

ANNUAL REPORT OF THE
INTERGOVERNMENTAL COOPERATION
AUTHORITY FOR HARRISBURG
TO THE GOVERNOR AND GENERAL ASSEMBLY



April 30, 2021

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DISCLAIMER

The statements, representations, and conclusions contained herein are those of the Intergovernmental Cooperation Authority for Harrisburg (the “Authority”), an independent public authority and instrumentality of the Commonwealth, and are done in conformity with the Intergovernmental Cooperation Authorities Act for Cities of the Third Class (“Act 124”), 53 P.S. § 42101, et seq. The unaudited statements of the Authority contain qualified opinions that are solely based upon the Authority’s review of previously created documents by others and the independent personal observations of the Authority. This is a required report under Act 124. The reporting of the Authority to the Commonwealth of Pennsylvania and its constituent parts has no bearing upon the previously produced and reasonable financial forecasts made by the City of Harrisburg. This report should be relied upon only insofar as it is a mandated requirement of the Authority under Act 124.

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EXECUTIVE SUMMARY.

The City of Harrisburg's financial condition is currently stable.

On March 10, 2021, pursuant to Act 124, the Authority approved the City's revised Five-Year Financial Plan. The plan projects a stable fiscal position, with a solid General Fund balance and relatively resilient revenues in spite of the global pandemic and economic crisis. It also provides for important initiatives, including funding for capital needs and restructuring debt obligations. However the plan also projects elevated levels of spending without demonstrating proper planning procedures, which the Authority has criticized.

The City is on the cusp of exit from Act 47 status. That and the essential planning necessary to navigate the City's finances into the future remain major focuses of the work of the Authority.

It is the opinion of the Authority that, with a push for results and accountability on the part of City management, the possibility of prosperity lies ahead.

The Authority emphasizes three themes to help advance the financial stability of the City:

1. sound financial management and reporting;
2. community and economic development; and
3. operational excellence.

The Authority continues to advise the City to develop and implement initiatives to address various issues affecting the City's progress to financial stability.

SOUND FINANCIAL MANAGEMENT AND REPORTING.

One of the Authority's top priorities is improvement of the City's financial management and reporting functions.

Director of Finance position remains vacant.

Since July 2020, the City's Director of Finance position has been vacant.

Independent Auditor identified numerous material weaknesses.

The City's Independent Auditor identified a number of material weaknesses and significant deficiencies in internal control over financial reporting and other matters, for which corrective action has not been completed. A "material weakness" is the most serious type of finding. Examples of findings are:

- For the second consecutive year, the Independent Auditor expressed a qualified opinion on major federal programs in the Single Audit Report.
- The City does not have adequate staffing to produce its financial statements in accordance with generally accepted accounting principles applicable to governmental entities (GAAP). The City should have the ability to produce GAAP financial statements.

- There were multiple findings for federal awards related to reporting, program income, equipment and real property management, allowability, and environmental review requirements. Failure to submit reports and plans by the required deadlines could jeopardize future funding.
- No physical inventory of capital assets has been taken since 2005.

We have urged the City to take immediate corrective action for all material weaknesses. The City has prepared an outline of responses, including remedied deficiencies and intended corrective actions, which was presented to the Authority.

Neighborhood Services Fund.

Created in 2016, the Neighborhood Services Fund (NSF) is a principal proprietary fund of the City. It accounts for the revenues and expenses associated with refuse collection and disposal. The NSF budget has historically relied on the use of fund balance for its capital needs and operating expenses. The City's Five-Year Financial Plan demonstrates a move to stabilization of the fund in 2025.

The City achieves a low collection rate on accounts receivable in the NSF. The City has committed to improve collection rates. The current collection rate is approximately 85%. Receivables on delinquent sanitation and disposal accounts as of January totaled over \$12 million.

Opportunities to restructure debt obligations.

In 2019 the City negotiated a debt restructuring with one of its key creditors, Ambac Assurance Corporation ("Ambac"). However the settlement was not concluded. Throughout 2020, negotiations resumed with Ambac. The City and Ambac reached a new agreement, which is now anticipated to be concluded in 2021. The settlement is expected to reduce the City's debt obligations and ultimately generate recurring budgetary savings and preserve fund balance. We believe it is a major step towards re-establishing the City's credit rating and re-gaining access to credit markets.

Special taxing powers extended.

Under Act 47 and Act 124, the City imposed a Local Services Tax (LST) and Earned Income Tax (EIT) at rates higher than otherwise allowed by law. These special taxing powers were slated to expire in 2024. In November 2020, the Commonwealth enacted amendments to the State Fiscal Code extending these special taxing powers. This will allow the City more flexibility with fiscal planning as the City can now count on those revenues for future financial planning. In 2020 these special taxing powers accounted for approximately 20% of the City's General Fund revenue.

COMMUNITY AND ECONOMIC DEVELOPMENT.

Key to securing the City's long-term health is expanding its economic base and the growth of its own local tax revenues.

Commitment to community and economic development.

The City does not currently have a Community and Economic Development Plan. The City has communicated that it will partner with community stakeholders to develop an economic development

strategic plan. We are hopeful for the opportunity to report progress in the future on a Community and Economic Development Plan for Harrisburg.

Impact of COVID-19.

The City's economic development efforts for much of 2020 were focused on helping the local business community cope with COVID-19 related pressures and hardships.

Currently the City awaits guidance on anticipated American Rescue Plan funding which is likely to be substantial.

New Comprehensive Plan in process.

City Council is in the process of conducting community-wide input sessions on the Harrisburg Planning Commission approved 2020 Comprehensive Plan. Final review and official adoption is expected in early 2021.

OPERATIONAL EXCELLENCE.

The City's full financial recovery will benefit from additional improvement with operational issues.

Communication and cooperation.

Historically, communications with City management have run hot and cold, with challenges of communications and cooperation culminating in the disapproval of the City's Five-Year Financial Plan in December 2020 and certification of noncompliance to the Secretary of the Budget in January 2021. That event triggered a reset in communications, and the certification was subsequently withdrawn.

