

SENATE APPROPRIATIONS COMMITTEE FISCAL NOTE

BILL NO. House Bill 1773

PRINTER'S NO. 3802

AMOUNT

See Fiscal Impact

FUND

Municipalities Financial Recovery Revolving Aid Fund

DATE INTRODUCED

October 17, 2013

PRIME SPONSOR

Representative Ross

DESCRIPTION AND PURPOSE OF BILL

House Bill 1773 amends Act 47 of 1987, relating to distressed municipalities to make various substantive and technical changes to the act.

In summary, the bill does the following:

- Permits a coordinator under Chapter 2 or a Receiver under Chapter 7 to examine the financial records of authorities incorporated by a distressed municipality as well as other organizations performing a governmental function on behalf of the distressed municipality;
- Eliminates the 2-page limit of the Survey of Financial Condition (SFC) that must be submitted annually by all municipalities by March 15 and specifies that the submission of the SFC supersedes the provisions of Act 42 of 2013 that requires allocation of liquid fuel monies to municipalities by March 1;
- Requires DCED to notify all state departments by January 1 of each year of the priority status of distressed municipalities to receive community and economic development funding;
- Requires distressed municipalities to adopt a recovery plan under Chapter 2 and to adopt 5/3 year exit plans under new subchapter C.1 in Chapter 2 to be eligible for applying to the court of common pleas to increase tax rates as provided in the bill;
- A provision that was removed in the House that would have permitted a distressed municipality to increase the rate of the Local Services Tax (LST) to no more than \$156 per year on residents and non-residents working in the distressed municipality *in-lieu* of an increase in the rate of the earned income tax (EIT) that currently may be levied to stabilize the financial condition of an Act 47 municipality was reinserted by amendment in the Senate Local Government Committee. This option is limited to only those municipalities who are not restricted by law from levying and enhanced EIT on nonresidents (Pittsburgh).
- Additional amendments added in the Senate Local Government Committee include:

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- With initial court approval, the bill permits the levy of a payroll preparation tax not in excess of the amount of revenue raised from the municipality's mercantile or business privilege tax generated during the previous fiscal year. The payroll preparation tax would be a permanent replacement for the business privilege/mercantile tax even if the distressed municipality status under Act 47 is rescinded.
 - Adds a special provision for levying a higher LST for those distressed municipalities that also have distressed pension systems under Act 205 of 1984 without court approval. While in Act 47, Act 205 distressed municipalities would be limited to utilizing the authorization under Act 205 to raise the earned income tax to levy an increase in the EIT that is at least as high on residents as nonresidents. An increase of the LST would be limited to \$104 if the municipality continues to levy an enhanced non-resident EIT under Act 205, or \$156 if they do not. The LST would be levied *in-lieu* of the enhanced EIT under Act 47. After exit from Act 47, the authority to continue a higher rate of the LST is permitted provided that the municipality meets certain requirements including a requirement that the revenue produced by the enhanced LST be used to retire pension debt. A higher LST could not be levied during the same year as an enhanced non-resident EIT under Act 205.
 - Requires that a City of the Second Class A (Scranton) increase an EIT rate under Act 47 by at least as much on residents when it petitions the court for an increase of the EIT rate on nonresidents.
- Adds a new chapter on the Early Intervention Program that provides matching grants to municipalities applying under the program that may not exceed \$200,000 in the initial year of the grant. To be eligible for the grant, a municipality must meet basic training requirements established under EIP guidelines. The matching grant amount required of municipalities could be reduced to 10% by an in-kind contribution by the municipality;
 - Requires a coordinator appointed by the Secretary of DCED to issue a preliminary report on the fiscal condition of the distressed municipality within 45 days of the appointment of the coordinator. Stakeholders, including municipal officials, employees, and members of collective bargaining units would be able to make recommendations on a fiscal recovery plan. The period of time a coordinator would have to complete the final recovery plan is extended from 90 to 120 days from the date a contract is executed with DCED;
 - Additional areas of analysis are added in relation to a coordinator's plan including the possible recommendation for disincorporation, changes in land use including regional approaches to promote economic development, and examination of tax burden in relation to generated revenue sources that may affect those within and outside of the distressed municipality;

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- Stipulates that if a recovery plan under Chapter 2 is not adopted or implemented, the Secretary of DCED may request a declaration of fiscal emergency from the Governor;
- Requires an annual performance evaluation of coordinators commencing July 1, 2015.
- Requires Act 47 municipalities to begin preparation of their annual budget at least 120 days before the end of the fiscal year and subjects the budget proposal to coordinator review and modification to insure consistency with the recovery plan;
- Creates a new Subchapter C.1 that provides a timetable for distressed municipalities to be under the provisions of Act 47. There will be a general 5 year period before the distress period may be terminated; however, this period may be extended an additional 3 years if recommended by the coordinator. There will be an assessment of the fiscal condition of the municipality in the first half of the 5th year, and specific recommendations will be made at that point by the coordinator, including – the distress status should be terminated in accordance with new procedures, the status should be extended for three years; the a state of fiscal emergency should be declared by the Governor, including the possibility of receivership, or in the worst case scenario, be disincorporated under proposed Chapter 4. If the status is extended an additional 3 years, the distress status could be terminated or a receiver could be appointed during those 3 years. After that time has expired, distressed status will be automatically terminated;
- Termination of status procedures are replaced with new, more objective criteria, the requirement that the Secretary hold a public hearing to consider making a determination terminating status if recommended by the Coordinator in the five year report, and including a right of appeal of a determination for labor unions or any party with standing to request a determination of distress (except DCED). The right of appeal of the parties with standing is prospective and does not apply to litigation that is already commenced on the issue of termination of status. This change does not preclude the Secretary's ability to consider making a determination at another time at the Secretary's discretion.

