East Whiteland Township
Executive Summary (Financial initiatives)

Presented by:

Gordon Mann

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Public Financial Management
www.pfm.com

1735 Market Street
Philadelphia, PA 19103

Phone: (215) 567-6100
Email: MannG@pfm.com

I. Recapping where we’ve been

Engagement summary

Public Financial Management (PFM) and The Novak Consulting Group (Novak) developed a multi-year financial management plan for East Whiteland Township with financial support from the Pennsylvania Department of Community and Economic Development and its Early Intervention Program (EIP). The Plan has three sections, one for each step in the planning process.

Section: I; Financial condition assessment

- We analyzed the Township government's financial position and the primary trends driving its financial performance. We then projected the financial performance under a baseline *status quo* scenario to identify and quantify specific financial challenges. We presented that analysis in December 2017.

Section II: Mission and Management review

- Township government does not exist just for financial purposes. It exists to deliver critical services to the people who live in, work in and visit East Whiteland. We met with the Board earlier this year to talk about Township government's mission and Novak interviewed and analyzed each department. **Their findings and recommendations are in the draft Plan, but will be presented at a later date.**

Financial Initiative development and plan delivery

- We focused our recommendations on three areas that will help close the Township's projected baseline deficit and position it to achieve other objectives selected by the Board later this year. **We will summarize and discuss those this evening.**

Plans don't make a difference by themselves – people implementing plans do. So our goal for this process is that you will review the plan, adopt it, implement it and then update it going forward.

Baseline assumptions

The baseline shows the Township's revenues and expenditures in a *status quo* scenario through 2023. On the revenue side, it assumes no changes in the tax rates or the level or types of service charges. On the expenditure side, it assumes no changes in the types of services provided, no layoffs or position cuts and no new positions (vacancies are filled). The baseline applies growth rates to the **2018 final budget**.

The baseline is **not a prediction** what financial performance *will be* through 2023. It is **an analytical tool** to help you understand the nature and magnitude of the government's financial challenges and guide discussions about how to address them.

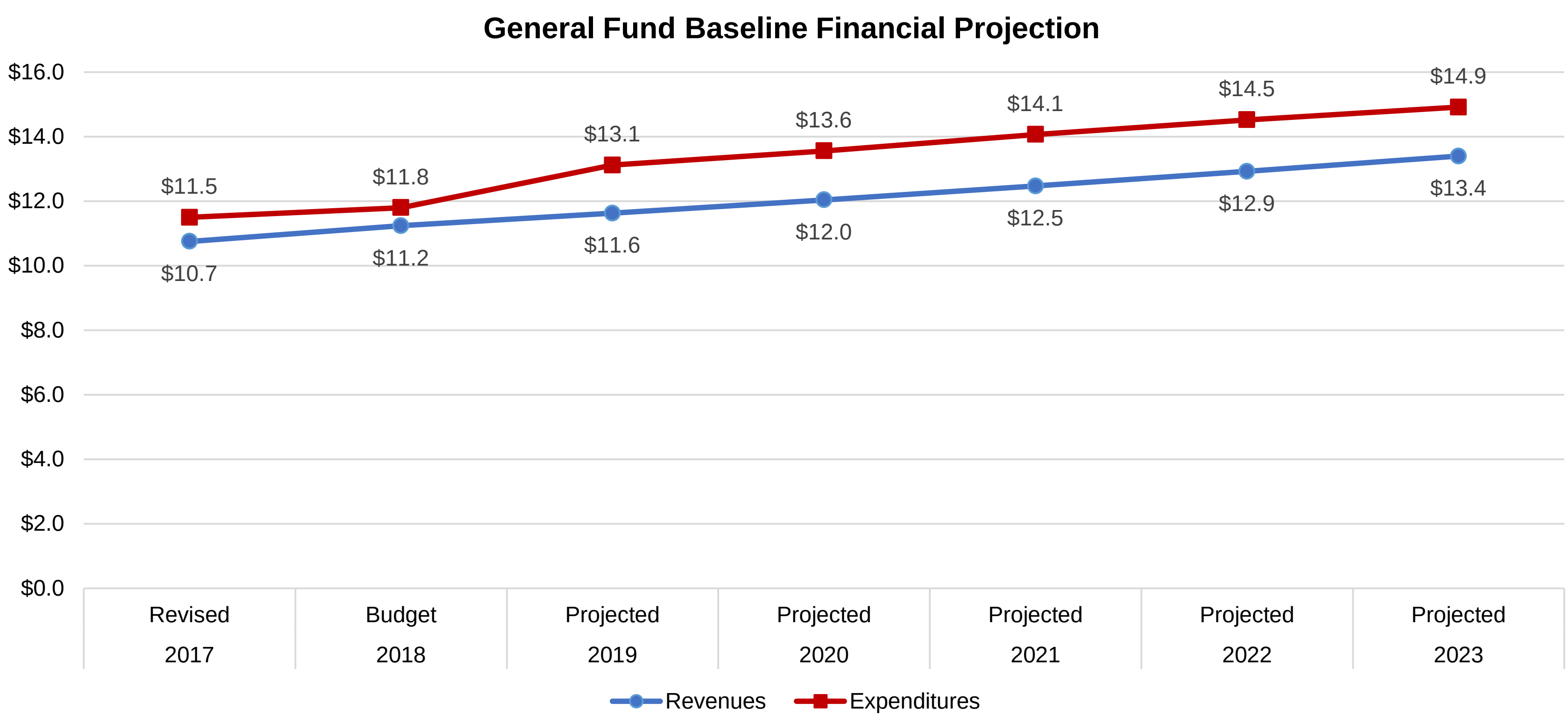
Key assumptions include:

- The Earned Income Tax, which is the Township's largest source of revenue, grows by 4.0 percent per year
- Transfer tax revenues are held at $1 million per year and license and permit revenues grow by 1.5 percent per year
- 3 percent annual across-the-board base wage increases plus applicable step increases for all employees
- 6 percent annual growth in health insurance expenditures for police officers and 6.3 percent for everyone else on the DVIT plan
- Pension contributions increase from $0.6 million in 2018 to $1.0 million in 2019 (actuaries' projections)
- Retiree health insurance expenditures that were zeroed out in 2018 return in 2019 ($300k). The supplemental contribution to the OPEB fund is not restored
- Debt follows the current schedule, without any refunding, refinancing or new debt. Vehicle replacement spending resumes in 2019 ($200k)

Please see Financial Condition Assessment for more discussion and analysis.

Baseline financial projection

The Township's 2018 budget has a $0.5 million General Fund deficit. The 2019 projection has a $1.5 million deficit because pension contributions grow and expenditures on retiree health insurance and vehicles return. Then the deficit gradually shrinks because the annual growth in revenues (3.7 percent) is higher than the growth in expenditures (3.2 percent) after 2019. **If the Township uses measures that have a recurring impact to close its deficit in 2019, that would stabilize the budget into the future according to the assumptions in the baseline projection.**



How did the Township do in 2017?

We completed much of the baseline projection analysis during 2017 when the most recent set of year-end audited results was 2016. The Township anticipated a $700,000 deficit in its 2017 budget, which we reviewed as a data point, but didn't use directly. Our projections start with the 2018 budget.

The 2017 draft audit shows the Township finishing 2017 with a $1 million positive annual result, which is $1.7 million better than the budget anticipated. The primary variances were:

- Earned income tax revenues finished $0.8 million higher than budgeted
- Transfer taxes finished $0.5 million higher than budgeted
- Operating expenditures were $0.5 million less than budgeted, including $0.4 million less in public safety. The public safety savings-to-budget were mostly in police ($228,000 or 4.7 percent) and then the rest spread across fire, planning/zoning and code.

The audit is still in draft form and won't be completed until after our engagement ends. But, assuming these numbers do not change much, the Township should review these major variances to determine whether the positive performance was due to recurring factors or non-recurring factors. Non-recurring factors would include one-time property sales that boosted transfer tax revenues, back payment of delinquent EIT revenues or vacant positions that have been or will be filled.

Based on that analysis the Township should also review and possibly adjust the baseline projection, which was based on the best information available at the time. Those reviews should generally occur twice a year (mid-year when the prior year audit is complete and during the next year's budget cycle) and more frequent if major changes occur.