Compliance for major federal programs.

The City's Independent Auditor expressed a qualified opinion on compliance for major federal programs in the Single Audit Report dated February 18, 2021. The Independent Auditor also identified additional findings for other instances of noncompliance and internal controls over compliance.

Information Technology infrastructure.

The City operates legacy Information Technology infrastructure with unsupported hardware and software that has the risk of failing at any point. The City's mainframe infrastructure is more than 30 years old.

The Authority believes the City is making significant strides to address its issues with legacy IT infrastructure and moving in the right direction. The City projects nearly \$1.5 million in IT capital projects over the next four years. These projects will allow the automation of certain time-consuming processes which are currently manual or maintained off system, as well as improve internal controls for the City.

Proper planning procedures.

The Authority has criticized the abrupt increase of budgeted employee headcount for fiscal year 2021 in the 2020 Five-Year Financial Plan (an increase of 36.5 FTEs or 8% from the prior plan projection for fiscal year 2019). The prior year plan projected stable employee numbers going forward, so this increase was unexpected.

In 2020 the City announced a new division within the Bureau of Police without detailed budgets, descriptions, and measurable outcomes that the new spending aims to achieve. The Authority has advised the City to include more description on strategy and benchmarks for this new service initiative.

Performance measurement.

The City does not practice systematic performance measurement. We believe implementing an effective system of performance measurement will enhance the efficient management and fiscal recovery of the City.

BACKGROUND.

The Intergovernmental Cooperation Authority for Harrisburg (the “Authority”) is a public authority and instrumentality of the Commonwealth of Pennsylvania. The Authority was created for the general purpose of fostering the fiscal integrity of the City of Harrisburg.

The Authority has prepared this report pursuant to Section 203(b)(4) of the Intergovernmental Cooperation Authorities Act for Cities of the Third Class (Act of October 24, 2018, P.L. 751, No. 124) (“Act 124”).

Act 124 confers upon the Authority specific duties, including the following:

To prepare an annual report within 120 days after the close of the assisted city’s fiscal year to the Governor and the General Assembly describing the assisted city’s financial condition and the authority’s progress with respect to restoring the financial stability of the assisted city and achieving balanced budgets for the assisted city. An annual report shall be signed by the chairperson of the board and shall:

(i) Be submitted to the Governor, the presiding officers of the Senate and the House of Representatives, the chairperson and minority chairperson of the Appropriations Committee of the Senate and the chairperson and minority chairperson of the Appropriations Committee of the House of Representatives and the governing body, chief fiscal officer and controller of the assisted city. The report shall be publicly available in the assisted city during normal business hours for public inspection, shall be posted on the authority’s publicly accessible Internet website and may be provided to a member of the public upon request at a cost not to exceed commercial costs of reproduction.

(ii) Clearly show by consistent category the last five years of operating revenues and expenditures, capital expenditures, gross and net indebtedness transactions, including a schedule of principal and interest, five-year projections of the assisted city’s operating and capital budgets and the entire projected indebtedness transactions, including a schedule of principal and interest of the indebtedness until any and all debt has been completely retired.

(iii) Contain a narrative explaining progress of the assisted city in meeting its annual and five-year budgetary objectives, an appraisal by the authority of the progress the assisted city is making to achieve its goals and an appraisal of the extent to which the assisted city is making a good faith effort to achieve its goals.

(iv) Disclose any violations of Federal and State law that the authority may have discovered.

(v) Include as appendixes all historical loans or other contracts entered into by the assisted city and its corporate entities.

In preparing this document, the Authority draws from previously published reports and studies by others, including:

- The City of Harrisburg's 2020 Five-Year Financial Plan dated March 10, 2020.
- The City of Harrisburg's Comprehensive Annual Financial Report for FY2019.
- The City of Harrisburg's Approved 2021 Budget.
- The Act 47 Recovery Coordinator's Quarterly Status Reports.
- The City Controller's Monthly Revenue and Expenditure Reports.
- The Harrisburg Strong Plan, as revised.
- Independent Auditor's reports for 2019 by Boyer & Ritter dated February 18, 2021.
- Interviews with public officials and other stakeholders and their generous allowance of time.

APPRAISAL OF THE CITY'S PROGRESS.

From 2012, when the City was placed in receivership, to date, on the cusp of emerging from the Act 47 program for distressed municipalities, the City has made significant progress: approaching sustainable and balanced operating budgets, building a fund balance reserve, funding capital projects, and increasing service levels. Despite these significant accomplishments, much work remains to be done to meet the objective of achieving financial stability. The Authority members have articulated issues and areas of concern that we have asked the City to address as we move forward toward progress.

The Authority is currently focused on a specific set of issues affecting the City's progress to financial stability.

ISSUE #1: INTERGOVERNMENTAL COOPERATION AGREEMENT.

Act 124 provides that the Authority and the City may enter into an intergovernmental cooperation agreement. An agreement will formalize key terms of the working relationship between the Authority and the City, as we work together to foster the fiscal integrity of Harrisburg. Once approved by the Authority, the Mayor, ratified by City Council, and authorized by Commonwealth Court, an agreement would allow the distressed status of the City under the Municipalities Financial Recovery Act ("Act 47") to terminate.

The Authority continues our efforts to enter into an intergovernmental cooperation agreement with the City. In our 2020 report, we reported that:

The Authority has been frustrated in our efforts to enter into an intergovernmental cooperation agreement with the City. The City has not made good faith efforts, as evidenced by Mayor Eric Papenfuse's refusal of a negotiating session.

We are pleased to report negotiations on the Agreement resumed on February 8, 2021. A draft of the Agreement was submitted by the City Solicitor, Neil Grover, to City Council on April 27, 2021. It was approved by Council, and the ICA was so notified. Notification by the City to the ICA included a request that the Agreement not be executed until such time as Commonwealth Court had reviewed pending legal matters that could be affected by the City's exit from Act 47. The ICA is granting that request and expects that the Agreement, which is mutually agreed to already by the parties, will be fully executed as soon as the Commonwealth Court's review of related matters has concluded.