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- Adds extensive procedures for the disincorporation of non-viable municipalities and creates unincorporated service districts to provide essential services to the residents. Act 47 municipalities except those which provide police and fire services through their own employees could be subject to disincorporation (this procedure would also not apply to Philadelphia.) The procedure for disincorporation is provided, including development of an essential services plan by an administrator appointed by DCED. After the Secretary determines that disincorporation is appropriate, the governing body or the voters of the municipality could initiate the process of disincorporation by petitioning the court of common pleas. The right of the Secretary to also petition the court was removed by an amendment on the House Floor. Disincorporation would be subject to a judicial procedure through which the court must find by clear and convincing evidence that the municipality is viable and can sustain itself in order to avoid disincorporation. Services as provided in the essential services plan would be provided by assessments against benefitted property. An unincorporated district covering the geographical area of the former municipality would be established as an entity of the Commonwealth. Assets of the district not disposed of would be held in trust by the Commonwealth until the district is either reincorporated or merged or consolidated with a neighboring municipality. Certain former ordinances of the municipality would be part of governing standards established for the district. Enforcement of land use ordinances would become the responsibility of the county. An unincorporated service district trust fund and restricted accounts for each unincorporated district are established in the state treasury for each district. All expenses and obligations of the service district will be paid from the account which is funded by the assessments against benefitted property.
- Chapter 6 (Fiscal Emergencies in Municipalities) and Chapter 7 (Receivership) are extended to all distressed municipalities – not just 3rd class cities.
- Amends the criteria for the Governor’s declaration of fiscal emergency where: (1) the municipality is insolvent or projected to be insolvent and is unable to provide vital and necessary services, or (2) The municipality has failed to adopt or implement a coordinator’s plan or an alternative plan.
- Provides that the Secretary’s termination of a fiscal emergency under Chapter 6 shall also constitute a termination of receivership under Chapter 7;

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- Adds a new provision by transitioning Act 47 municipalities out of receivership by having their distress status rescinded or subjecting them to additional proceedings under Chapter 2 of Act 47 including the appointment of a coordinator (who could be the receiver appointed under Chapter 7). The receivership plan under Chapter 7 will continue in effect and be the recovery plan under Chapter 2. The coordinator would retain powers of the receiver with regard to enforcement of the plan and the Commonwealth Court would retain jurisdiction to adjudicate disputes and enforce orders issued by the coordinator. A municipality returning from receivership to Chapter 2 would be limited to five years of distressed status following receivership. This post-receivership process would not apply to the City of Harrisburg since it entered receivership prior to the effective date of this act.

FISCAL IMPACT:

This legislation is expected to add minimal costs for DCED as the legislation adds some additional administrative duties for the department. It is anticipated that these costs could be absorbed within current available funding. In the event that a municipality becomes an unincorporated service district, DCED indicates that the aggregate cost of an unincorporated service district would not exceed \$500,000 for administrator expenses and reimbursements for courts of common plea proceedings. These costs could eventually be reimbursed through the liquidation of municipal assets, interest earned, as well as assessments from property owners. Expanding the receivership option to all municipalities may result in additional costs for the Commonwealth. The City of Harrisburg's receivership resulted in \$5 million in appropriations over the past 3 fiscal years.

With the codification of the EIP into new Chapter 1-A of Act 47 as provided in the bill, if an audit has not been completed in the last fiscal year for a municipality seeking to enter into the EIP, DCED may provide a grant to the municipality for this audit that would be conducted by an independent auditor or firm. The cost of the audit could be up to \$50,000.

In the event that a municipality becomes an unincorporated service district for a full year or more, the Auditor General would be required to perform an annual financial audit. According to the Department of the Auditor General, a normal financial audit covering transactions by the unincorporated service district would cost between \$30,000 and \$50,000 annually per district. The department indicates that they could not absorb those costs within available appropriations.

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The legislation would provide the Commonwealth with an opportunity to realize savings in the longer term as municipalities would have a faster exit out of Act 47 "financially distressed" status. Disbursements are made through the Municipalities Financial Recovery Revolving Aid Fund after appropriation from the General Fund. Disbursements from this special fund were \$2.6 million in 2010-11, \$2.4 million in 2011-12, and \$5.8 million in 2012-13. The average of the 3 fiscal years is \$3.6 million per year. During those 3 fiscal years there were 20, 21, and 21 "financially distressed" municipalities, respectively. Currently, there are 20 municipalities under Act 47 "financially distressed" status. The average cost per "financially distressed" municipality was approximately \$173,000 annually over the past 3 completed fiscal years.

The legislation would have no adverse fiscal impact on municipal funds. It would provide additional revenue options such as tripling the local services tax where municipalities choose to do so. The municipalities would lose the ability to levy an earned income tax on resident and nonresidents above and beyond what is permissible under the Local Tax Enabling Act. According to DCED, those 20 municipalities all levied a local services tax which aggregately totaled \$22.1 million in the last years available (2010, 2011, and 2012). DCED indicates that they do not possess the ability to break out the earned income tax in excess of what is permissible under the Local Tax Enabling Act; therefore, a net revenue calculation is impossible. This legislation also exempts the local services tax on earned incomes or net profits less than \$15,600, which varies from the \$12,000 provided under current law, thus complicating an estimate even further. According to DCED, the 20 "financially distressed" municipalities generated about \$12.9 million in business privilege/mercantile taxes in the last years available (2010, 2011, and 2012). These municipalities, currently levying a business privilege/mercantile tax, would have the ability to convert these taxes to a payroll preparation tax not to exceed the amount received from the aforementioned taxes in the preceding calendar year.