II. EIT options

Earned income tax: Rules of the game

We were asked to review whether East Whiteland Township could increase its earned income tax on residents and non-residents and project how much money a tax increase would generate. We'll walk you through our projections which are based in part on the following parameters:

- **A person's EIT bill depends on the rate where they live and where they work**. People generally pay the tax to the municipality where they live first. If the municipality where they work has a higher EIT rate than their home municipality, they then pay an additional tax to their municipality of employment.
- **East Whiteland can increase its resident EIT from 0.5 percent to 1.0 percent.** Other communities have higher resident EIT rates for reasons not applicable to East Whiteland at this time.
- **East Whiteland can increase its non resident (or commuter) EIT from 0.5 percent to 1.0 percent.** A few communities have higher commuter tax rates for reasons not applicable to East Whiteland at this time.
- **If East Whiteland wants to increase the non-resident EIT, it has to increase the resident EIT by at least the same amount.** There's no scenario where East Whiteland can only increase the non-resident EIT rate.
- **Relying on commuter tax carries some risk because East Whiteland is depending on other places not changing their tax rates.** Remember that other municipalities can also increase their resident EIT and take commuter tax revenue away from East Whiteland Township.

EIT increase: Impact on residents

We used the 2016 EIT receipts as reported by Keystone as the basis for our calculations. In 2016, the Township had about 7,600 residents pay $2.0 million in EIT. About 2,200 of those residents live and work in East Whiteland Township. Another 2000 live in East Whiteland and work somewhere that has a non-resident EIT rate equal to or lower than 0.5 percent. For these 4400 residents the impact of a tax increase is straight forward. They will just pay more to East Whiteland.

Additional Resident EIT revenue from Tax Increase

	2019	2020	2021	2022	2023
If resident EIT was 0.5% (no change)	$0	$0	$0	$0	$0
If resident EIT was 0.6%	$267,000	$278,000	$288,000	$299,000	$311,000
If resident EIT was 0.7%	$533,000	$555,000	$577,000	$599,000	$623,000
If resident EIT was 0.8%	$800,000	$832,000	$865,000	$899,000	$935,000

There were about 3400 residents who work in places where the commuter EIT is higher than 0.5 percent. In those cases the person pays 0.5 percent to East Whiteland and some additional amount to the municipality where they work. For these employees increasing the resident EIT results in a tax *shift*, not a tax increase, depending on how much you increase the resident rate. They will pay the same amount, but more of it to you.

Additional Resident EIT revenue from Tax Shift

	2019	2020	2021	2022	2023
If resident EIT was 0.5% (no change)	$0	$0	$0	$0	$0
If resident EIT was 0.6%	$161,000	$167,000	$173,000	$181,000	$188,000
If resident EIT was 0.7%	$321,000	$334,000	$347,000	$362,000	$376,000
If resident EIT was 0.8%	$482,000	$501,000	$521,000	$542,000	$564,000

EIT increase: Impact on commuters

In 2016 there were slightly more commuters paying EIT to East Whiteland than residents (8100 vs 7600) and they paid more by dollar amount than residents ($2.9 million vs $2.0 million). About 30 percent of that group lived out of state. Another 36 percent lived in one of five places without a resident EIT. The rest were spread across 40+ municipalities. Increasing the tax on people who already pay the commuter tax has a larger impact than increasing the resident EIT.

Additional Revenue from Current Commuter Tax Payers

	2019	2020	2021	2022	2023
If non-resident EIT was 0.5% (no change)	$0	$0	$0	$0	$0
If non-resident EIT was 0.6%	$664,000	$691,000	$718,000	$747,000	$777,000
If non-resident EIT was 0.7%	$1,328,000	$1,382,000	$1,437,000	$1,494,000	$1,554,000
If non-resident EIT was 0.8%	$1,993,000	$2,072,000	$2,155,000	$2,241,000	$2,331,000

There are more than 8100 commuters working in East Whiteland. Some commuters don't pay any EIT to East Whiteland and never will because their resident EIT is at least 1.0 percent. But there are about 700 commuters who live in towns where the resident EIT is less than 1.0 percent. Those may become new commuter tax payers for East Whiteland depending on how much you increase the rate.

Thinking through the options

The Board has two options – just increase the resident EIT above 0.5 percent or increase the resident EIT and the commuter EIT above 0.5 percent. If you increase the resident EIT, you will have to increase it for everyone. You can't target the tax increase just to people who are already paying commuter EIT where they live.