ISSUE #2: COMMUNICATION AND COOPERATION.

The Authority believes Act 124 presents a valuable opportunity to engage the leaders of our Commonwealth and present an alignment of vision between the Authority and the City. Historically, communications with City management have run hot and cold, with challenges of communications and cooperation culminating in the disapproval of the City's Five-Year Financial Plan in December 2020 and certification of noncompliance to the Secretary of the Budget in January 2021. That event

triggered a reset in communications, and the certification was subsequently withdrawn (see discussion below).

Communications between the Authority and the City are facilitated by the City's *ex officio* member of the Authority board. In July 2020, at the departure of the City's former Director of Finance, City Solicitor Neil Grover, Esq. was designated to serve as the City's *ex officio* member. Subsequently in February 2021, Dan Connelly was named to replace Mr. Grover as the City's designee. Mr. Connelly is Senior Advisor with Marathon Capital Strategies, and in that role he advises the City in its fiscal affairs. Since his designation to the board, Mr. Connelly communicates regularly with the Authority.

ISSUE #3: CITY'S FIVE-YEAR FINANCIAL PLAN.

Under Act 124 the City is required to develop, implement, and periodically revise a financial plan.

Initial Five-Year Financial Plan.

On May 29, 2019, the Authority approved the initial Five-Year Financial Plan submitted by Mayor Eric Papenfuse to the Authority for our review. The plan includes an introduction, historical financial results, a capital improvements budget, baseline financial forecasts, and a narrative entitled "Path Forward." In addition, a supplemental Capital Improvement Plan and the existing 2019 Budget were provided.

2020 Five-Year Financial Plan

The Authority approved the 2020 Five-Year Financial Plan on March 10, 2021. The late stages in the path to final approval were tortuous and bear some elaboration.

The filing deadline for the 2020 Five-Year Financial Plan was extended by mutual agreement, multiple times, until December 14, 2020. On October 30, 2020, the Assisted City submitted a draft of its proposed plan. On November 24, 2020, the Authority transmitted a review letter to the Assisted City, and on December 2, 2020, the Authority held a public hearing on the draft plan. We note that the special meeting for December 2 was scheduled at the request of Mayor Papenfuse, but neither he nor any representative of City management attended.

On December 14, 2020, the City submitted and certified its proposed Financial Plan. At its public meeting on December 16, 2020, the Authority reviewed the proposed plan for conformance with the criteria set forth in Act 124, and with consideration for components that will eliminate projected deficits, implement sound budgetary practices, and provide procedures to avoid a fiscal emergency condition in the future. At that same meeting, the Authority took action to disapprove the proposed Financial Plan, set in context of recommended changes and offering a further extension.

Following such disapproval the City was required to submit a revised plan to the Authority. Instead, the City, through outside legal counsel, objected to the reasons for disapproval, and stated the City would not be forwarding a revised plan.

Accordingly, due to the City's failure to submit a revised plan, the Authority was required under Act 124 to certify the City's noncompliance to the Secretary of the Budget, the President pro tempore of the Senate and the Speaker of the House of Representatives, which was done on January 28, 2021.

Following the certification of non-compliance, Authority members held additional discussions with City administration on resolving the impasse and finding a path toward removal of the certification. On February 19, 2021, the Authority received a submission of the revised 2020 Five-Year Financial Plan. On February 24, 2021, at its regularly scheduled meeting the Authority Board acted to accept it retroactively as a good faith effort and certify the City's compliance.

The revised plan was reviewed by the Authority and approved on March 10, 2021.

2021 Five-Year Financial Plan

Authority staff and City representatives have been meeting on the parameters and content of the 2021 plan, due for submission to the Authority on April 30, 2021. The City expects to meet the deadline.

Meanwhile, a number of significant issues still exist in the 2020 Five-Year Plan that may be addressed in the 2021 revision:

- *Effect of COVID-19.* COVID-19 represents significant service delivery, budgeting, and administrative challenges. In general, the 2020 plan update continues deferral of projected recovery from such challenges into 2022.
- *Summary of Principal Funds.* The Authority acknowledges, and has communicated to the City, the dual needs of working to meet GASB accounting standards and GAAP reporting standards, and of addressing accounting and procedural matters contained in the findings of the 2019 audit.
- *Transfers from Other Funds.* The plan document indicates that funds transferred to the General Fund from the Neighborhood Services Fund (NSF) have stopped. It also notes no intent for the Neighborhood Services Fund to compensate the General Fund for back office operations after 2021. Given there are likely other indirect costs borne by the General Fund, such as billings and collection staff, supervisory staff, and general overhead, the Authority urges the City to estimate of these costs and make a policy determination to reimburse the General Fund at an appropriate level.
- *Improve Collection Rates in the Neighborhood Services Fund.* The City collects approximately 85% of current billings for sanitation and disposal accounts. The City has indicated that it will build on its efforts to improve on its collections by 3% in 2022 and an additional 5% in 2023. The Authority has encouraged the City to accelerate this timeline.
- *Headcount of employees.* The 2020 Plan increases FTEs by 36.5, an 8% increase from the 2019 plan. Given that the majority of these positions will fall within collective bargaining units, the Authority has encouraged long range cost calculations.
- *New Division.* A Community Services Division was unveiled in the 2021 budget but lacks an adequate description on strategy and benchmarks of the division.

- *Debt Refinancing Alternatives.* The Authority awaits the final decision from the City as to how to address the debt: prepayment, defeasance, consolidation or a combination of all three.

Annual submission of Five-Year Financial Plan.

Pursuant to Act 124 the City is required to prepare and submit its proposed Five-Year Financial Plan to the Authority annually, at least 100 days prior to the beginning of the City's fiscal year or on another date as the Authority may approve.

On November 20, 2019, the Authority granted an extension to the annual submission deadline until April 30 of each year. This extension was granted at the City's request in light of available staffing and competing reporting obligations throughout the year.

