Coordinator to develop a new Plan in consultation with all stakeholders; that Plan was approved by City Council and the Mayor on June 30, 2009. The Amended Recovery Plan provided an aggressive strategy to meet the objectives identified by the Secretary so that the City could complete its financial recovery, fund its legacy costs, and exit Act 47 oversight. In order to meet the Secretary's challenge to the Act 47 Coordinator to address the City's $1.2 billion in unfunded legacy costs while providing a roadmap out of oversight, the Amended Recovery Plan initiatives focused on funding pensions and other post-retirement benefits (OPEB), reducing and reorganizing debt service while drafting a sufficient long-term capital investment plan, and reforming and strengthening management of workers' compensation claims. After Plan approval three years ago, the City's administration and Council began to tackle these challenges.

Other events helped move the City to address its legacy costs. In September of 2009, the legislature passed Act 44 to provide municipalities with pension liability relief. If the relief options failed to mitigate a local government's pension distress, the Act proposed to move municipal pension plans that are less than 50 percent funded under the administration of the Pennsylvania Municipal Retirement System (PMRS). The legislation required Pittsburgh to increase its pension funding level to more than 50 percent by January 1, 2011 to avoid PMRS takeover. A takeover would have

[2] As described elsewhere in this report, the two years when expenditures exceeded revenues were characterized by large transfer payments to cover City legacy costs, approved by the two oversight bodies. In all years, the City maintained a positive and adequate fund balance.

increased the City's annual pension contributions by a significant amount and ceded local control of pension investments.

In late 2010, the City set a course to contribute at least $13.4 million to the pension each year above its minimum municipal obligation (MMO). This met the Amended Recovery Plan's requirement that the City contribute $12.0 million to $14.0 million a year above the MMO to the pension fund. Since the City committed future parking tax revenues to the pension fund and those revenues were treated as a pension asset, the City's pension funding level reached 62 percent. The Pennsylvania Public Employee Retirement Commission (PERC) certified the Pittsburgh's employee pension trust fund as "moderately distressed," meaning it was sufficiently funded to avoid the State administrative takeover provided under Act 44. The higher funding level lowered the City's annual MMO, allowing it to make the additional pension contributions while still maintaining annual budget balance and to set aside funding for future OPEB costs and cover its scheduled debt payments. In order to provide additional security and ensure that the pension funds do not lose principal over the next five years, the ICA reached agreement with the City as part of this year's budget process to dedicate an additional $5.0 million per year from gaming funds to the pensions from 2013 through 2017.

In 2011, as a byproduct of the City's execution of the initial Recovery Plan initiatives, Pittsburgh generated nearly $2.0 million in worker's compensation savings, and then used the savings to settle existing claims. Pittsburgh's embrace of these initiatives, its success at implementing the reforms and reducing the liability, and its overall financial condition led to the elimination of the annual prefunding requirement for workers' compensation originally imposed by the Pennsylvania Department of Labor and Industry when the City went into distress. As a result of these changes, the Coordinator's 2011 Act 47 Annual Progress Report noted that the City had made significant progress toward addressing two of the four legacy costs that the Secretary of the Department of Community and Economic Development identified as obstacles to the City's financial recovery in 2008: the severely underfunded employee pension trust fund and workers' compensation liabilities.

In the first half of 2012, the City tackled its OPEB liabilities by enacting legislation to establish an OPEB trust fund, becoming the first major City in the Commonwealth to do so.[3] The OPEB Trust will hold the assets aside to be used to fund the long-term liability as opposed to the year-to-year costs of retired employee health insurance. The City's 2012 budget included a $2.2 million allocation to the OPEB Trust as required by the Amended Recovery Plan, and the 2013-2017 Five-Year Plan recently approved by the ICA includes continuing annual appropriations.

In the fourth quarter of 2011, the City also approved a debt policy that laid out the principles to guide the Administration's debt management decisions.[4] The policy capped tax-supported debt at 17 percent of General Fund expenditures, and set a future goal of reducing the figure to a more manageable 12 percent of expenditures as the mountain of debt from the pre-recovery era is paid off in the next several years. The 2012 general obligation bond issue for capital projects complied with the policy. Finally, the City enacted a formal collaborative process for developing a multi-year capital improvement program.[5] The process requires the Mayor to declare his capital improvement priorities at the beginning of the year and for an interdepartmental committee to select and prioritize projects over a six year period. Transparency is dramatically increased with Council

[3] *See*, OPEB Trust – Resolution 2012-17 of January 31.
[4] *See*, Debt Policy – Ordinance 2011-29 of December 12.
[5] *See*, Ordinance 2012-2 of January 31.

participation in capital plan development and public hearings before the final plan is proposed. The ordinance also creates the position of a full time coordinator of capital improvement projects who will ensure timely project execution, clear financial reporting, and monitor the capital budget. This year, the City hired the capital projects coordinator and had a successful first round of the new capital plan process.

The City's progress in executing specific Amended Recovery Plan initiatives, including the legacy cost challenges, is documented in the 2011 Annual Report of the Act 47 Coordinator and included in this report as Appendix 1. Progress has also been noted in the City's quarterly financial reports, filed without fail since the beginning of oversight in 2004. External observers have pointed out the City's improvement as well: in September 2012 Moody's Investors Service, in a review of Pennsylvania government credits, noted Pittsburgh's progress:

> "In contrast to the most distressed cases, the cities of Philadelphia and Pittsburgh, the commonwealth's two largest cities by population, have shown considerable resilience since the onset of leaner times in 2007. Improved governance and financial management have resulted in sufficient financial reserves despite some draws in recent years. A sizable concentration of employers specializing in healthcare and higher education has partly insulated both cities from the steep rises in unemployment that accompanied the recession elsewhere."[6]

Under almost nine years of Act 47 oversight, the City of Pittsburgh has made major progress toward reducing exposure and installing financial controls over its long-term fiscal obligations while maintaining positive operating budgets. By dedicating revenue sources for the pension fund, formally setting aside annual funding for OPEB, reducing the liability and improving the management of workers' compensation, establishing a debt policy, and adopting a formal capital improvement plan and budget, Pittsburgh has executed the blueprint for exiting Act 47 set out in the 2009 Amended Recovery Plan. It is time for Act 47 status for Pittsburgh to be rescinded.

Termination of Distress Status

Pittsburgh is unique in operating under two separate but complementary distress programs. Act 47 focuses on state intervention to address a municipality's immediate danger of fiscal failure and to restore fiscal stability in the form of timely payment of debt obligations, meeting basic financial obligations to employees, vendors and suppliers and provision for proper accounting, budgeting and taxing policies. Act 11, enacted specifically to address Pittsburgh, adds provisions for the City's multi-year improvement and ICA oversight of City related municipal authorities. In general, the goal of Act 47 is to return local governments to self-sustaining operations; in the specific case of Pittsburgh, the Coordinator was also directed to implement the 2009 Amended Recovery Plan with the termination of Act 47 oversight as a primary goal.

Under Act 47 there are four factors that the Secretary of the Department of Community & Economic Development shall consider in determining whether the conditions that led to a determination of municipal financial distress are no longer present.[7] The factors are: 1) the municipality has operated, for a period of at least one year, under a positive current operating fund

[6] Moody's Investors Service, Credit Trends: Pennsylvania Local Governments Face Credit Pressure in Weak Recovery, September 27, 2012.
[7] *See*, 53 P.S. §11701.253.

balance or equity as evidenced by the municipality's audited financial statements prepared in accordance with generally accepted accounting principles; 2) accrued deficits have been eliminated; 3) obligations issued to finance the municipality's deficit have been retired; and, 4) a report from the Coordinator indicating that termination of status of municipal financial distress is appropriate. Below is a discussion of the City's compliance with each of these factors for the Secretary's consideration.

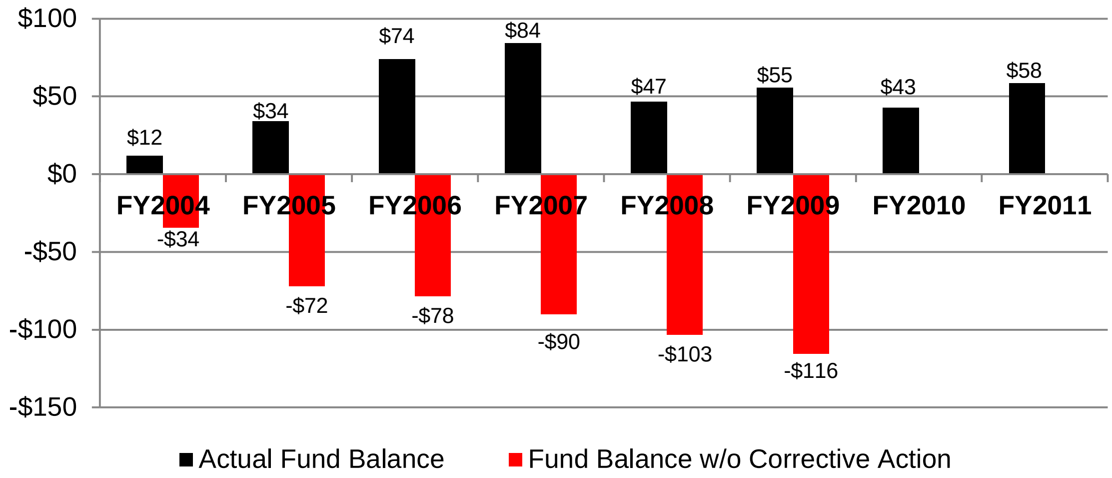
Positive Current Operating Fund Balance

Since 2005, the City of Pittsburgh has been operating with a positive current operating fund balance. According to the City's Comprehensive Annual Financial Report[8], at the end of fiscal 2005 the City had an unreserved fund balance for the General Fund of $34.1 million, or 8.5 percent of total General Fund expenditures and operating transfers. The results were due to a series of revenue enhancing measures approved by the state legislature[9] in the fourth quarter of 2004 and expenditure reductions required by the Recovery Plan. The new revenues included a 0.55 percent tax on gross payroll of all for-profit businesses, a $52 local services tax on all individuals working in the city and a 3.0 percent tax on wages earned by non-resident sports players and performers. On the expenditure side of its budget, the City froze wages, reduced headcount and continued to control the growth of employee expenses, which generated $8.5 million in savings. In addition, a new five-year employment contract with the Firefighter's union was signed in the first quarter of 2005, which generated over $9.1 million in savings. Beneficial new labor agreements with several other bargaining units were also concluded. The combined savings of over $17.6 million held expenditures below revenues for the year, and led to a strong increase in the City's fund balance.