Total Additional Revenue from Resident EIT Increase

	2019	2020	2021	2022	2023
If resident EIT was 0.5% (no change)	$0	$0	$0	$0	$0
If resident EIT was 0.6%	$428,000	$445,000	$461,000	$480,000	$499,000
If resident EIT was 0.7%	$854,000	$889,000	$924,000	$961,000	$999,000
If resident EIT was 0.8%	$1,282,000	$1,333,000	$1,386,000	$1,441,000	$1,499,000

Increasing the commuter tax has a larger impact because (1) it has to be coupled with a resident EIT increase and (2) the commuter tax base is larger. The table below assumes you increase the resident and commuter EIT by the same amount, though you could increase the resident EIT by more than the commuter EIT.

Total Additional Revenue from Resident and Commuter EIT Increase

	2019	2020	2021	2022	2023
If the resident and non-resident EIT was 0.5% (no change)	$0	$0	$0	$0	$0
If the resident and non-resident EIT was 0.6%	$1,110,000	$1,155,000	$1,199,000	$1,247,000	$1,297,000
If the resident and non-resident EIT was 0.7%	$2,218,000	$2,309,000	$2,400,000	$2,496,000	$2,595,000
If the resident and non-resident EIT was 0.8%	$3,332,000	$3,464,000	$3,602,000	$3,746,000	$3,896,000

Is this revenue sustainable?

The projections are based on a certain set of assumptions including:

- EIT revenues grow by 4.0 percent per year absent any tax change
- Increasing the EIT rate would not have a detrimental effect on employment or earnings
- Commuters' home municipalities would not also increase their resident EIT rates

That final assumption is an important one because it speaks to the risk inherent in relying on commuter EIT. If any municipality with a large number of commuters working in East Whiteland Township increases its resident EIT rate, that would directly reduce the amount of revenue that East Whiteland receives.

As a hypothetical example, if Tredyffrin instituted a 0.5 percent resident EIT and East Whiteland did not change its non-resident EIT rate, East Whiteland's revenue would drop by close $0.5 million per year. That risk is present even if East Whiteland doesn't change its tax rate. But the more East Whiteland relies on non-resident EIT to fund core services, the more vulnerable it is to revenue loss produced by decisions beyond its own control.

That said, the projections are also based on the 2016 EIT receipts grown by 4 percent each year. The 2018 budget assumed your EIT revenues would grow from $5.3 million in 2017 to $5.7 million in 2018. The draft audit shows $6.1 million in 2017 year end revenues. You need more information to determine how much of that 2017 revenue is recurring but, even if the County received a lot of one-time EIT revenues last year, the base is likely larger than $5.3 million budgeted for 2017 and the tax base may be growing faster than 4.0 percent, at least in the near term.

So what are our next steps?

We recommend the following course of action as it relates to the EIT:

1) **Get the final audited 2017 numbers, then review and possibly adjust the 2018 budget and baseline projection.** The final 2017 numbers may be different from the draft audit figures, but it looks like performance was much better than anticipated in the 2017 budget. You should determine how much of that stronger performance is recurring and then see whether the 2018 budget needs to be adjusted. That will impact the baseline projection in the Plan which is tied to the 2018 budget, though it's likely there will still be a deficit because of the increased pension contribution, return of retiree health costs, etc.

2) **Quantify what you need for other priorities, besides eliminating the projected deficit.** For example…

   - What are your capital needs? What do you want to spend on potential projects like the Township Hall or parks improvements? What's the right mix of debt versus pay-go to fund those projects?
   - What will you need for the employee pension plans? Are you considering further adjustments to the assumptions underlying your MMO calculations? If so, what will that cost you?
   - What will you want to set aside for the retiree health insurance expenditures? At a minimum you need to pay the current year claims from the General Fund starting in 2019. Do you also want to bring back or increase the OPEB Fund contributions?
   - What other operating needs do you have?

