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'FISCAL CLIFF' THREATENS CITY

PG INVESTIGATION

Internal documents show shrinking tax revenues could drain city's bank accounts in just a few years

By Neena Hagen and Mike Wereschagin
Pittsburgh Post-Gazette

Just six years after emerging from state receivership, Pittsburgh again is barreling toward a "fiscal cliff" that could drain its bank accounts in only a few years, according to internal city documents obtained by the Pittsburgh Post-Gazette.

Key sources of tax revenue have been beset by a series of unprecedented challenges that are likely to cause them to shrink significantly or dry up altogether in coming years, imperiling cash flows that pay for critical services and support quality-of-life programs relied upon by the city's 300,000 residents.

The new tax revenue projections, detailed in a series of internal documents prepared by the city Controller's Office, are starkly at odds with the public

SEE **CITY**, PAGE A-7

Lucy Schaly/Post-Gazette

Toni Swick and her husband, Tom, put their home in North Sewickley, Beaver County, on stilts but that did not save their garage from the rising water of Connoquenessing Creek last week.

Sebastian Foltz/Post-Gazette

A hillside in West Virginia washed away at the Wheeling Mt. Zion Cemetery last week, plowing over dozens of headstones, some more than 100 years old. Grave vaults were believed to be secure.

A MESS LEFT BEHIND

Now, the real work has begun. After one of the worst weeks of flooding in two decades, residents of the Pittsburgh region are cleaning up the dirty and sometimes dangerous mess. Some areas along the region's rivers and creeks were hit harder than others. On the bright side, most major roadways have reopened, but some secondary routes are still blocked.

Stories, Pages A-4 & A-5

Sebastian Foltz/Post-Gazette

Mike McKinnis, 32, and Nikki Smith, 39, of Meadville, watch their step as they take a stroll Saturday along the mud-caked walkway encircling Point State Park. Water there had receded to below flood stage.

WITH EVERY BREATH

After tumultuous recall, breathing machine maker must launch new safeguards

Philips and DOJ reach deal on CPAPs

By Michael Korsh and Evan Robinson-Johnson
Pittsburgh Post-Gazette

Philips Respironics must hire an independent safety monitor, undergo regular facility inspections for at least five years and pay part of its revenue to the federal government under an agreement with prosecutors filed in federal court in Pittsburgh on Thursday that caps one of the most catastrophic medical device recalls in decades.

The company also will have to undergo a review of its testing on the millions of replacement sleep apnea machines it sent to customers after the old ones were recalled in 2021.

POST-GAZETTE, PROPUBLICA INVESTIGATION

The consent decree with the Justice Department comes nearly three years after Philips acknowledged that an industrial foam fitted inside its widely used sleep apnea machines and ventilators to reduce noise could degrade and release toxic particles and fumes into masks worn by patients.

A Pittsburgh Post-Gazette and ProPublica investigation last year found the medical device giant had withheld thousands of complaints about the degrading foam for more than a decade before warning its customers — including medically vulnerable patients, such as infants and the elderly — about the dangers.

The news organizations also revealed that a new, silicone-based foam that the company used in the replacement machines was also found to emit dangerous chemicals, including formaldehyde, a known carcinogen.

Though Philips maintained that the new foam was safe, scientists involved in the testing raised alarms, and the Food and

SEE **PHILIPS**, PAGE A-8

It's eclipse mania as big crowds flock to Erie

By Neena Hagen and Jacob Geanous
Pittsburgh Post-Gazette

2024 ECLIPSE

ERIE, Pa. — Two days before the long-awaited total solar eclipse — likely the largest tourism event in Erie's history — the city was already seeing a deluge of visitors.

Long lines outside hotels. Restaurants teeming. Parking lots full of cars from all over the country.

"The most people we've ever had at an event in Erie," Mayor Joe Schember said Saturday.

On April 8 at 3:16 p.m. the moon will cover the sun completely for 3 minutes, 41 seconds, marking the first total solar eclipse in Erie in more than 50 years, with another one not expected until 2144. Tens of thousands of people have begun to inundate Erie for the literal once-in-a-lifetime event.