It is therefore anticipated that the City will submit to the Authority the 2021 plan on April 30, 2021.

ISSUE #4: COMMUNITY AND ECONOMIC DEVELOPMENT.

The Authority is interested in a comprehensive approach to community and economic development. It is the City's responsibility to formulate and implement such a plan. The Authority will advise, assist, and be a partner to the City.

Community and Economic Development Planning.

The City does not currently have a Community and Economic Development Plan. The City has communicated that it will partner with community stakeholders to develop an economic development strategic plan.

The City's economic development efforts for much of 2020 were focused on helping the local business community cope with COVID related pressures and hardships.

The City has a Local Economic Revitalization Tax Assistance (LERTA) program. The City reports that in its current form, it has not proven to be a largely effective tool for encouraging major redevelopment projects in Harrisburg. In order for the City to realize some of the benefits that the LERTA program hoped to encourage such as elimination of blight and significant redevelopment, the program may require modifications.

Key to securing the City's long-term health is expanding its economic base and the growth of its own local tax revenues. We are hopeful for the opportunity to report progress in the future on a Community and Economic Development Plan for Harrisburg.

New Comprehensive Plan in process.

The City is in the process of completing the review and update of its Comprehensive Plan and planning and zoning criteria. A required 45-day review period of the Comprehensive Plan recently ended. City Council will review and adopt the plan early in 2021. City Council is currently guiding community-wide input sessions.

ISSUE #5: FINANCIAL MANAGEMENT AND REPORTING.

One of the Authority's top priorities is the improvement of the City's financial management and reporting functions.

Director of Finance position remains vacant.

Since July 2020, the City's Director of Finance position has been vacant. This vacancy deprives the City of critical financial management and leadership and can have potentially severe consequences to the basic administration of the City. The City has advertised and conducted interviews for this position, and the Authority and the City share frustration in the time it is taking to find a qualified candidate.

Material weaknesses and significant deficiencies.

The City's Independent Auditor, in its audit findings issued on February 18, 2021, identifies a number of material weaknesses and significant deficiencies in internal control over financial reporting and other matters, for which corrective action has not been completed. A "material weakness" is the most serious type of finding. Select highlights of the findings include:

- For the second consecutive year, the Independent Auditor expressed a qualified opinion on major federal programs in its Single Audit Report.
- The City does not have adequate staffing to produce its financial statements in accordance with generally accepted accounting principles applicable to governmental entities (GAAP). The City should have the ability to produce GAAP financial statements. This is a repeat finding.
- There were multiple findings—including four (4) repeat findings—for federal awards related to reporting, program income, equipment and real property management, allowability, and environmental review requirements. As an example, the City did not timely complete and file all required reports for the CDBG program for the years ended December 31, 2018 and 2019. Failure to submit reports and plans by the required deadlines could jeopardize future funding.
- As previously noted in the December 31, 2007 through December 31, 2018 audits, no physical inventory of capital assets has been taken since 2005.

We have urged the City to take immediate corrective action for all material weaknesses. The City has prepared an outline of responses, including remedied deficiencies and intended corrective actions, which was presented to the Authority.

Inability to practice GAAP accounting.

The City practices a form of cash-based accounting for its regular operations and does not have the ability at a staff level to produce financial statements in accordance with generally accepted accounting principles applicable to government entities (GAAP).

The Authority has advised that the ability to maintain accounting and render financial reports in a manner consistent with GAAP standards is a crucial tool for management and others to know the City's financial position on a real-time, day-to-day basis.

The Authority believes this matter may be addressed in the Intergovernmental Cooperation Agreement now pending between the Authority and the City. We note that the City is in the process of upgrading its IT systems, which will better position the City to implement accounting practices and standards in accordance with GAAP.

Neighborhood Services Fund.

Created in 2016, the Neighborhood Services Fund (NSF) is a principal proprietary fund of the City. It accounts for the revenues and expenses associated with refuse collection and disposal.

The NSF budget has historically relied on the use of fund balance for its capital needs and operating expenses. The City's Five-Year Financial Plan demonstrates a move to stabilization of the fund in 2025.

The City achieves a low collection rate on accounts receivable, a matter the Authority has reviewed with the City on a regular basis. The Authority has urged the City to improve collection rates. The current collection rate is approximately 85%. Receivables on delinquent sanitation and disposal accounts as of January totaled over \$12 million.

The City has set a goal of improving its collection rate by 3% to 88% by 2022, and an additional 5% to 93% by 2023. The Authority has suggested accelerating this timeline.

In 2018 the City wrote off approximately \$9 million in receivables on delinquent sanitation and disposal accounts. The Authority has requested a commitment to address arrearages in collections with additional detail including specific strategies and incentives for past due accounts and benchmarks.

In recent years the City has reduced administrative transfers from the NSF to the General Fund, previously intended to recognize City indirect costs for administration of the NSF, to help cover projected operating deficits in the NSF. As noted previously, the Authority has recommended review of those costs and the advisability of resuming those transfers.

2020 Year-End Budget to Actual.

For the year ending December 31, 2020, budgetary General Fund balance was \$29.5 million, an increase of \$5.2 million from the prior year balance of \$24.3 million.

Total General Fund revenue was \$65.2 million. This represents a \$3.5 million or 5.2% decrease from 2019. It was \$12.4 million less than the year-end amended budgeted amount of \$77.6 million.

Total General Fund expenditures plus year-end encumbrances was \$64 million, \$13.5 million less than the year-end amended budgeted amount of \$77.6 million.

For the year ending December 31, 2020, the Neighborhood Services Fund (NSF) balance forecast was \$6.94 million, a decrease of \$820,000 from the prior year balance of \$7.76 million.

Total NSF revenue was \$15.8 million, and expenditures plus year-end encumbrances was \$17.6 million, resulting in a \$1.7 million deficit.

The following is a summary of the City Controller's Budget to Actual revenue and expenditures report.