As shown in the following table, under oversight the City has dramatically reversed the negative fund balance trend projected in the 2004 Act 47 Plan, and has maintained a solid positive fund balance from 2005 forward. It is important to note two dips in the fund balance over the years that are due to Pittsburgh's aggressive action to reduce debt and pension obligations. In 2008 the City transferred $27.0 million to the capital fund to stave off borrowing and $45.4 million to the debt service fund to pay down liabilities. These one-time transfers pushed General Fund expenses above revenues. Similarly in 2010, the City transferred $55.0 million to the pension fund and an addition $3.1 million to the debt service fund, which again put expenses above revenues for the year. The transfers pulled resources from the City's unreserved fund balance and were approved by the two oversight bodies.

[8] Compiled in accordance with generally accepted accounting principles and prepared by the City Controller and Maher Dussel - Certified Public Accountants.
[9] *See*, Act 222 of 2004.

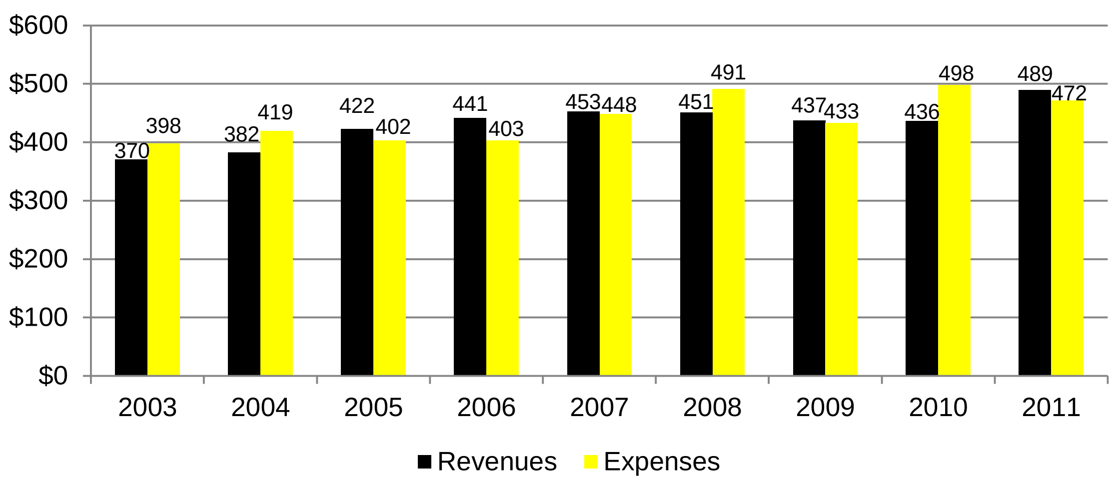
General Fund Unrestricted Fund Balance 2004-2011 (Millions)



Source: City of Pittsburgh, Comprehensive Annual Financial Reports & Act 47 Recovery Plan Projections

By end of fiscal year 2011, the City's comprehensive annual financial report stated that unreserved fund balance for the General Fund was $58.4 million or 12.3 percent of total General Fund expenditures. Actual General Fund revenues were above the budgeted revenues by $24.5 million mainly due to greater than budgeted parking tax revenue of $14.1 million, greater pension state aid of $11.5 million (a one-time event) and greater local share of slots revenue of $6.1 million. This was offset by shortfalls in federal and state grants revenue of $3.3 million and provision of services revenue of $3.3 million. In addition, the final cash basis revenues were greater than the final cash basis expenditures by $16.5 million, creating a surplus for the year.

General Fund Revenues to Expenses Comparison – 2003 to 2011[10] (Millions)



Source: City of Pittsburgh, Comprehensive Annual Financial Reports

[10] Beginning in 2005, Act 47 eliminated "netting" of pension and other external fund payments; 2008 results reflect the transfer of $72.4 million to capital and debt service funds; 2010 results reflect $44.1 million in additional transfer to the pension fund and $7.3 million in gaming funds not received; 2011 results reflect a one-time increase in state pension aid of $11.5 million over budget.

Elimination of Accrued Deficits

As noted in the chart above, for five of the last seven years Pittsburgh has achieved operating surpluses and avoided the substantial deficits projected in 2004 if it did not change course. The years when this was not the case were characterized by large strategic transfers to address legacy cost challenges. In contrast, when the Act 47 Recovery Plan was adopted by the City in June 2004, the City's budget shortfall was estimated to be over $34.0 million in 2004, over $70.0 million in 2005 and nearly $80.0 million in 2006 without corrective action. With the approval of new revenues by the General Assembly, expenditure reductions, including the conclusion of groundbreaking new labor agreements with the majority of the City's bargaining units, and the implementation of many of the initiatives identified in the Act 47 Plan, the City eliminated its deficits and achieved positive operating balances, which began in 2005.

According to the 2005 comprehensive annual financial report, at year-end 2005 revenues to the General Fund increased by $39.7 million or 10.4 percent, while expenditures decreased by $16.4 million or 3.9 percent compared to 2004. The increase in tax revenue was mostly due to an increase of $38.3 million in the new payroll preparation tax, $16.3 million in the local services tax, $4.9 million increase in the parking tax, offset by a $7.4 million decrease caused by the elimination of the mercantile tax, a $3.2 million decrease due to the elimination of the occupational privilege tax, and a $26.4 decrease in business privilege tax due to a decrease in millage. Earned income taxes were up $1.8 million, amusement taxes increased by $3.2 million, and deed transfer tax increased by $6.5 million. Real estate taxes were flat mainly due to changes in the assessed values caused by taxpayer appeals on the value of their property. The occupation tax of $10 per employee was replaced in 2005 by the $52 per employee local services tax. Actual expenditures came in $24.3 million or 5.8% below budgeted expenditures. By the end of fiscal 2005, the City turned a projected $70.0 million deficit into a current year operating surplus of over $19.6 million.

By year-end 2011, the City's adherence to the Amended Recovery Plan and control of its expenditures continued to keep an operating deficit at bay. According to the audited annual financial statement, final cash basis revenues were greater than the final cash basis expenditures by $16.5 million for the year. Salary freezes city-wide for at least two years, public safety cost reductions achieved primarily through the renegotiation of the Firefighters' contract, and reductions to all elected officials' budgets in adherence to the Plan's budget all helped the City successfully control expenditures. On the revenue side, actual General Fund revenues for the year were above the budgeted revenues by $24.5 million mainly due to greater than budgeted parking tax revenue of $14.1 million, greater pension state aid of $11.5 million and greater local share of slots revenue of $6.1 million. This was offset by shortfalls in federal and state grants revenue of $3.3 million and provision of services revenue of $3.3 million.

Based on current reports and historical trends, the Act 47 Coordinator projects the City will post another positive net operating balance at the end of 2012. While only 2011's result is necessary to meet the Act 47 rescission requirement, this year's result is encouraging. As of the end of the second quarter, the City projects that General Fund revenues ($467.5 million) will exceed expenditures ($464.5 million) for a positive operating result of $2.9 million. The second quarter 2012 year-end revenue projection is $1.07 million below the City's 2012 budget, while the according expenditure projection is $3.8 million below budget. The biggest expenditure savings ($2.75 million) are coming from salaries and wages. Pittsburgh continued to generate more revenue than expenses, sustaining a current year operating fund balance. The City projects that fund balances will continue into the future, as benefits of the labor agreements under the Act 47 Plan continue to temper expenditure growth and the suite of new revenues provides balancing revenue growth in the City's budget.

Obligations to Finance Deficit are Retired

In December of 2003, as it entered Act 47 oversight, the City secured a $40 million line of credit from a consortium of local banks. The credit was secured as a precautionary measure against a liquidity crunch in the first quarter of 2004 since year-end obligations came due before property tax revenues arrived in March. . Moreover, the state's Department of Labor & Industry had asked for a multi-million dollar upfront payment to ensure that workers' compensation payments would be made on time. To avoid this potential crisis the City secured a line of credit; because the borrowing would occur so late in the year, it could not be done as a tax and revenue anticipation note ("TRAN") since a TRAN is required to mature and be repaid from taxes and other revenues received prior to the end of the fiscal year in which it is issued. However, the City was able to accelerate some tax payments, defer some expenditures, and as a result did not use the line of credit. The City had no other cash borrowings or loans which are required to be repaid in order to exit Act 47 oversight.

Coordinator's Report and Recommendation

Based on the data set out above, the Act 47 Coordinator for the City of Pittsburgh recommends that the Secretary of DCED rescind the City's status as a financially distressed municipality. In the opinion of the Coordinator, the City of Pittsburgh has successfully balanced its annual operating budget over a multi-year period, has reduced its long term liabilities and implemented the financial practices required to control its legacy costs. Although the sluggish economy may challenge the City's short-term financial situation and the City's obligations to retirees will continue to pressure the annual budget, Pittsburgh's financial outlook is positive. The challenges facing Pittsburgh are similar to those confronting many local governments in Pennsylvania and nationally that are not under financial oversight, many of which do not have the same recent financial track record of regular positive operating balances that the City has posted.

Key Accomplishments

As noted earlier, the City of Pittsburgh has made significant progress since entering financial oversight in late 2003. The City has achieved financial stability as evidenced by reporting regular annual operating surpluses, installing improved financial reporting and tighter controls over expenditures, improving revenue collections, and paying down and more effectively managing its legacy costs. Below is a brief discussion of other notable accomplishments that will help ensure Pittsburgh's long-term fiscal stability.

Installation of the Enterprise Resource Planning System

An Enterprise Resource Planning (ERP) system is a computer software program that organizes and manages the information and activities of the City's financial, accounting, payroll and human resource functions. The ERP stores sensitive employee compensation information; enables the City to complete transactions such as payroll, procurement and grant reimbursement; provides quick access to the information the City needs to monitor its fiscal health; and supports required critical accounting functions. Though the ERP is not one of the four major legacy cost areas, implementing a new ERP is central to the City fulfilling one of the four policy objectives of Act 47 and has been a priority for the City, the Controller, the DCED, the ICA and the Coordinator for several years.

In 2004, the Recovery Plan identified the need for the City to consolidate, upgrade and integrate its technology needs. The Plan called for an ERP, the consolidation of e-mail systems and related servers, the consolidation of City and County access to internet service providers, and the merger of programming and other application support. The Act 47 Coordinator funded two studies providing a detailed rationale for moving to a City-County ERP and a roadmap for doing so. The Coordinator also promoted intergovernmental dialogue to help the County see the advantages of such collaboration. After these early efforts, the ICA took an active leadership interest in bringing about a City-County ERP. In 2009, the Amended Recovery Plan reflected the joint priorities of the ICA and the Coordinator. It acknowledged the ongoing dialogue between the City and County regarding the ERP purchase and installation and recommended that the City migrate its ERP functions to the County platform. A successful merger of the City and County systems was projected to provide an excellent base from which additional shared services, for information technology or other areas, could be developed over time. In 2010 the ICA directed $7.5 million from the City's share of local gaming revenue to the acquisition of the new system. In the fourth quarter of 2011, the City began training its employees on the program.