3) **Make a policy decision on whether you want to increase the resident EIT or the commuter and resident EIT.**

4) **Set your new resident and commuter EIT rates before you start the 2019 budget process.**

II. Other options to consider

Three other tax options

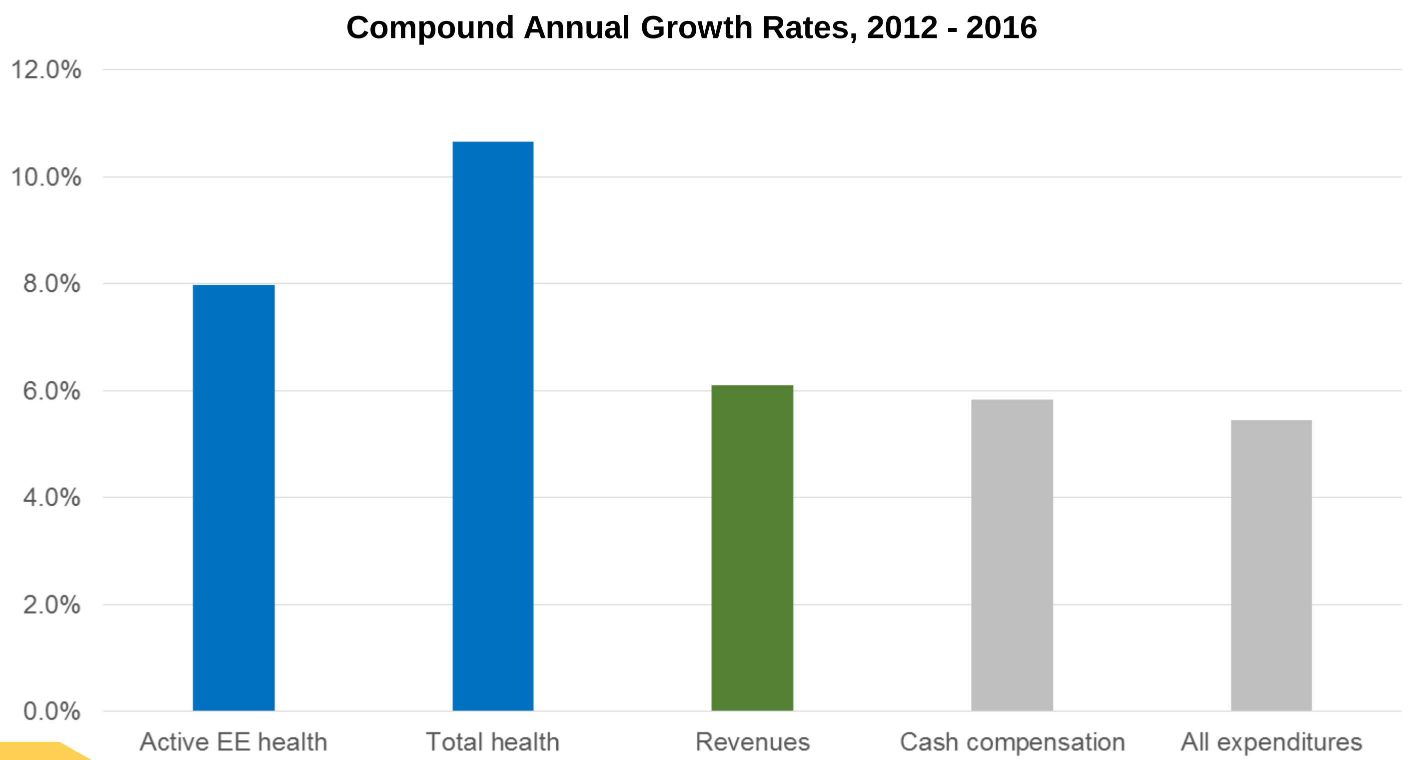
- **Homestead exemption:** This is a flat dollar amount deducted from the assessed value of each eligible property, lowering that value and the resulting tax bill for home owners. The real estate tax already accounts for a small portion of total Township revenue. Since a resident EIT increase would impact several resident income earners who are also property owners, the homestead exemption appears to be an option for lessening the impact on the home owner's total tax burden. There are prohibitions on the Township explicitly increasing the earned income tax or real estate tax itself to offset the cost of the homestead exemption. But the Township is permitted to use budget surpluses, which assumedly could be caused by real estate or EIT increases, to pay for the exemption. The Township should consult with its solicitor on these restrictions.

- **Special purpose real estate tax millage:** The real estate tax generates money that can be used for any purpose, whether it is to support daily operations, retire debt or fund capital projects. Some Chester County municipalities use special purpose real estate tax rates, in addition to their general purpose millage, to generate revenue for specific purposes, like public safety, capital projects, debt repayment or a contribution to the local library. Some communities find these special purpose taxes more palatable and the real estate tax is less sensitive to economic fluctuations than the EIT, though it also grows less than the EIT.