Early Saturday, a section of Downtown Erie was blocked off for a street fair for local vendors and business owners, who said the eclipse has brought with it an influx of interest in all things Erie.

Tony DiPasqua, the 36-year-old owner of Lake Erie Variety, which has been selling eclipse-themed clothing among other

SEE **ECLIPSE**, PAGE A-6

Benjamin B. Braun/Post-Gazette

Copper Carriage Spring Market in Erie was crowded on Saturday with people visiting the city ahead of Monday's total solar eclipse.

Weather
Daytime high, 58; tonight's low, 42.
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Internal documents warn Pittsburgh faces an impending 'fiscal cliff'

Lucy Schaly/Post-Gazette

Internal city documents predict key sources of city tax revenue will dwindle in coming years, potentially draining the city's reserve fund and imperiling cash flows that pay for crucial city services.

CITY, FROM A-1

financial picture presented by Mayor Ed Gainey's administration, whose five-year plan projects a healthy bank account balance of between $83 million and $160 million during that span.

The administration's projections fail to take into account a multimillion-dollar drop in property tax revenue driven by cratering Downtown real estate values. The mayor's estimates also rely on two key streams of revenue — interest income that's been massively increased in recent years by federal COVID aid and a tax on visiting athletes and performers— that could dry up as soon as this year.

Controller Rachael Heisler last month sent a letter to the mayor and members of City Council warning of a potential impending financial crisis, but the dire revenue forecasts behind that alert offer far greater detail than anything previously reported.

"Without intervention, these figures will quickly put the city in a net operating deficit for the foreseeable future," according to one controller report, titled "How We Got Here: The City of Pittsburgh's Impending Fiscal Cliff."

If that happens, one-time bailouts won't be enough, the report warns.

In the early 2000s, a similar problem — a tax structure that didn't bring in enough money to cover expenses — forced the city to lay off hundreds of workers, close key facilities including a police station and cut services it had provided for decades.

That crisis, which had been more than a decade in the making, led the state to declare the city financially distressed under Act 47, triggering years of oversight of Pittsburgh's finances. The city regained its autonomy in 2016 after sweeping changes to its taxing and spending, and an infusion of additional revenue.

But the recent hits in property tax revenues and other income streams pose threats that have not been seen in years.

"It's all getting worse. We're heading right back to a structural deficit," said Ann Dugan, who served on the Intergovernmental Cooperation Authority, a board created by state lawmakers in 2004 to help control Pittsburgh's spending. The board has since been dissolved.

In the most likely scenario laid out in the controller's documents, Pittsburgh's reserve fund — a pool of cash set aside to cover budget deficits — will run out of money sometime in 2027 and be almost $60 million in the red by the end of the following year.

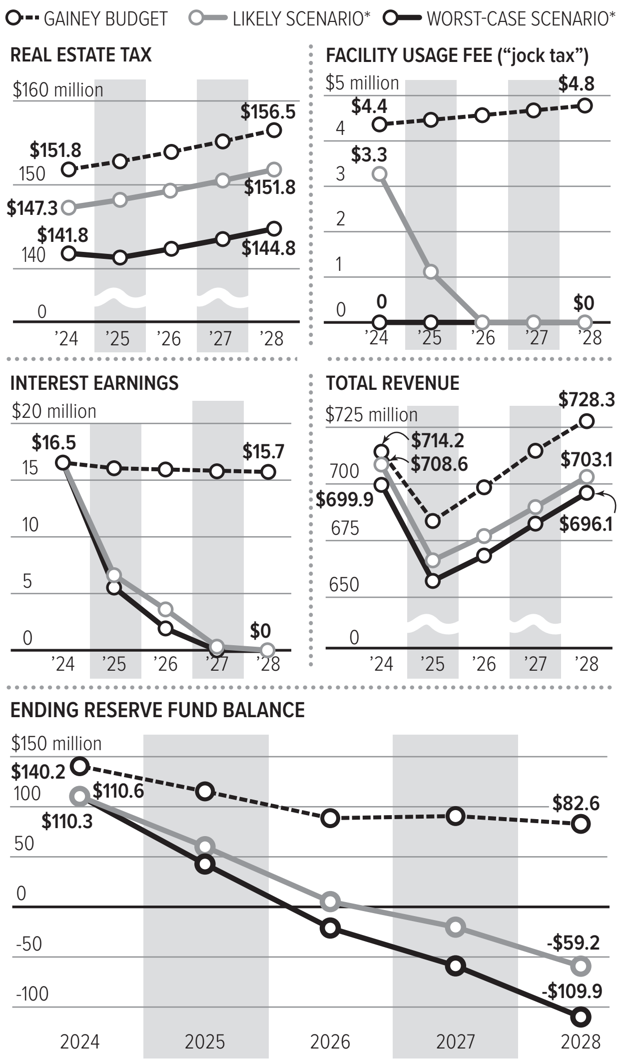
That's a $140 million gap from the mayor's current public forecast detailed in the city's 2024 budget, which predicts Pittsburgh will have nearly $83 million in the bank after 2028.