By January of 2012, the system was live, and the City began producing financial reports at the end of the first quarter. The installation of the ERP was not easy, nor was changing the daily practices and customs of employees throughout the City in various departments. Nonetheless, the new ERP system provides robust tools for financial management and opportunities to share the resource with neighboring and overlapping political subdivisions. It is important to note that as part of the ERP transition, the City has adopted a slightly different chart of accounts. This change will mean that financial reports from 2012 and subsequent years will be presented in a different format from prior years, which will make some direct comparisons difficult. However, this issue is far outweighed by the benefit of moving the City's financial backbone to a reliable hardware and software platform with a standard reporting structure.

Implementing a Capital Improvement Program

The Pittsburgh Home Rule Charter requires the administration to develop a six year capital program and budget.[11] Prior to 2012, the City code lacked a definition for "capital projects", there were no objective criteria for selecting and funding projects, and many expenditures in the annual capital budget supported operating programs and social welfare initiatives. The City Charter laid out a general process that required the administration to develop a multiyear capital plan and budget for Council to review and adopt, but neither the Charter nor City Code specified the mechanics for creating the plan or budget.

With support from the Act 47 Coordinator and the ICA, during the first quarter of 2012 City Council enacted and the Mayor signed an ordinance to establish a formal process for developing a capital improvement plan and budget.[12] The ordinance adopted a definition for "capital projects",

[11] *See*, City of Pittsburgh, Home Rule Charter, Article 5.
[12] *See*, Ordinance 2-2012 of February 7.

established an interdepartmental committee to select and prioritize project funding, and provided Council and City residents an expanded opportunity to participate in the process. Under the new ordinance, each year the Mayor must declare his capital priorities in May, each department must submit its proposed projects to the Office of Management and Budget by June, the interdepartmental committee had to submit a report to the Mayor by the end of August, and two public meetings had to be held to allow residents to comment on the multiyear plan. In addition, the City had to appoint a Capital Improvement Manager, and the capital project accounting will be established in the ERP system by the end of 2012. To date, the City is on pace to produce the first capital plan and budget under the ordinance.

In addition, up until 2012 the City funded its capital program with pay-as-you-go financing.[13] This was a key initiative of the Administration, as the high annual debt service levels it inherited, along with a debt structure that severely limited refunding and restructuring opportunities, meant that limited funds were available for critical capital projects. The pay-as-you-go approach allowed the City to use the proceeds from its successful annual operating budget management to continue capital investment while paying down the extremely high debt burden of $840 million it inherited.

However, reliance solely on pay-as-you-go capital financing, in combination with the short life of remaining outstanding debt (all Pittsburgh's current debt will be retired by 2026) meant that current taxpayers were bearing a disproportionate burden of capital improvements that will last for many decades. Therefore, in 2012, with a strong bond rating, the City issued $80.0 million in General Obligation bonds to fund backlogged capital needs and the annual purchasing program for vehicles. By the end of 2012, the City will complete a study on the feasibility of acquiring a mobile asphalt plant. The City plans to include the acquisition of the plant in its multiyear capital plan. Moving forward, the City plans to fund the capital budget through a combination of pay-as-you-go financing and new debt at a rate of $29.9 million a year through 2016.[14]

The new collaborative capital planning process among the Administration, Council and residents is a strong step forward in the transparent selection and prioritization of capital investments; that process will help the City of Pittsburgh grow and prosper by maintaining existing assets as they age and adding new ones when required. The process adopted this year will also help the City improve the management of its capital needs and identify the long-term resources required to invest in its infrastructure. The new annual capital investment review and budgeting process timeline is shown below:

[13] This practice allowed the City to reduce its total outstanding debt.

[14] For most governments not all capital projects can be funded on a pay-as-you-go basis, but a significant contribution from current funds is preferable.

Schedule of the Annual Capital Improvement Process

Date	Task
April	Statement of Mayoral priorities provided to City Council and operating departments
First week of May	Office of Management and Budget distributes forms requesting capital project proposals from operating departments and City Council
First week of June	Capital project proposals submitted to OMB
June – July	Capital Program Facilitation Committee (CPFC) meetings
First week of August	CPFC provides list of project rankings to the Mayor
September – October	Public meetings
First week of October	Mayor proposes a capital budget and six-year CIP to Council

Debt Reduction and Adoption of a Debt Policy

When the Act 47 Plan was proposed in 2004, the City had $845.7 million in General Obligation and Pension Obligation bonds outstanding. The 2004 debt service obligation of $86.2 million represented almost 23 percent of the City's budgeted expenditures for 2004.[15] The Recovery Plan noted that annual debt service on non-pension general obligation bonds was approximately $68.0 million in each of the following six years while annual debt service on pension general obligation bonds was approximately $20.0 million in each of the following eight years. In response to the need to reduce its annual debt service, in 2005, 2006 and 2008 the City executed current and advance refundings on its outstanding bonds. These transactions created significant savings for the City, especially the 2006 refunding and restructuring, which created over $20.0 million in savings that later allowed the City to direct annual funds to its pay-as-you-go capital program in lieu of borrowing.

By 2009, the City had $723.1 million in outstanding obligations. While this debt had a relatively short remaining life of 15 years, with all current debt scheduled to be repaid by FY2026, the City's scheduled debt service payments would have been over $80.0 million per year through FY2017 before dropping to approximately $30.0 million per year in FY2019. In order to address this challenge, the City dedicated some of its recent fund balance to reducing the debt burden in the period from FY2010 to FY2013 and continued with the pay-as-you-go capital investment program.

The City further restructured its debt and issued $80.0 million in new money debt in early 2012.[16] As of November 1, 2012, the City had $598.1 million in General Obligation and Pension Obligation debt outstanding. The City has paid down over $350.0 million of the debt principal outstanding on December 31, 2003, and its budgeted debt service for 2013 is down to 18.6 of expenditures with future declines expected. Its remaining debt will be paid off by 2026, with an average life well within rating agency guidelines of 50 percent of principal amortization within 10 years (or in this case 100 percent of principal amortization within 13 years).[17]

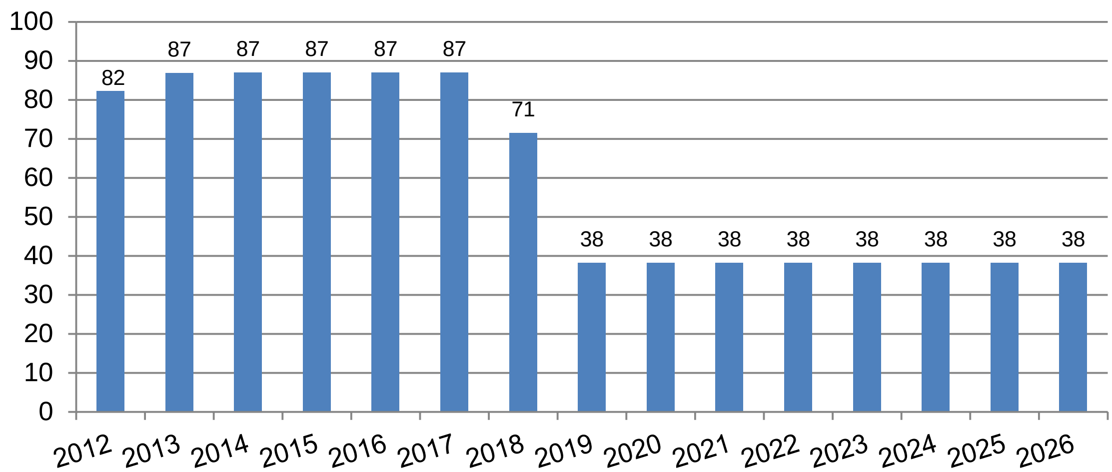
[15] The total debt burden, including General Obligation Bonds, Pension Obligation Bonds, SEA payments and URA payments, was $86.2 million or approximately 24.6 percent of budgeted expenditures in 2004.
[16] Raising its total outstanding principal debt to $617.5 million
[17] *See*, Fitch Ratings, U.S Local Government Tax-Supported Rating Criteria, August 14, 2012.

The next step was to establish a stronger written debt service policy to memorialize the principles so that they remain in place after the current personnel have left and state oversight has ended. A formal debt service policy should provide clear standards for evaluating whether to use financial tools (like debt refinancing or variable rate bonds) which can be helpful if used under the right conditions. In addition, such a policy will also act as a safeguard against the kinds of mistakes that contributed to the City's financial distress determination such as over-reliance on one form of borrowing, whether fixed rate, variable rate, callable or non-callable structures or scoop refundings.[18]

In the fourth quarter of 2011, City Council adopted and the Mayor signed an ordinance enacting an official debt policy.[19] The ordinance requires, among other actions, that the City contract with an independent financial advisor, issue debt only for capital projects that are included in the capital program, limit the use of TRANs, limit its tax supported debt service to 17 percent of General Fund revenues and establish a 10 year goal of reducing the ratio to 12 percent. In addition, the ordinance prohibits the City from issuing debt with derivative products. The ordinance acknowledges that the foundation of a well-managed debt program is a "comprehensive debt management policy that exists to establish parameters and provide guidance governing the issuance, management and evaluation of debt obligations."[20] As noted earlier, in the second quarter of 2012 the City issued $80 million in General Obligation bonds to fund its backlog of capital projects in accordance with the debt policy.

The debt policy is another tool for ensuring long-term financial stability, and it will provide current and future administrations with strong guidance on the use and management of debt.

Revised Debt Service 2012 – 2026 (Millions)



Source: Department of Finance, City of Pittsburgh

As reflected in the chart above, the City's annual debt service payments, which have consistently averaged from $85.0 million to $90.0 million during the last decade, are scheduled to drop precipitously in 2018 and 2019. As prior debt service declines, the budget will have undedicated

[18] Scoop refunding is a financial tool whereby a government issues refinancing bonds at a lower interest rate then existing bonds achieving interest savings and some upfront cash for the issuer.
[19] Ordinance 29-2011 of December 12.
[20] *Id*.

revenues for new debt service with some capacity left over for addressing other annual and legacy costs. It will be critical for the Administration, Council, the ICA and other stakeholders to reach a consensus on how to use the additional budget capacity generated by the debt service reduction. In particular the City should focus on tracking the savings to ensure that expenditure commitments do not exceed available savings.