STATEMENT OF ACTUAL AND BUDGETED REVENUE FOR THE PERIOD ENDED DECEMBER 31, 2020			
	Adjusted Budget	YTD Revenue	Variance
Total General Fund	\$ 77,616,853	\$ 65,212,518	\$ (12,404,335)
Total Capital Projects Fund	12,846,977	3,538,865	(9,308,112)
Total Debt Service Fund	15,273,638	10,083,351	(5,190,287)
Total State Liquid Fuels Tax Fund	3,372,231	1,422,384	(1,949,847)
Total Neighborhood Services Fund	19,716,340	15,883,785	(3,832,555)
Total Harrisburg Senators Fund	674,690	506,780	(167,910)
Total Other Funds	<u>2,225,099</u>	<u>851,688</u>	<u>(1,373,411)</u>
Grand Total	<u>\$ 131,725,828</u>	<u>\$ 97,499,371</u>	<u>\$ (34,226,457)</u>

STATEMENT OF ACTUAL AND BUDGETED EXPENDITURES FOR THE PERIOD ENDED DECEMBER 31, 2019			
	Amended Budget	Expenditures + Encumbrances	Available Budget
Total General Fund	\$ 77,616,226	\$ 64,076,196	\$ 13,540,031
Total Capital Projects Fund	12,846,977	3,741,667	9,105,310
Total Debt Service Fund	15,273,638	10,073,638	5,200,000
Total State Liquid Fuels Tax Fund	3,372,231	1,558,256	1,813,975
Total Neighborhood Services Fund	19,716,340	17,607,799	2,108,541
Total Harrisburg Senators Fund	674,690	646,552	28,138
Total Other Funds	<u>2,233,497</u>	<u>835,830</u>	<u>1,397,667</u>
Grand Total	<u>\$ 131,733,599</u>	<u>\$ 98,539,938</u>	<u>\$ 33,193,662</u>

2020 Fiscal Matters

On November 24, 2020, the Commonwealth enacted amendments to the State Fiscal Code, adopted as part of the Commonwealth's mid-year budget revisions. The amendments include provisions to resolve a looming deadline for the temporary taxing authority given to the City of Harrisburg as part of the exit strategy from its Act 47 fiscal distress status.

The provisions extend Harrisburg's ability to levy an enhanced Local Services Tax (LST) on all people who work in the city for 15 years; the first 10 years at \$3-per-week, or \$156 and for the five years after that, not to exceed \$2-per-week, or \$104. After that, it would revert to the same \$1-per-week rate that

generally applies to municipalities statewide. It also permits the city to retain its 2% Earned Income Tax (EIT) on city residents in perpetuity, which is double the rate permitted in other Third-Class Cities throughout the Commonwealth.

The authorizations for both the LST and EIT were previously set to expire in 2025.

This extension of the taxing authority will allow the City much more flexibility while fiscally moving forward as the City will no longer have the great concern of these taxing sources ending abruptly. The City can now count on those revenues for future financial planning.

2021 Budget

The budget for total expenditures across all City funds for 2021 is \$136.5 million, an increase of \$16.5 million or 13.7% from the prior year. The following are highlights of the budget.

- General Fund Expenditures of \$79,506,034, compared to \$74,317,446 in the prior year (an increase of \$5,188,587 or 7%). This includes a fund balance appropriation of \$15.2 million.
- Neighborhood Services Fund (NSF) Expenditures of \$17,956,800, compared to \$17,474,305 in the prior year (an increase of \$482,495 or 2.8%). This includes a fund balance appropriation of \$1.77 million.
- Capital Expenditures of \$24,603,166 across all funds.
- Defeasance of Series 2005A-2 Bonds with a gross cost of approximately \$6.0 million.
- Ambac Forbearance Liability Prepayment of \$2,000,000.
- Decrease in General Fund Balance of \$15,190,034.

Variation due to impact of COVID-19.

At the time of this writing, we note the ongoing and as yet unresolved impact of COVID-19 on City finances and services. The City has disclosed that the budgeted spending plan and revenue projections for 2021 may be impacted due to the ongoing pandemic and economic crisis. The variations cannot be confidently forecast at this time.

Another significant financial, services and administrative matter for the City will be allocation and administration of Federal American Rescue Act funds, both direct receipt and through the Commonwealth. Funding amounts are substantial, potentially the equivalent of more than half of the City's general fund budget. While the City is working on initial plans for their expenditure, like all state and local governments nationwide it is hampered by incomplete and delayed federal guidance on their allowable expenditure. The amounts represent potentially significant infrastructure and economic development opportunities, but at the same time require administrative overhead for efficient and timely use as well as strict compliance to avoid any potential for penalty or payback.

Authority role in budgets and financial plans.

Once there is a finalization of our intergovernmental cooperation agreement and the associated exit of the City from Act 47 distressed status, the Authority anticipates a greater role in the construction of budgets and plans. The Authority has a statutory responsibility to consult with the City and make recommendations concerning the City's budgetary and fiscal affairs.

ISSUE #6: PROGRAM MANAGEMENT WITH FEDERAL FUNDING.

The City's independent auditors identified a number of material weaknesses and significant deficiencies with the City's management of federal funding. As a result the auditors expressed a qualified opinion in their Single Audit report.

The Authority believes it is a matter of utmost urgency to rectify these audit findings and maintain access to federal funding. The City has prepared an outline of responses, remedied deficiencies and intended corrective actions, which was presented to the Authority.

ISSUE #7: INFORMATION TECHNOLOGY INFRASTRUCTURE.

The City operates legacy Information Technology infrastructure with unsupported hardware and software that has the risk of failing at any point. The City's mainframe infrastructure is more than 30 years old.

\$250,000 was earmarked in the 2020 Budget to replace the "DCIT" and "DREV" Systems but this was not accomplished. The system replacements are now projected to cost \$500,000 and be accomplished by 2022. The project will replace the current mainframe City system (DCIT) and Revenue system (DREV) with an industry standard system developed by a reputable vendor. Also, it will allow the automation of certain time-consuming processes which are currently manual or maintained off system. The City has begun the process of vendor selection for this project.