Sebastian Foltz/Post-Gazette

The internal documents call into question the fiscal future predicted by the administration of Mayor Ed Gainey. On Friday, he said he would appoint a task force to study city finances.

Reality check

As key sources of tax revenue face unprecedented challenges, internal city documents warn that the Gainey administration's budget projections are out of step with reality — and could soon drain the city's bank account.



*Likely and worst-case scenarios based on controller's projections.

Source: City of Pittsburgh records

Research: Neena Hagen, Mike Wereschagin; graphic: James Hilston/Post-Gazette

Plunging investment earnings

Driving the predictions are steep declines in major sources of cash — chief among them the city's investment income.

During the 20 years before the pandemic, Pittsburgh averaged about $1.3 million a year in interest earnings. But a massive infusion of $335 million in federal aid from the American Rescue Plan Act allowed the city to invest more money in the market, and its interest earnings ballooned to nearly $17 million last year.

In Mr. Gainey's budget, the city predicts it will continue earning between $15 million and $16 million in interest payments through 2028.

There's one major problem with that assumption: Federal law requires that the aid be spent by the end of 2026, which would eat away almost all of the principal that's generating those enormous returns.

"Because the ARPA money will no longer be in an interest-accruing fund, the city's interest earnings will decrease significantly," according to one internal city report. "These interest earnings, currently averaging $16.5 million, are predicted to decrease by approximately $10 million in 2025."

Ms. Dugan called the interest earnings in the city budget "a shell game" — a risky strategy to plug holes in the budget.

"They're not thinking long-term, because the ARPA money will go away if it's not spent," she said. "What happens in 2027?"

Mr. Gainey did not respond to an interview request, but on Friday, the day after the Post-Gazette sent a list of detailed questions about the projections, he announced the formation of a task force on city finances.

In his announcement, the mayor acknowledged concerns about the city's financial future, but said he remains "confident about our overall budget situation."

On Friday, Ms. Heisler issued a statement saying she is "glad Mayor Gainey is pursuing this conversation on city finances."

"With revenues and expenditures uncertain, we will be facing challenging times in the next several years if we do not act now," she said.

Among the concerns is a major revenue stream that could disappear as early as this year. The city is counting on its facilities usage fee — a 3% fee imposed on out-of-town athletes and entertainers performing at publicly funded venues, often referred to as the jock tax — to generate between $4.3 million and $4.8 million every year from now through 2028.

In January, Commonwealth Court ruled the jock tax unconstitutional and slapped an injunction on the city to prevent it from collecting the fee.

"It's reasonable to say [the revenue from the fee] should be zero," said Eric Montarti, research director at the Allegheny Institute for Public Policy, a Castle Shannon-based think tank. That echoes Ms. Heisler's March letter, in which she said the city shouldn't count on that money.

The city has appealed the ruling to the state Supreme Court, and Pittsburgh began collecting the jock tax again April 1, according to an internal document from the Controller's Office.