Establishing an OPEB Trust

In 2009, the Amended Recovery Plan required the City to establish and begin to fund an OPEB trust fund.[21] The Plan prescribed an initial contribution to the trust fund of $2.7 million in 2011, which was $2.2 million more than was allocated in FY2011 budget. On January 1, 2010, the City had a $488.6 million unfunded OPEB liability. Again, this liability was one of the four critical legacy costs addressed by the Secretary of DCED that became a directive for the Amended Recovery Plan. The initial Recovery Plan noted the skyrocketing cost of other post-employment benefits (OPEB), primarily retiree health benefits for police officers and firefighters.[22] The Plan required the City to eliminate retiree healthcare to employees hired under new labor contracts effective after the Plan's adoption, retain the right to change the provider, and have retirees pick up the cost of any future premium increases. The goal was to control the growth of the City's OPEB liability and to consider additional funding options to meet the future liability.

In 2012, City Council adopted a resolution to establish an OPEB Trust Fund that will hold the assets aside to address this liability in the out years.[23] The resolution established an irrevocable trust for other post-employment benefits. The City projects an annual funding rate for the Trust of $2.5 million through 2017 and beyond. The assets will be used to fund the long term OPEB liability as opposed to the year-to-year costs of retired employee health insurance.[24] The City's FY2012 budget allocated $18.2 million for retired employee health insurance, which is $5.8 million more than the City budgeted in 2005. General Fund expenditure on current OPEB costs will peak at $29.2 million by 2031 in order to continue to outpace expenditures. The Trust Fund will help pay for the rise in cost in the out years.

Establishing the OPEB trust is an important initial step toward addressing a legacy cost that threatens to consume a growing portion of the City's limited resources. Pittsburgh will be one of the first local governments and the first major city in Pennsylvania to implement this recognized best practice.

Creating a Funding Stream for Employee Pensions

In 2004, the Recovery Plan noted that severe cost pressures had caused the City's pension cost to grow at a rapid pace, with net pension costs rising from $5.9 million in FY2002 to a projected $17.2 million in FY2004. Growth in the range of $29.7 million was anticipated in FY2005. Under these projections, the Plan projected that pension costs that already more than doubled from FY2002 to FY2004 would nearly double again by FY2009. Even with dramatic contribution increases, the extremely weak funding status of the City pension funds threatened the ongoing stability of retiree benefits as well as the City's finances. The Recovery Plan called for a series of

[21] Initiative PNO3.
[22] There is also a small amount of OPEB associated with life insurance benefits for police officers, firefighters and certain other employees.
[23] *See*, OPEB Trust – Resolution 2012-17 of January 31.
[24] The City covers year-to-year cost in its operating budget at average allocation of about $18 million a year.

reforms to the way the City manages its pension liability including reevaluating the contribution level, increased monitoring of the funding status, initiating a moratorium on pension benefit enhancements and changing the date on which the City made its annual contribution.[25]

In 2009, the Amended Recovery Plan noted that despite the City's success at eliminating a large, recurring annual operating deficit the City continued to face extraordinary legacy cost pressures that had reached unsustainable levels, primary among them employee pension costs. The Plan called for aggressive action to improve the City's ability to provide the retiree pensions benefits it had promised. The pension related initiatives in the Amended Recovery Plan also laid out a broader strategy to address the City's pension crisis including state partnerships for long-term structural changes, increased funding contributions from the City, sound plan administration and liability management.[26]

Three months after the City adopted the Amended Recovery Plan, the Pennsylvania General Assembly enacted Act 44 of 2009, giving the City until January 1, 2011 to increase its pension funding ratio to at least 50 percent or face takeover by the Pennsylvania Municipal Retirement System (PMRS). That takeover would have required the City to make much higher annual contributions to the pension fund. One projection showed the City contributing $82 million in 2013, $123 million in 2017 and $130 million in 2022, compared to the $67 million budgeted for 2011.

In December 2010, City Council enacted an ordinance that irrevocably dedicated $13.4 million in parking tax revenue to the Comprehensive Municipal Pension Trust Fund each year through 2017.[27] The amount of dedicated parking tax revenue rises to $26.8 million for 2018 through 2041. Council also moved $45 million from a previously dedicated debt service reserve fund to the pension fund to help meet the 50 percent funded threshold. The Act 47 Coordinators determined that Council's approach to increasing the annual pension contribution complied with the Amended Recovery Plan since it met the additional annual contribution levels mandated in the Plan.

Pursuant to the requirements of Act 44, the City submitted an on-time pension valuation report to the Pennsylvania Public Employee Retirement Commission (PERC) in September 2011. Later that month PERC certified that the City's pension funds were "Level 2 distressed," with a 62 percent funding level, accepting the future stream of parking tax revenues as an asset of the pension funds. PERC's determination was important for several reasons: it established that the City will retain administrative oversight for its pension fund and avoided the projected increase in minimum contributions associated with state takeover.

These actions set a foundation for meeting the City's pension obligations in future years while maintaining positive operating balances. Additional contributions are needed to increase fund assets and maintain positive cash flow, and a strategy to do so is discussed later in this report.

Executing a Non-Profit Contribution Agreement

A key aspect of the Recovery Plan in 2004 was the participation of a broad cross-section of stakeholders in the City's financial recovery. As a county seat, regional center for state and federal

[25] *See*, 2004 Recovery Plan, Pension Chapter at 84.
[26] June 30, 2009 Amended Recovery Plan, Initiatives PN01-PN13.
[27] Ordinance 42-2010, of December 30.

offices and home to regional and national non-profit universities and hospitals, well over 33 percent[28] of property in the City was found to be exempt from property tax, the City's largest source of revenue. To address this, the Recovery Plan set a baseline for non-profit contributions for city service at $6.0 million a year beginning in 2005. The Plan noted that the Pittsburgh Financial Leadership Committee – a group of civic leaders that developed recovery recommendations for State and City elected officials in 2003 – had reached a consensus that increased annual contributions from non-profits should be part of the package for fiscal reform in the City. These revenues would depend on the willingness of exempt institutions to negotiate agreements and make annual payments to a special fund.

The Secretary of DCED and the Act 47 Coordinator played a major role in establishing a Pittsburgh Public Service Fund to accept the contributions and distribute them to the City. The fund was the first ever established under the terms of Act 55 of 1997, the statute governing tax exempt qualification in the Commonwealth. An initial agreement provided for contributions to the Fund by tax exempt entities for the three year period from 2005 to 2007. According to the Fund's leadership, over 100 tax exempt institutions made contributions over the three year period. Although the agreement did not reach the Recovery Plan's goal of $6.0 million in contributions per year, it provided substantial and critical revenue for the City by providing almost $14.0 million to the City's coffers over the period.

In 2009, the Amended Recovery Plan required the City to secure continuous non-profit contributions.[29] In 2011, the City received contributions from non-profits totaling $3.5 million. In 2012, the City signed a two-year agreement with the non-profit community that will contribute $2.6 million annually.

Despite its success in negotiating annual agreements, the City seeks long-term revenue stability; non-profits seek predictability and an end to recurring requests for contributions, while the School District and the County have their own programs. As a result, during this year's ICA budget process the City agreed to put together a regional task force to consider the appropriate level of non-profit contributions and report back before the current agreement expires. The ICA's approval of the 2013 budget and five-year plan was conditioned on the City continuing to actively pursue an extension of an agreement with the non-profit community.

Intergovernmental Cooperation

The initial Recovery Plan contained 29 initiatives related to shared-services between the City and other governmental entities. City-County cooperation at various levels received a particular focus in the Plan, beginning with County assumption of 911 services in 2004. Between 2004 and 2008, the City began establishing the political foundation and relationship needed to create shared service agreements. In October 2006, the Mayor and then County Chief Executive announced the creation of the Citizens Advisory Committee on the Efficiency and Effectiveness of City-County Government, chaired by the Chancellor of the University of Pittsburgh. In February 2007, the City and County entered into a joint purchasing agreement through which the County handled procurement for some materials, general supplies and equipment on behalf of the City.

[28] *See*, 2004 2004 Recovery Plan, Tax Exempt Institutions Chapter, at 207.
[29] Initiative RE03, Amended Recovery Plan at 272.

In November of 2008, CONNECT, a collaborative organization of 35 contiguous communities, held its first meeting with the goal of leveraging its demographic, economic and political power. Earlier that year, the Western Pennsylvania Energy Aggregation program generated $1.5 million in savings for taxpayers through a joint natural gas purchase that included the City of Pittsburgh, Pittsburgh Public Schools, Water & Sewer Authority, Allegheny County, Airport Authority, and the Pittsburgh Zoo and Aquarium. The two year agreement accounted for 230,000,000 kilowatt hours.

By 2009, the City made progress on a number of initiatives. As previously discussed, the City merged its financial functions into Allegheny County's ERP. In 2007, the City entered into an intergovernmental agreement to provide refuse collection service to the neighboring Borough of Wilkinsburg. In 2011, following further negotiations, Pittsburgh began providing Wilkinsburg fire suppression services. In the same year, the Controller began exploring regional funding alternatives for emergency medical services, and the Mayor became the chair of CONNECT.

In 2012, the City continues to provide services to its municipal neighbors. Pittsburgh provides road paving services for four other municipalities, and will seek to continue and expand those services. The administration is also pursuing agreements with other municipalities for sharing services that include, but are not limited to, the Enterprise Resource System, Emergency Medical Services, Parks Management, and police and fire services. The Mayor has set four specific priorities for CONNECT, which include the continuation of multi-municipal energy purchasing, the establishment of a regional land bank to help address blighted and vacant properties, collaborative implementation of the consent decree, and working with the members on the U.S. Department of Energy's SunShot Rooftop Solar Challenge.

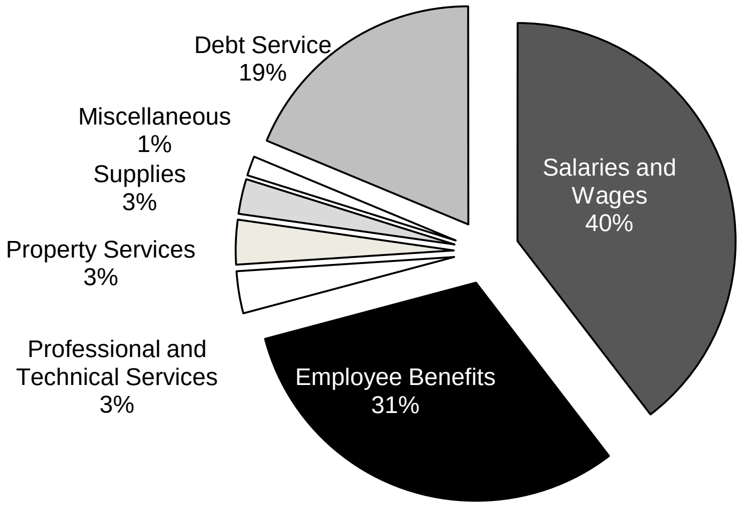
By improving its fiscal condition and operational management, the City has become an attractive partner for shared service delivery with its surrounding neighbors.