Additional systems identified for replacement are its "DPER" System, network switching equipment, and data center equipment, at a budgeted cost of \$750,000.

These system replacements will also have the benefit of improving internal controls for the City. Currently the City has segregation of duties issues noted in the Bureau of Information Technology where staff have control over multiple IT functions. In effect, opportunities exist for undetected intentional or unintentional errors in the City's processes, as well as penetration of the system by outside actors. City management recognizes its limited resources to maintain the legacy mainframe systems, which does hamper the ability to achieve a good segregation of duties among all City functions.

The City's Independent Auditor has transmitted additional recommendations to City management on strengthening the City's IT functions. These recommendations include:

- Developing formal program change and system change control policies and procedures;
- Providing IT employee training;

- Developing a technology disaster recovery plan for the City’s network servers;
- Restoring IT system backups periodically; and
- Creating a policy for use of the City’s Virtual Private Network (VPN).

The Authority believes the City is making significant strides to address its issues with legacy IT infrastructure and moving in the right direction.

In 2019-2020 the City implemented a system allowing it to backup all mainframe systems and data to virtual tapes and replicate them to a data center in Altoona, Iowa, for disaster recovery purposes. This is a significant accomplishment, as the City’s last disaster recovery services contract was terminated in 2012.

The City is implementing disaster recovery and redundancy capabilities for its open systems environment and anticipates completing it in 2021.

ISSUE #8: DEBT LOAD AND RESTORING ACCESS TO CREDIT MARKETS.

The City currently does not have an investment grade credit rating. Key to the City’s long-term viability is access to the debt markets to fund capital projects and other deferred maintenance needs. To that end, the City should endeavor to restore an investment grade credit rating to build standing with investors and minimize borrowing costs.

Negotiations with Ambac Regarding Series 1997 D and F Bonds.

In 2019 the City negotiated a forbearance liability prepayment with one of its key creditors, Ambac Assurance Corporation (“Ambac”). The terms provided that the City would make a significant paydown of its existing debt liability, in exchange for certain concessions from Ambac. In December 2019, the Authority endorsed the City’s term sheet. However the settlement was not concluded.

Throughout 2020, negotiations resumed with Ambac regarding a settlement. Harrisburg and Ambac reached a new agreement regarding the City’s Series 1997 D& F General Obligation Bond forbearance liability and the Harrisburg Redevelopment Authority Series 2005A-2 Bonds (“Series 2005A-2 Bonds”), which are guaranteed by the City. The agreement requires the City to defease the Series 2005A-2 Bonds in exchange for a material reduction in the forbearance liability related to the Series 1997D&F General Obligation debt. The agreement also involves a temporary reduction in the interest rate applied towards the liability and an optional upfront prepayment from the City towards the forbearance liability, in exchange for additional credit towards the overall liability. Finally, the agreement lays the groundwork to refinance debt and finance the Series 2005A-2 Bond defeasance, the net result of which will generate recurring budgetary savings and preserve fund balance.

The Authority continues to believe this is an excellent step for the City. The Authority supports City efforts to find ways to allocate additional funds toward debt prepayment. The Authority believes it is a major step towards re-establishing the City’s credit rating and re-gaining access to credit markets.

Series 1997D&F General Obligation Bonds

In 1997, the City issued its Series D&F Bonds to advance refund its Series 1997 B-1 Bonds and currently refund its Series 1995 Bonds. The Series 1997 D&F Bonds are capital appreciation bonds and not subject to redemption prior to maturity. Financial Guaranty Insurance provided credit enhancement on the bonds, which is now Ambac Assurance Corporation (“Ambac”).

In 2012, facing severe financial distress, the City defaulted on the bonds and the insurer agreed to make scheduled principal and interest payments on the bonds. The City and Ambac entered into an amended settlement agreement in April 2013 under which the City’s forbearance liability accrues interest and is scheduled to be repaid over a ten-year period from 2023 to 2032.

Issue	Amount Outstanding/ Accreted Value†	Purpose	Call Date	Maturity	Coupon Rate	Enhancement
Series 1997D (Capital Appreciation Bonds)	\$3,076,324	Advance refunding	Non-callable	2022	Zero coupon	Ambac
Series 1997D (Capital Appreciation Notes)	\$12,852,163	Current refunding	Non-callable	2022	Zero coupon	Ambac
Series 1997D&F Forbearance Liability	\$25,454,829	Repay draws on enhancement facility	Any time	2032	6.75%	N/A

† As of March 15, 2021.

ISSUE #9: LABOR AGREEMENTS.

Salaries and wages, are the largest component of personnel costs, representing 56% of these expenses and 37% of all General Fund expenses. (Overall compensation costs would reflect a much greater percentage.) As described below, in 2020, the City and the Fraternal Order of Police Capital City Lodge No. 12 (“FOP”), ratified a new collective bargaining agreement that runs through 2025 and includes regular salary increases based on a fixed pay scale determined by years of service and job classification. Based on the pay scale and anticipated staffing levels, the City projects average annual salary increases of less than 2%.

Per its collective bargaining agreement, salaries for the International Association of Firefighters, Local No. 428 (“IAFF”) union members will increase 2% annually through 2022. The projections assume 2% increases in 2023 and 2024.

The City and the American Federation of State County and Municipal Employees District Council 90, Local 521 (“AFSCME”) have agreed to a 2% salary increase for 2021. The projections assume 2% annual increases through 2024.

Similarly, salary increases for non-represented employees will average 2% for 2021 and are projected to increase 2% annually through 2024.

In addition to salaries, overall compensation includes a wide variety of components, such as overtime, longevity pay, shift pay, special assignment pay, other cash premiums and bonuses, employer portion

of applicable payroll taxes, vacation, holidays, paid leave, active employee life insurance, and other miscellaneous fringe benefits.