- **Open space EIT:** PA Act 153 of 1996 enables townships to seek voter approval through referendum for an earned income tax on its residents to generate money for purchasing property for open space preservation or repaying debt incurred for that purpose. The Township could use this act to levy an open space EIT after its resident EIT reaches 1.0 percent. In the near term the Township should consider increasing its resident EIT under the taxing powers already provided under Act 511 and designating a portion of the proceeds for open space.

Expenditure control: Employee health insurance

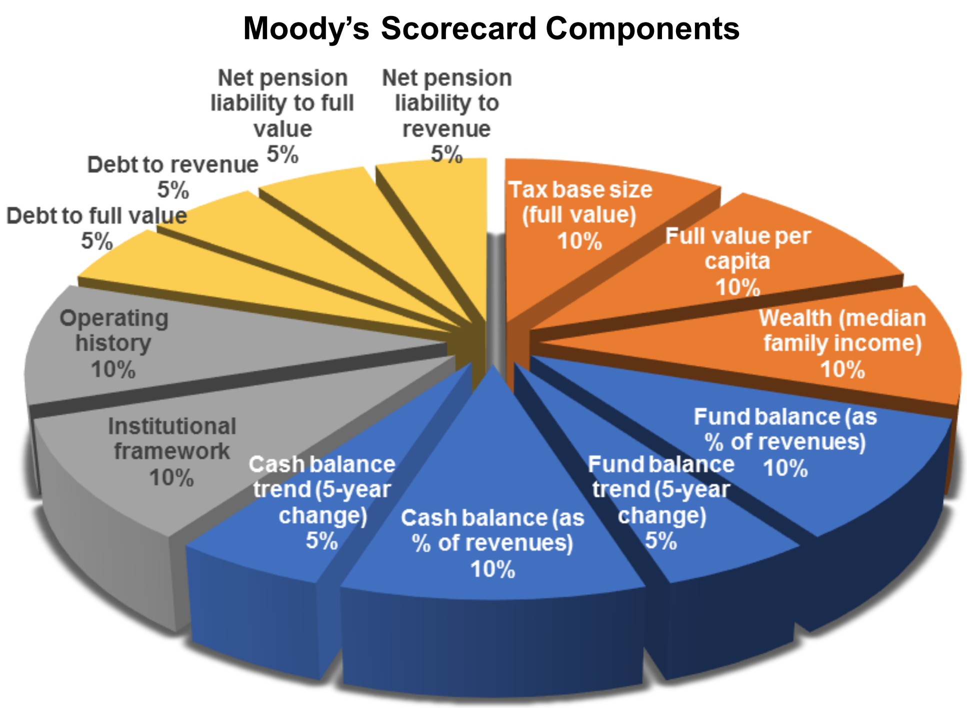
We caution against relying solely on an EIT increase to close the projected deficit and accomplish other financial goals. A balanced approach will also address expenditure growth and employee health insurance is a good target for that. Those expenditures grew faster than the Township's revenues, cash compensation or other expenditures from 2012 through 2016. In early 2017 DVIT found the current plan for firefighters and civilian employees would trigger a $652,000 liability under the "Cadillac Tax" provision of the federal Affordable Care Act. The police health plan exposes the Township to large liabilities for claims "lasered out" of stop-gap coverage. The Township could reduce the cost growth for its health insurance plans and still provide quality coverage to its employees by changing the plan design, such as it proposed during the IAFF arbitration.



Credit rating strategy

When local governments borrow money, one of the factors that determines their cost to do so is the government's credit rating – a measure of the government's ability to repay the debt in full and on time. East Whiteland is in a very favorable position already at Aa1 on Moody's scale, which is the second highest rating possible. East Whiteland could do even better and take its credit rating to Aaa, as is the case for some of its neighboring municipalities.

PFM Financial Advisors can you more information on where East Whiteland currently stands and how to boost the credit rating. The Township's fund balance and cash balance are particularly important to those efforts since they account for 30 percent of your credit score and are easier to control than other factors. If your fund balance grew by $1 million as the draft 2017 audit indicates, you may already be in a good position to take the final step up.



Thank You

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