Labor Agreements

In 2004, the Recovery Plan identified the single largest expense for the City of Pittsburgh – employee wages and benefits – totaling approximately two-thirds of overall General Fund expenditures or $241.1 million in FY2003 on a $349.1 million budget.

Employee compensation continues to account for the majority of the City's operating budget in any given year. In the 2012 operating budget, more than seven of every 10 dollars (71 percent) are allocated for employee compensation including salaries, overtime compensation, other forms of cash compensation, health insurance coverage and the City's contribution to the employee pension fund.

2012 Operating Budget by Subclass



Source: Department of Finance, City of Pittsburgh

Since employee compensation accounts for the majority of the City's operating budget and most City employees are members of one of nine employee unions, the City's ability to keep its finances balanced on an ongoing basis depends on its ability to successfully negotiate collective bargaining agreements that are fair to its workers, competitive in the regional market place and affordable given City revenue growth.

The original Recovery Plan provided a specific wage and benefits structure that was applied to City employees as their collective bargaining agreements expired. The initiatives in that plan set maximum base wage increases, froze longevity payments, reduced paid leave and increased employee contributions to health insurance. Those changes, combined with the City's own management of workforce costs, helped the City to reverse the trend of operating deficits.

Because of the City's successful financial management after 2004, the Amended Recovery Plan adopted in 2009 used a different approach. It provided a specific dollar allocation for compensation and benefits to be paid to all members in each bargaining unit over a five year period, allowing employees to share in the City's improved finances. The allocation was based on a recommended salary increase pattern, but the Amended Recovery Plan gave the City and each bargaining unit the flexibility to negotiate a different pattern or changes to other elements of compensation (e.g. longevity, shift differential) so long as the total compensation costs did not exceed the Amended Recovery Plan's allocations.[30]

The City and eight of its nine employee unions have successfully negotiated new collective bargaining agreements that comply with the Amended Recovery Plan. At time of publication, the City had not completed negotiations on a new collective bargaining agreement with the Fraternal Association of Professional Paramedics, whose agreement expired in December 2010.[31]

Some unions took the recommended salary structure in the Amended Recovery Plan without any significant modification. Others, like the Fraternal Order of Police and International Association of

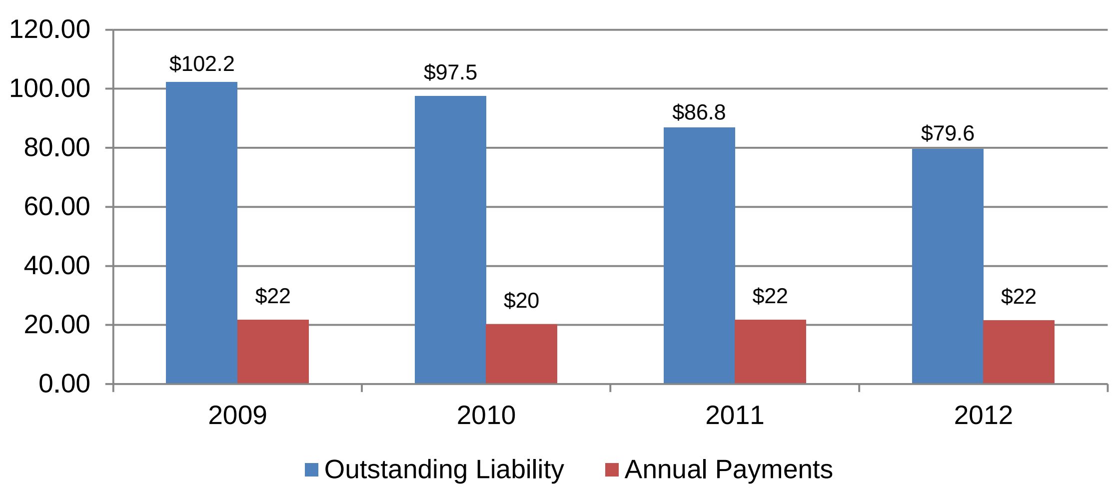
[30] The Amended Recovery Plan prohibited changes to existing health and retirement benefits.
[31] The City has reached new multiyear agreements with PJCBC that is consistent with the terms of the Amended Recovery Plan.

Firefighters, took a lower base wage increase in some years so that they could increase other elements of compensation. In all cases, the City and bargaining units demonstrated the ability to negotiate changes to employee compensation after calculating the cost of those changes and considering those costs within the context of the City's broader financial picture. While the Recovery Coordinator checked the City's calculations for accuracy, the City's Public Safety and Finance Department staff took primary responsibility for their successful completion. That provides a pattern for successful negotiations of future agreements that are fair to employees and affordable for City taxpayers.

Workers Compensation

On November 23, 2003, the Commonwealth Bureau of Workers' Compensation (Bureau) preliminarily approved the City's self-insurance renewal application conditioned upon the City establishing a trust account to fund anticipated liabilities and to prefund its payments for 2004 by January 31, 2004. The Bureau then issued an amended decision on January 29, 2004 with revised conditions concerning its self-insurance approval, which required establishment of a Voluntary Employee Benefits Account (VEBA) to be established by the City by February 1, 2004 and monthly deposits into the account. The Recovery Plan required compliance with the Bureau's requirement. In 2004, the City established the VEBA fund and made the monthly deposits. The Bureau subsequently rescinded the VEBA requirement in 2011 after the City's finances stabilized, liability reduced and timely payments were made during the period.

Outstanding Workers' Compensation Liability 2009 – 2012



Source: City of Pittsburgh – Personnel & Civil Service Commission

The 2009 Amended Recovery Plan initiatives required changes to collective bargaining agreements to improve the management of this legacy cost. In addition, the City made significant progress in other areas of workers' compensation. The number of older, costly "legacy claims" (those with a claim date prior to 2006) has been reduced from 965 in 2005 to 616 in 2010 according to the City Controller's 2011 performance audit. The Department of Personnel continues to work with the Department of Law, the third party administrator and outside labor counsel to target more claims for settlement. New claims are handled in a professional and active manner and the City renegotiated its contract with the private company that handles medical claims to capture additional savings.

The Amended Recovery Plan set a five percent savings target off baseline workers' compensation costs projected in the City's FY2009 budget and five-year plan. That savings target translated to $23.2 million in total worker's compensation costs for FY2011. At year-end, the City reduced costs by $1.9 million, and then redirected those savings to settlements of current claims in compliance with the Amended Recovery Plan.

The City's success at reducing its overall workers compensation liability while maintaining a positive operating balance is an indicator of effective operational and financial management.

Improved Bond Rating

In October and November 2003, each of the three major national credit rating agencies downgraded the rating of the City's general obligation debt to speculative or "junk bond" status. Moody's Investor's Service noted that "the city is expecting a budget deficit of approximately $40 million by the end of the year, reducing General Fund reserves to inadequate levels to operate through fiscal 2004 without external liquidity." The Recovery Plan noted that the return of the City's bond ratings to investment grade status would not occur until the Recovery Plan was implemented and the City had sufficiently demonstrated both that it has balanced revenues and expenditures and would continue to do so in the future.

In 2005, the City returned to investment grade status. Fitch ratings noted that "the return of the city's rating to investment grade reflects last month's city council approval of the 2005 budget, which is in compliance with an approved five-year spending plan."[32] As the City began implementing the Act 47 Recovery Plan, which decreased expenditures and expanded the revenue options, the City started generating a positive operating balance.

By 2009, Fitch raised the City's rating to BBB+ and Moody's and S&P assigned a Baa1 and BBB respectively to $725 million in outstanding general obligation bonds. All three agencies noted the City's stabilized financial position, expanded taxing authority and reductions to its overall debt. However, the rating agencies cited the City's long-term liability profile as a key credit concern, and noted that while the City funded its annually required pension contributions, actual investment returns had declined significantly and it was not expected that funding ratios would reach satisfactory levels for some time. These concerns mirrored those expressed by the Secretary in continuing Act 47 oversight and calling for increased focus on legacy costs given improved annual operating results.

In 2012, the City requested a review by the rating agencies when it sought to issue general obligation bonds to fund its capital needs. The rating agencies upgraded the City's credit rating to its highest ratings in eight years. Fitch assigned an A rating to the issuance of $80 million in new GO Bonds, and to the $565.5 million in outstanding debt. Moody's upgraded the City's debt rating to A1 and S&P retained a BBB stable rating. Again, all three agencies acknowledged the City's financial stability and overall debt reduction.

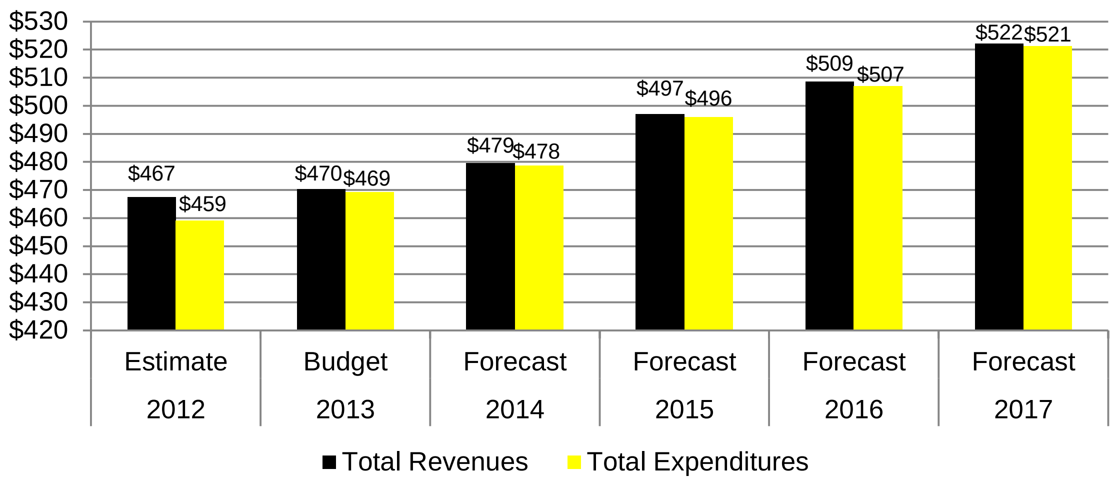
[32] *See*, Fitch Ratings Press Release, Pittsburgh, Pennsylvania GOs to 'BBB', January 31, 2005.