As a result of the 2013 contract amendments, all full-time employees (represented and non-represented) were moved to the Basic Health Plan that previously had only been mandatory for non-represented City employees. In addition, all unions agreed their members would contribute towards the cost of health care premiums, as set forth below:

Tier of Coverage	FOP	AFSCME
	Percent of base salary effective 2020-2025	Percent of base salary effective 2021
Single coverage	2.5%	2.5%
2 person coverage	4.5%	4.5%
3 person coverage	5.5%	5.5%
4 or more person coverage	6.5%	6.5%

IAFF employees contribute towards their health insurance coverage at the rate of \$40 per biweekly pay for single coverage, and \$90 per biweekly pay for two or more person coverage.

The City self-insures for health insurance coverage, meaning it does not use a third-party provider for health insurance.

The City also provides for certain post-retirement health benefits for its represented employees. In recent contract negotiations, the bargaining units have agreed to change retirement benefits with respect to active employees and future (yet-to-be-hired) employees. All units agreed that future employees would not be entitled to receive post-retirement health care at the City's cost. All bargaining units agreed that active employees, upon their retirement, would be provided benefits at the same levels as active employees, and that such retiree coverages may be modified from time to time if similarly modified for active employees.

OPEB Trust

The Strong Plan mandated the City establish an OPEB (Other Post Employment Benefits) Trust and funded it with an initial \$3.2 million in escrow. At their March 23, 2021 meeting, City Council passed the OPEB Trust ordinance. The City is finalizing appropriate documents and the proceeds have been distributed for initial funding of the Trust.

Headcount of Employees

For 2021, Harrisburg is budgeted to employ 498.5 full-time employees, including 408.15 full-time equivalents budgeted to be paid out of the General Fund, 87.35 to be paid out of the Neighborhood Service Fund, and 3 paid from the Host Fee Fund..

The following table shows the number of budgeted 2021 full-time employees by employee group:

Employee Group	Covered Positions	2019 Budgeted Total FTEs	2021 Budgeted Total FTEs	Contract Expiration
Non-represented	Executive, management, confidential	96	112.5	N/A
FOP	All sworn police officers	149	151	December 31, 2025
AFSCME	All non-executive, non-management, non-confidential employees not otherwise covered in FOP or IAFF	135	149	December 31, 2021
IAFF	All firefighters, lieutenants, captains, battalion chief, and deputy chiefs	82	86	December 31, 2022
Total		462	498.5	

The Authority has criticized the abrupt increase of employee headcount in 2021 (an 8% increase from the 2019 plan). The prior year plan projected stable employee numbers going forward, so this increase was unexpected.

In 2020 the City announced a new Community Services Division within the Bureau of Police. The goals of the new division are laudable, but the formal presentations do not provide detailed budgets, descriptions, and measurable outcomes that the new spending aims to achieve. The Authority has advised the City to include more description on strategy and benchmarks for this new service initiative.

ISSUE #10: PRIVATIZATION INITIATIVES.

The City made a commitment to the Authority to explore possibilities of intergovernmental agreements with surrounding municipalities for police services, regionalized fire protective services, and solid waste and recycling collection and disposal service.

Neighborhood Services Fund.

In 2019 the City entered into an Intermunicipal Solid Waste Agreement with the Borough of Steelton to provide refuse collection and disposal services. In 2020, the City entered into similar service agreements with the neighboring boroughs of Paxtang and Penbrook. The City was unable to provide an analysis of the financial impact on the City’s operating and capital budgets prior to entering into these agreements.

City management eventually submitted a report on revenues and expenses related to the Steelton agreement in December 2020. It included obvious material misstatements and inaccuracies and contributed in part to the disapproval of the Five-Year Financial Plan.

As part of the submission of the revised Five-Year Financial Plan in February 2021, a revised report was prepared. The revised report projects net income of \$301,115 from these intermunicipal service agreements. We note though that indirect costs and overhead which are paid for out of the NSF and/or General Fund have not been accounted for (see previous indirect cost discussions in this report) and so the real benefit to taxpayers and ratepayers for these intermunicipal service agreements remains unknown.

ISSUE #11: INTERGOVERNMENTAL COOPERATION OPPORTUNITIES.

Key stakeholders.

The City's financial difficulties can best be addressed and resolved by cooperation with stakeholders. To foster cooperation and assist the financial recovery of Harrisburg, Authority members invest a significant amount of time engaging with key stakeholders. A non-exhaustive summary of key stakeholders is as follows.

- *City Management.* Authority members met regularly with Mayor Eric Papenfuse. A standing meeting with Mr. Papenfuse and Authority Chair Audry Carter and Vice-Chair Ralph Vartan was scheduled monthly, generally for the Monday prior to the Authority's board meeting. These meetings were seen as an opportunity to review the upcoming board meeting agenda, discuss Authority business, and foster cooperation. The last meeting took place on February 24, 2020. Mr. Papenfuse canceled the meetings for March and April to focus on community needs and the health emergency. The meetings have never resumed, although Mr. Papenfuse has met on an as-needed basis and attended a recent Authority meeting. City Business Administrator Marc Woolley has attended Authority meetings on request and communicated with Authority members and staff. Opportunities exist for further engagement between the Authority and City management.
- *City Council.* Authority members have met periodically with City Council President Wanda R. D. Williams and Vice-President Ben Allatt. These meetings are an opportunity to share information and opinions, discuss Authority business, and foster cooperation.
- *Act 47 Coordinator.* Act 47 Coordinator Marita J. Kelley assists in implementing the Harrisburg Strong Plan, monitors the City's cash flows on a bi-weekly basis, and files quarterly status reports with the Commonwealth Court as long as the City remains in Act 47 distressed status. She regularly sits in on the Authority meetings. We applaud Ms. Kelley for her valued service.
- *City Controller.* The office of City Controller Charlie DeBrunner assists the Authority to receive and interpret useful information regarding the City's finances, and to foster integrity in financial management and reporting. Mr. DeBrunner is knowledgeable about internal operations and helps to ensure the implementation of and adherence to prudent financial management policies and procedures. This office is a valued partner in the financial recovery for Harrisburg.
- *City Treasurer.* The office of City Treasurer Dan Miller assists the Authority to receive and interpret useful information regarding the City's finances, and to foster integrity in financial

management and reporting. Mr. Miller is focused on prudent financial management practices such as policies and solutions to increase the collection of receivables. This office is a valued partner in the financial recovery for Harrisburg.

- *Dauphin County.* Dauphin County is very supportive of the City's financial recovery. Numerous opportunities for cooperation exist to benefit the City's financial recovery. In the past, for example, the County has offered assistance with information technology operations for the City and regionalized solutions to critical public services like public safety and 911 dispatch. The Authority looks forward to exploring and facilitating further partnerships between these two vital bodies.
- *Impact Harrisburg.* Coming out of the Strong Plan, Impact Harrisburg primarily benefits Harrisburg by providing grants for City economic development and infrastructure projects that bolster Harrisburg's tax base, provide jobs for City residents and positively improve the operational efficiency of the City. Most recently, at the onset of the pandemic Impact Harrisburg launched and administered the Neighborhood Business Stabilization Program in concert with the City. The fund provides grants to small Harrisburg businesses.
- *Harrisburg Regional Chamber & CREDC.* The Harrisburg Regional Chamber & CREDC is a champion for Harrisburg and a key partner in the City's financial recovery. HRC/CREDC is equipped to engage in more opportunities for cooperation in the area of community and economic development.
- *Capital Region Water.* Capital Region Water was created in 2013 as part of the Strong Plan. It has vastly improved the quality of service being provided to the City's water and sewer customers. In 2015 CRW and the City entered into a partial consent decree to help reduce runoff pollution entering the Paxton Creek and Susquehanna River. CRW launched a program, dubbed "City Beautiful H2O," to restore failing infrastructure, reduce combined sewer discharges, improve the health of our local waterways, and beautify our neighborhoods through community greening. CRW is a vital partner in Harrisburg's financial recovery.
- *Additional stakeholders.* The Authority believes residents and businesses of the City are a vital part of the process of Harrisburg's financial recovery. The Authority has committed to holding Listening Sessions with these stakeholders in cooperation with the City.

Opportunities for cooperation.

As provided in Act 124, the Authority has recommended taking into consideration various opportunities for cooperation or merger of services with other public entities.

Through conversations with various stakeholders, Authority members have become aware of several opportunities that the City should re-visit.

- *Information Technology Infrastructure.* The City operates legacy IT Infrastructure that must be replaced. The Authority has advised the City to explore cooperation opportunities with Dauphin County in this area.

- *Public Safety.* The Authority is aware of past studies on the merits of regionalizing public safety as a way to create cost savings and improve service levels. The Authority has advised the City to explore cooperation opportunities with Dauphin County and suburban municipalities in this area.

OTHER MATTERS.

Listening Sessions.

The Authority has committed to holding Listening Sessions with residents and businesses of the City. Identified goals for this outreach include soliciting ideas for further consideration, and connecting individuals where appropriate to form an organized effort. The Listening Sessions will be organized in cooperation with the City. Given the current emergency declarations, the timeline for these sessions is up in the air.

Economic Development Symposium.

The Authority has committed to launch an initiative to establish an Economic Development Symposium for Harrisburg. It was envisioned as a way to collect best management practices and highlight them for the stakeholders in Harrisburg. The Authority secured a partnership with the Harrisburg Regional Chamber to help execute the event with an anticipated attendance of 300+ persons. Given the current emergency declarations, the timeline for this event is up in the air.

Cultural issues related to acceptance and expectation of errors.

The firm of Alvarez & Marsal conducted a high-level review following the arrest of the former City Treasurer. Their report, dated February 2016, identified a culture at the City where errors are accepted and expected. This was blamed on a variety of factors, including personnel shortages, the City's past fiscal problems and budget cuts, mistakes by previous City employees and administrations, and lack of competence or work ethic displayed by other current City employees. To further its progress to financial stability, City management needs to set a tone at the top and change the culture of acceptance and expectation of errors.

Litigation between the City and Authority.

In February 2020, the Authority was sued by The City of Harrisburg, Mayor Eric Papenfuse and Bruce Weber in Commonwealth Court alleging improper action by the Authority regarding an *ex officio* Board member. This assertion was and is disputed by the Authority. Despite numerous requests to the litigants to resolve this issue amicably, the litigation remains active. On January 7, 2021, Mayor Papenfuse and the City were dismissed as parties to the litigation as a result of the Authority's preliminary objections. The sole remaining Petitioner in the matter is Bruce Weber, who is no longer a municipal employee or an *ex officio* member of the Authority Board. The Authority believes the legal action is frivolous and will be adjudicated in the Authority's favor.

SUPPLEMENTAL INFORMATION.

FINANCIAL PRESENTATIONS.

Section 203(b)(4)(ii) of Act 124 provides that this report shall:

Clearly show by consistent category the last five years of operating revenues and expenditures, capital expenditures, gross and net indebtedness transactions, including a schedule of principal and interest, five-year projections of the assisted city's operating and capital budgets and the entire projected indebtedness transactions, including a schedule of principal and interest of the indebtedness until any and all debt has been completely retired.

Enclosed with this report is the City's Five-Year Financial Plan dated March 10, 2021, which contains several of the required financial presentations as of 2020.

VIOLATIONS OF FEDERAL AND STATE LAW.

Section 203(b)(4)(iv) of Act 124 provides that this report shall:

Disclose any violations of Federal and State law that the authority may have discovered.

The Authority has not discovered any violations of federal or state law except as may be discussed herein.

HISTORICAL LOANS OR OTHER CONTRACTS.

Section 203(b)(4)(v) of Act 124 provides that this report shall:

Include as appendixes all historical loans or other contracts entered into by the assisted city and its corporate entities.

There has been no new activity in this area and thus no new appendixes are included. The Authority is working with the City to assure that new agreements of major significance meet the requirements of the Act.