The City has made significant progress in managing and reducing its short, medium and long-term liabilities. However, as the rating agencies note, much work still needs to be completed by the City to control its legacy costs, and decrease the pressure on the General Fund. Fitch Ratings stated in its January 2012 rating report that "debt levels remain high" and "pensions continue to pose risk," and Moody's noted that "rising contractual salary and benefit costs could limit reserve increases going forward."

A Balanced Forecast

The City projects to end FY2012 with total revenues of $467.4 million outpacing total expenditures of $459.0 million, which results in a positive operating balance of $8.3 million. A fund balance of $48.5 million is projected for the end of FY2012. In addition, over the next five years the City projects that revenues will continue to exceed expenditures. Although the difference between revenues and expenditures will fluctuate throughout the five year period, the City anticipates maintaining a fund balance of over six percent of annual expenditures through 2017.[33] The City's proven ability to control expenditures below the historically conservative revenue projections fosters confidence in a positive fiscal outlook.

Five Year Projection of Revenues v. Expenses (Millions)



Source: City of Pittsburgh 2013 Proposed Budget Approved by the ICA

Continuing Concerns

As the City prepares to exit Act 47, there are a few ongoing issues that require continued vigilance. While Act 47 focuses on short-term stability, there are a number of longer-term challenges that should receive ongoing attention. Over the past couple of years, Pittsburgh established funding strategies for employee pensions, other post-employment benefits (OPEB) and capital needs. However, the plan for funding pensions will not meet 100% of the projected outstanding obligation as the strategy meets only approximately 70% of the liability. Funding for OPEB will also fall short of the total liability, and capital needs will continue to outpace resources although borrowing can

[33] GFOA recommends an unreserved fund balance of no less than 1 to 2 months of regular General Fund Operating Expenditures.

be set to affordable levels. When the City went to market earlier this year, all three rating agencies raised concerns about the impact of the City's long-term legacy costs on its annual budgets.

- Moody's noted that "The city was able to increase its pension funding above the 50% threshold, by utilizing a significant portion of its financial reserves to bolster the pension funding ratio, as well as by dedicating $736 million in parking tax revenue as a new pension funding source through 2041. As of September 2011, the pension system was 62% funded…we expect will retain sufficient financial flexibility over the medium-term…but rising contractual salary and benefit costs could limit reserve increases going forward."[34]

- Standard & Poor's stated that "Pittsburgh's diminished budgetary flexibility due to high fixed costs associated with the city's long-term debt, pension, and other postemployment benefit (OPEB) liabilities, and limited revenue-raising options beyond those encompassed in its recovery plan"[35] burden the City's credit rating.

- Fitch Ratings noted "The city's five-year operating budget shows a small increase in fund balance in 2012 followed by further draws from fund balance in 2013 and 2014 to pay for capital projects. Contractually agreed-upon pay increases consist of the largest expenditure pressure point, along with increased pension costs. Fitch believes that greater fund balance declines than currently projected could limit the city's financial flexibility and cause downward rating pressure."[36]

In addition to the need to manage its legacy costs, the Administration and Controller need to formalize a process for responding to external audits to ensure that City maintains strong financial reporting.

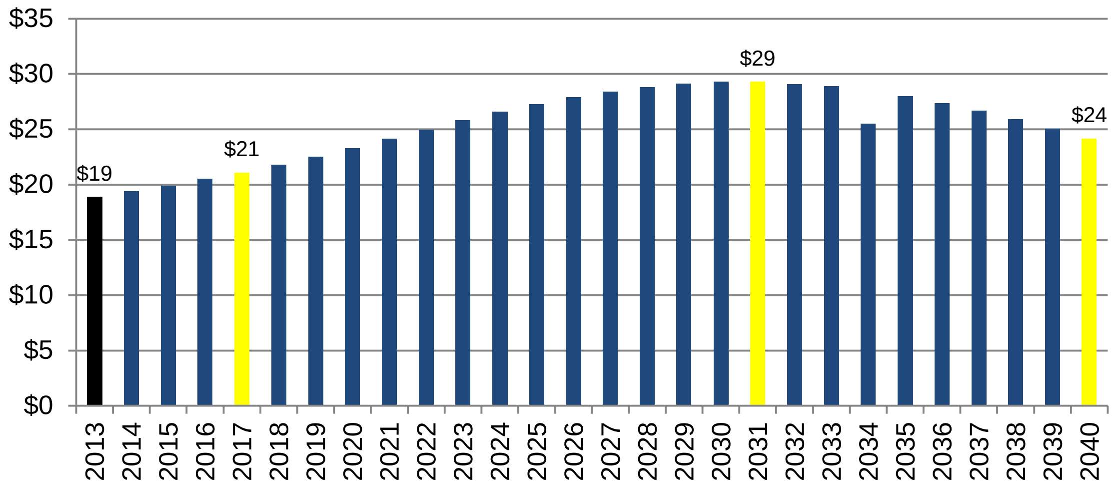
The ICA can be a strong partner in helping the City to manage its long-term liabilities and improve its response to independent audits. In addition, the ICA may be able to address other issues such as the City's cooperation with the tax-exempt community, addressing the rise in workers' compensation liability, and examining the operations that drive capital expenditures. City staff can focus on the continuous improvement of daily operations and resident services while the ICA tackles the long-term issues and paves a path toward long-term fiscal stability. Below is a synopsis of the future challenges and some recommendations for the Administration and Council to consider.

Funding OPEB

Expenditures for other post-employment benefits in 2013 are projected at $18.8 million. As noted above, in 2012 the City established an irrevocable trust to meet the future expenses of retiree health. The City's five year financial plan shows an annual contribution to the Trust of $2.5 million. Expenditures over the next five years will rise at an average rate of $547,750 a year, exceeding $21.0 million in 2017.

[34] *See*, Moody's Investor Service, January 19, 2012 assessment.
[35] *See*, Standard and Poor's, January 20, 2012 assessment.
[36] *See*, Fitch Ratings, January 20, 2012 assessment.

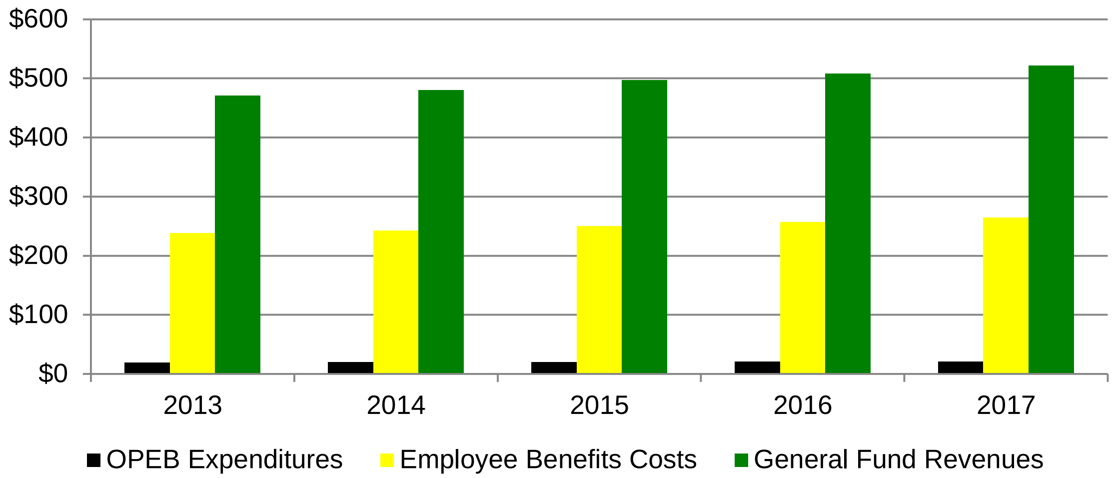
Projected OPEB Expenditures 2013-2031 (Millions)



Source: Department of Finance, City of Pittsburgh

Over the next five years, OPEB expenses will make up 7.96 percent of all expenses for employee benefits including pensions, healthcare and workers compensation.[37] By 2031, total OPEB expenses are expected to peak at $29.2 million, representing an increase of 35.5 percent from the 2013 level. During the period between 2013 and 2031, the liability will increase at a blended rate of 2.4 percent per year. After 2031, the liability is expected to decrease at a rate of 2.2 percent per year through 2040. Although total employee benefits expenditures will consume 50.6 percent of total revenues, OPEB expenses are projected to remain at around four percent of the projected General Fund Revenues in the near future.

Projected OPEB & Total Employee Benefits Costs v. General Fund Revenues (Millions)



Source: Department of Finance, City of Pittsburgh

Therefore, given the continuous rise of employee benefits over the next few years and beyond, the City should remain vigilant about funding the OPEB Trust in order to secure the resources to meet

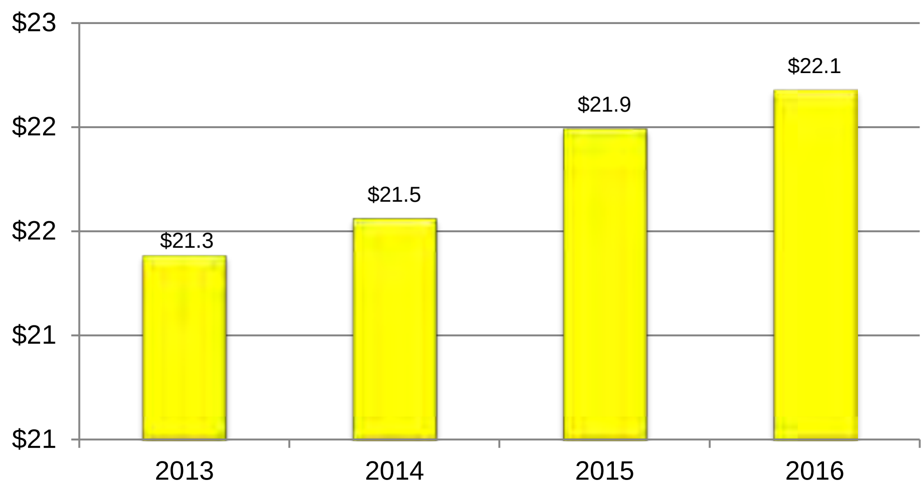
[37] Actuarial Valuation provided by the Department of Finance, City of Pittsburgh.

the long-term future OPEB liability. In addition, the ICA and the City should aggressively monitor collective bargaining agreements in the out years to control the cost of retiree health benefits.

Managing Workers' Compensation

As noted above, the City continues to settle prior workers' compensation claims at a rate of 88 percent of the indemnity exposure, and has historically controlled workers' compensation costs and invested in settlements. However, in the current five-year projection, expenditures for workers' compensation are expected to grow. Workers' compensation represents an average of 4.53 percent of total expenditures over the next four years, with an increase of $793,483 by 2016 from 2013.

Projected Workers' Compensation Expenditures 2013 – 2016 (Millions)



Source: Department of Finance, City of Pittsburgh

Although the City is effectively settling claims at pennies on the dollar, the projected increase in expenditures reflects a need for a more proactive long-term plan to reduce the occurrence of claims. The ICA could assist the City in reviewing why workers' compensation costs remain stubbornly high despite almost a decade of settlements, more effective third party administration, and an improved safety program.

Funding Capital Expenditures

When the City enacted the ordinance establishing a Capital Improvement Program it established a formal procedure for selecting and prioritizing capital projects. Like most cities, infrastructure, building, vehicle, and equipment needs will far outpace the resources that can or will be created. The City of Pittsburgh is no different. The 2013 six-year CIP identified $262.7 million in capital needs. However, the City only has $180.0 million in available funding – a mixture of bonds and pay-go funding – to invest over the next six years.[38]

The Government Finance Officers Association recommends that the municipal services and operations generating the capital needs should be reviewed and reduced if the municipality is

[38] Annual capital funding from 2013 – 2018 will fund on average70 percent of the identified projects.

unable to generate sufficient funds to meet the demands.[39] Therefore, over the next few years, the City and ICA are encouraged to examine the operations or services that drive its largest capital expenditures, and devise a way to reduced costs, increase resources or share the burden with neighboring municipalities.

Coordinated Response to Independent Audit Findings

The Amended Recovery Plan noted that the City does not have a formal process for addressing comments made by the City's independent auditors. Subsequent audit reports have contained the same comments on the same issues over a period of years. It is highly recommended that the City develop written responses for all comments in the annual audit. The responses include whether a City department agrees (and why), the plan for addressing the issue and the time frame for doing so.

In order to ensure that the City is collaboratively addressing the identified flaws in its financial management, the Controller and Finance Director need to create a formal policy and procedure for responding to the findings of an independent auditor. The goal is to fix the procedural problems, improve the City's financial reporting, and optimize the City's standard operating procedures.

In order to do this, the Controller's Office and the Department of Finance must develop a formal process for responding to findings and recommendations from the independent audits. The Controller's Office is the logical coordinator for the City's response in the next management letter.

Funding Employee Pensions

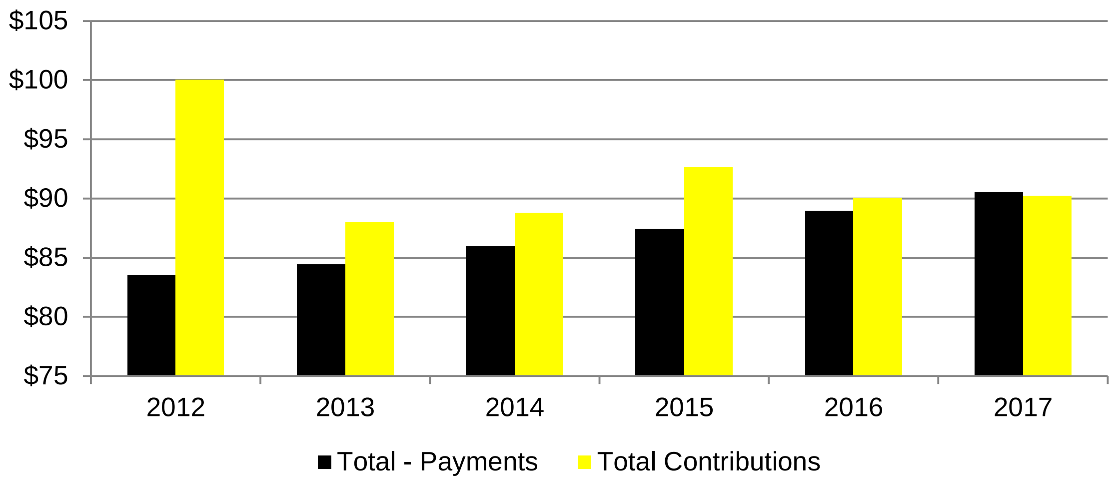
Although the City avoided state takeover of the pension system by dedicating the use of parking tax revenues, more efforts are needed to improve long-term pension funding. PERC's determination noted that the funding structure does not completely resolve the City's pension funding problem. Even at 62 percent, the pension fund is "moderately distressed" according to Commonwealth standards. The pension fund has to be at least 90 percent funded to avoid any distress designation by the Pennsylvania Public Employee Retirement Commission. Moreover, with recent market changes, the funded level has fallen below 60 percent.

Although the pledge of future parking tax revenues to the pension fund as an asset affects pension fund valuation, it has only a minor impact on the ability of the City to make benefit payments as they come due each year. In 2010, the City's pension contributions exceeded distributions because of the one-time move of $45.4 million from the debt service reserve fund to the pension fund. According to the City's 2011 pension valuation report as of January 1, 2011 there were $56.9 million in total contributions[40] and $44.7 on investment returns (totaling $101.6 million) to the pension funds with $80.4 million in payments, leaving the total assets for all funds at $590.3 million. In 2012, the actuaries project $41.5 million in total contributions by year-end, $45.5 in investment returns (totaling $87.0 million) and $81.2 million in distribution leaving $594.0 in assets.

[39] *See*, GFOA Policy on Capital Expenditures
[40] Act 205 MMO, employer and employee contributions.

Despite the increase in contributions, the funding level is at 57.4 percent of its liabilities by the end of 2012. Below is chart that shows the projected cash inflow and outflow. Based on these projections the City may begin dipping into the principal at around 2017 if it does not find a way to further increase annual contributions. Under these calculations, the projected total asset value of the Pension Fund will decline by $19.5 million by 2022.

Projected Pension Fund Cash Flow 2012 – 2017 (Millions)



Source: Actuaries for the City of Pittsburgh

In order to address the cash flow problem, the Administration and the ICA have reached an agreement to dedicate an additional $5.0 million a year in gaming revenue over the next five years to help stabilize the fund in the short-term.

Nonetheless, given the relatively low pension funding level and these cash flow issues, the City should continue its improvements in plan administration, such as issuing quarterly performance reports and making quarterly pension contributions. It must not enhance pension benefits during future collective bargaining negotiations. Given pension pressures on Commonwealth, education, and municipal funds across the state, it is likely that in the next several years the General Assembly will turn its focus back to reform of laws that govern municipal pension plans. Therefore, the Administration should continue its efforts to advocate for such changes, and work closely with the ICA, which has membership directly appointed by the legislative caucuses and the Governor.

Moving forward, the City and the ICA should monitor the cash flow of the pension fund and continue to lobby the General Assembly for alternative employee retirement options.

Non-Profit Contributions

As noted earlier, tax exempt entities consume 33 percent of the City’s property tax base, and consume fire, police, and other city services. While the City has successfully partnered with the nonprofit community to secure millions of dollars in contribution over the years and signed a short-term agreement that will generate $2.6 million annually until 2013, a long-term partnership is needed. As the large nonprofit organizations continue to grow, the City will continue to provide services without property tax support. The Pittsburgh School District and County government also provide vital services to nonprofit organizations, and the tax exempt community should be able to coordinate with their governing bodies through a single contact or forum.

During the September 2012 ICA meeting, the ICA discussed the creation of a City taskforce where leaders of the nonprofit community and local government can meet to discuss these issues. The taskforce could function as the forum for creating a long-term partnership for financial and land use issues and the provision of city services. The proposal was based on mechanism similar to one that yielded a much more comprehensive, balanced and significant non-profit contribution structure in Boston in recent years. While attendees at the ICA meeting expressed differing opinions on the issue, the ICA board was able to establish broad agreement to explore creation of a broad-based community panel to investigate various aspects of the role of non-profits in Pittsburgh. The final ICA budget agreement for this year included a commitment from the Mayor to establish a nonprofit task force to create a long-term partnership between government and the nonprofit community in service to city residents, including the School District and the County to the extent possible. The task force is required to report back before the current non-profit agreement expires at the end of 2014.

Future Collective Bargaining Agreements

During the term of the Act 47 Recovery Plans the City successfully negotiated collective bargaining agreements in accordance with the plan provisions. In 2012, the City secured an agreement with the PJCBC. While the City has yet to secure an agreement with the Fraternal Association of Professional Paramedics, the negotiation of two successive rounds of successful, affordable agreements with eight of the nine city unions is not an outcome that would have been predicted.

A keystone of the City's financial health is labor contracts that provide fair pay to employees while maintaining a cost structure – including retiree benefits – which the City can forward today and in the future. Continuing to reach accords with labor unions that mitigate the growth of pension and OPEB liabilities will be vital to the City's long-term fiscal stability. The ICA and the City should work together to ensure that future labor contracts are equitable and reflect the City's ability to pay.

Appendix 1 – Status of All Act 47 Initiatives

Since 2010, the Coordinator has drafted quarterly reports on the City's fiscal position and annual reports on the status of the 132 Amended Recovery Plan initiatives as required by statute. Below is a listing of the final status of each of the initiatives. The City has successfully completed 64 percent or 85 of the 132 initiatives. A total of 38 initiatives or 29 percent are labeled as "in progress" meaning, demonstrable progress has been made to achieve completion, but the required action is not complete or it may require a long term effort. Lastly, nine of the initiatives or 7 percent are labeled as "not applicable" meaning, the opportunity to complete or the need for the initiative has passed, or the initiative is out of the City's direct control.

	Category	Description
Status Key	**Completed**	The action required has been achieved or achieved to date and may require a recurring action to remain "complete". For example, if the City makes an appropriation required by the Recovery Plan and that appropriation would have to be made in future years to remain "complete."
	In progress	Demonstrable progress made to achieve completion, but the required action is not complete or it may require a long term effort.
	Not Applicable	The opportunity to complete or the need for the initiative has passed, or the initiative is out of the City's direct control.
	Incomplete	No demonstrable progress has been made toward completing the action required or the required action is due at a future time.

Chapter	No.	Initiative	Status
Pension/OPEB	PN01	Contribute an additional $10.0 to $14.0 million per year toward pensions; direct revenue windfalls to pay down legacy costs	Complete
Pension/OPEB	PN02	Evaluate pension obligation bond funding	Complete
Pension/OPEB	PN03	Establish and begin to fund OPEB trust fund	Complete
Pension/OPEB	PN04	No pension or OPEB benefit enhancements, including retroactive enhancements	Complete
Pension/OPEB	PN05	Eliminate overtime from firefighter pension benefit calculation for new hires	Not Applicable
Pension/OPEB	PN06	Explore the creation of new, less expensive defined benefit plan for new employees	Complete
Pension/OPEB	PN07	Explore a defined contribution plan for retiree medical costs for police and firefighters hired since 2005	Complete
Pension/OPEB	PN08	Eliminate City contribution to retiree life insurance for new hires	Complete
Pension/OPEB	PN09	Continue to evaluate investment performance regularly	Complete
Pension/OPEB	PN10	Make a portion of the annual City pension contribution earlier in the year	Complete
Pension/OPEB	PN11	Complete actuarial valuations in a timely manner	Complete
Pension/OPEB	PN12	Explore State pension funding partnerships and reform legislation	Complete
Pension/OPEB	PN13	Petition the General Assembly to credit EMS employees with two units for pension reimbursement	Not Applicable
Workers' Compensation	WC01	Require employees to treat with City panel physicians for duration of disability	Not Applicable
Workers' Compensation	WC02	Expand job offer program	Complete
Workers' Compensation	WC03	Implement post-incident drug testing	Complete
Workers' Compensation	WC04	Create an Employee Disability Review Committee	Complete
Workers' Compensation	WC05	Continue the settlement program	In progress
Workers' Compensation	WC06	Ensure full use of workers' compensation pension credit	Complete
Workers' Compensation	WC07	Improve internal communication on labor and employment cases	Complete
Workers' Compensation	WC08	Maintain increased claims adjuster staffing	Complete
Workers' Compensation	N/A	Savings target for Workers' Compensation	In progress
Debt	DS01	Debt service payments or debt defeasance from 2008-2009 debt reserve contributions	Not Applicable
Debt	DS02	March 2012 refunding	Complete
Debt	DS03	Establish debt service policies	Complete
Debt	DS04	Refunding Opportunities	Complete
Debt	DS05	Direct gaming windfall revenue to legacy obligations	Complete
Debt	DS06	Other debt refunding opportunities	Complete

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Chapter	**No.**	**Initiative**	**Status**
Workforce	WF01	Limit new contract enhancement	Complete
Workforce	WF02	Compensation flexibility and costing analysis	Complete
Workforce	WF03	Health insurance contribution	In progress
Personnel & Civil Service	PC01	Conduct compensation comparability study	Complete
Personnel & Civil Service	PC02	Petition the General Assembly to change State law restricting City's ability to reduce workforce	Not Applicable
Personnel & Civil Service	PC03	Confer with department managers on other concerns and establish alternatives for collective bargaining negotiation	Complete
Personnel & Civil Service	PC04	Increase Citywide focus on training	Complete
City Information Systems	IT01	Explore alternative staffing structures for cable television operations	In progress
City Information Systems	IT02	Increase cable television associated revenue	In progress
Planning	PL01	Create and adopt a comprehensive plan	In progress
Planning	PL02	Expand online access to GIS datasets and products	Complete
Law	LW01	Reduce current staffing levels by one Assistant Solicitor	Complete
Law	LW02	Continue to modify and revise City ordinances as necessary to implement the Recovery Plan	Complete
Finance	FI01	Reduce general fund expenditures by 1.0 percent each year	Complete
Finance	FI02	Participate in implementation of EIT collection changes	Complete
Finance	FI03	Maintain fund balance	Complete
Finance	FI04	Increase utilization of online payments and tax collection	Complete
Finance	FI05	Increase automation of manual processes	Complete
Finance	FI06	Continue improvements in budget preparation, presentation and monitoring	Complete
Finance	FI07	Formalize process for follow-up on internal and independent audit recommendations	In progress
Finance	FI08	Create a departmental chargeback process for centralized costs and services	Complete
Finance	FI09	Improve tax audit and collection process	Complete
Finance	FI10	Identify and pursue opportunities to lease City-owned property	In progress
Finance	FI11	Budget Amendments	Complete
Finance	FI12	Act 47 Status Reports	Complete
Procurement/Fleet	PF01	Procure vehicles designated for BBI use	Complete
Procurement/Fleet	PF02	Continue efforts to reduce vehicle fleet size	In progress
Procurement/Fleet	PF03	Maintain an Annual Purchasing Plan (APP) and integrate it into the annual operating and capital budget process	Complete
Procurement/Fleet	PF04	Expand proposed Facility Maintenance Plan to include space utilization study	Complete
Controller	CN01	Address conditions noted by independent auditor	In progress
Controller	CN02	Formalize process for follow-up on performance audit recommendations	Complete
Controller	CN03	Work with the Department of Finance to integrate performance audits into budget process	Complete
Controller	CN04	Reduce manual processes	In progress
Controller	CN05	Develop and maintain workload and performance measures	Complete
Controller	CN06	Document office procedures	In progress
Controller	CN07	Realign staff titles	In progress
ERP	EP01	Merge the City's ERP functions into the County's platform	In progress
ERP	EP02	Establish a project management team	Complete
ERP	EP03	Ensure ERP improvements address critical financial management needs	In progress
ERP	EP04	Provide adequate project staffing	Complete
ERP	EP05	Minimize customization of any new ERP system to allow future integration with other government entities	In progress
ERP	EP06	Provide an effective training program	In progress

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Chapter	No.	Initiative	Status
Insurance/Risk	IR01	Establish Citywide risk manager position	Complete
Insurance/Risk	IR02	Establish a risk management team	Complete
Insurance/Risk	IR03	Establish a risk management implementation program	Complete
Insurance/Risk	IR04	Create comprehensive facilities and equipment inventory	In progress
Insurance/Risk	IR05	Conduct interdepartmental liability risk audits	In progress
Public Safety Admin.	PS01	Improve cooperation between the Bureaus of EMS and Fire through coordinated training	In progress
Public Safety Admin.	PS02	Enhance rescue services by building the Bureau of Fire's capacity	In progress
Public Safety Admin.	PS03	Work with the Department of Finance to maintain an Annual Purchasing Plan	Complete
Public Safety Admin.	PS04	Adopt a recruitment plan	Complete
Animal Control	AC01	Create a contingency plan for animal shelter services	Complete
BBI	BI01	Restructure training requirements	Complete
BBI	BI02	Perform asbestos inspections in-house	In progress
BBI	BI03	Decentralize code inspections	Complete
BBI	BI04	Maintain fire plan review, system testing and inspection responsibilities within BBI	Complete
BBI	BI05	Seek best practices for managing vacant structures and absentee landlords	Complete
BBI	BI06	Streamline permitting process	Complete
BBI	BI07	Improve online services and telephone response	Compete
BBI	BI08	Digitize historic data	Complete
BBI	BI09	Consider expanding coverage to include evenings and weekends	In progress
EMS	EM01	Northside EMS Review	Complete
Fire	FB01	Decrease the total number of Deputy Chief positions	Not Applicable
Fire	FB02	Petition the General Assembly to change State law requiring fire trial board approval for disciplinary action	Complete
Police	PB01	Civilianization	In progress
Police	PB02	Develop an overtime reduction strategy	Complete
Police	PB03	Pursue privatization of tow pound	Complete
Police	PB04	Study reuse of Zone 3 police station	Complete
Police	PB05	Police retention and recruitment	In progress
Public Works	PW01	Conduct an independent operational review of refuse, bulk waste and recycling collection and disposal	Complete
Public Works	PW02	Achieve a target Act 101 recycling rate of 15 percent by 2013	Complete
Public Works	PW03	Fully analyze the costs and benefits associated with a new asphalt plant	In progress
Public Works	PW04	Identify and plan to meet technology and professional needs	Complete
Public Works	PW05	Management system	Complete
Parks	PR01	Close underutilized pools	Complete
Parks	PR02	Consolidate senior centers and recreation centers to create multipurpose facilities	In progress
Econ. & Comm. Develop.	ED01	Continue to collaborate on priority community development projects	Complete
Econ. & Comm. Develop.	ED02	Continue active participation in the Community Development Collaborative	Complete
Econ. & Comm. Develop.	ED03	Develop a plan for decommissioning vacant land to be used for redevelopment or green space	Complete
Econ. & Comm. Develop.	ED04	Continue to develop the Riverfront and other City biking trails	Complete
Intergovernmental Coop.	IG01	Pursue joint collection of delinquent taxes and fees	Complete
Intergovernmental Coop.	IG02	Continue joint energy procurement	Complete
Intergovernmental Coop.	IG03	Establish a shared services organization (SSO) for IT and other services	Complete
Intergovernmental Coop.	IG04	Explore police regionalization initiatives	Complete

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Chapter	No.	Initiative	Status
Intergovernmental Coop.	IG05	Resolve differences with County procurement regulations	Not Applicable
Intergovernmental Coop.	IG06	Explore City-County partnerships for regional parks	In progress
Intergovernmental Coop.	IG07	Pursue shared security costs at City-County building	Not Applicable
Intergovernmental Coop.	IG08	Explore the transfer of pet licensing to the County	Complete
Intergovernmental Coop.	IG09	Negotiate an Agility Agreement with the County for public works and other services	In progress
Intergovernmental Coop.	IG10	Pursue City-County consolidation of departments	In progress
Intergovernmental Coop.	IG11	Pursue intergovernmental service arrangements with neighboring municipalities	Complete
Capital Budget	CB01	Develop comprehensive multi-year Capital Improvement Plan	Complete
Capital Budget	CB02	Institute quarterly CIP status reports	Complete
Capital Budget	CB03	Fully adopt and implement Capital Asset Policies and Procedures Manual	Complete
Capital Budget	CB04	Sustain City CIP funding	In progress
Capital Budget	CB05	Develop a long-term capital financing strategy	In progress
Revenues	RE01	Generate at least $10.0 Million per year in local revenue or expenditure reduction, or enact tax increase	In progress
Revenues	RE02	Freeze parking tax reducations; direct funds to capital	Complete
Revenues	RE03	Secure non-profit contributions of at least $6.0 million per year	In progress
Revenues	RE04	Update City fees to generate 30% more revenue	In progress
Revenues	RE05	Implement Market Based Revenue Opportunity (MBRO) program	In progress
Revenues	RE06	Petition the General Assembly for Reimbursement of River Rescue Calls	Not Applicable
Revenues	RE07	Explore the feasibility of charging private boaters for services rendered	In progress
Revenues	RE08	Explore mooring/launching fee	In progress
Revenues	RE09	Pursue full compliance with City tax regulations	Complete

Total "In progress"	38
Total "Complete"	85
Total "Incomplete"	0
Total "Not Applicable"	9
Total All Categories	132