For now, the future of that money remains far from certain.

"If the city loses their appeal, they're going to end up owing back that money," Ms. Dugan said.

In the worst case scenario laid out in the reports, the city would have to refund $21 million collected from the tax since Allegheny County Common Pleas Judge Christine Ward first declared it unconstitutional in 2022. The controller's report predicts it's more likely the city would have to pay back $9 million to $13 million — "another burden on the city's fiscal health."

Downtown property values drop

Adding to the city's financial woes, skyscrapers and office towers in Downtown Pittsburgh — whose property taxes are a crucial source of money for the government — are hemorrhaging value amid rising vacancy rates in the post-pandemic market.

Owners of some of the most valuable buildings in Pittsburgh have won property assessment appeals that drastically reducede amount of money they have to pay in real estate taxes. In Mr. Gainey's announcement of the financial task force on Friday, he said the Department of Finance anticipates revenue from the tax will be lower than was forecast in his budget.

In all, the appeals of 2023 property assessments could cut about $3 million in city tax revenue, plus millions more in refunds for years of overcollections.

"It's not just like, OK, going forward, you're going to be at a new, reassessed, lower rate," Ms. Dugan said. "We have to pay that back as a city."

Those refunds could cost as much as $10 million, according to the controller's report. Add in the jock tax refunds, and the city could owe more than $20 million in overcollections.

None of that is accounted for in the current budget, potentially further straining the city's finances if it has to find millions to repay downtown property owners and visiting athletes and performers.

"The average citizen is not paying attention to these things," Ms. Dugan said.

One way the city might be able to offset potential losses would be to challenge property owners on the size of assessment reductions, but there are no guarantees on how much the city would gain.

'Concerns have been overstated'

In recent months, officials in Mr. Gainey's administration have challenged the dire predictions.

"The city ended 2023 with a surplus," Deputy Mayor Jake Pawlak said at a news conference recently. "While we are certainly keeping a watchful eye on trends as property tax appeals come in, and with the end of ARPA funds, I still think that some of those concerns have been overstated."

Top officials in the administration have pointed to reports by credit ratings agencies that rate Pittsburgh's bonds as safe investments, and call the city's financial outlook stable.

"We retained — as S&P and Fitch noted in their recent reaffirmation — significant ability to control spending in our current financial practices," Mr. Pawlak said.

If the shortfalls do come, "We have ample tools" to protect city services, he said.

Experts cautioned against using credit ratings as the only benchmark of the government's financial health. Ratings agencies like Fitch and S&P are focused on whether it's safe to buy a city's bonds, and whether investors can expect to be paid back for what are in essence loans to the government.

Unlike businesses that rely on profits to stay alive, city governments can raise taxes to keep revenue flowing.

"Ratings are an important summary measure of credit health, but they're not a be-all and end-all that we should mechanically follow," said Samuel Bonsall, an accounting professor at Penn State University.

"There are plenty of instances where the credit rating doesn't tell the whole story."

Uncertainty ahead

In her letter to council and the mayor in March, Ms. Heisler urged lawmakers to reopen the city's 2024 budget and account for the potential multimillion-dollar shortfalls.

So far, neither the mayor nor City Council has done so.

Because they haven't publicly grappled with the potential shortfall, it's not clear what programs could be impacted. And for now, the city is predicting another budget surplus at the end of this year.

If the competing forecast prevails, cuts will invariably have to be made, Ms. Heisler warned in her March letter.

During the last major financial crisis — which prompted the state to declare Pittsburgh financially distressed in December 2003 — key programs lost their funding.

Pools closed. Senior centers shut their doors. More than 400 workers were laid off. Pittsburgh became the only major city in the country to have its credit rating downgraded to junk status, a move that raised the city's borrowing costs because it had to pay higher interest rates to offset risk to investors.

Under state receivership, officials raised taxes as the city slowly clawed its way back to financial stability over the course of four successive mayoral administrations.

At the time, financial experts and government watchdog groups blamed city leaders for using budget gimmicks and one-time revenue sources such as selling city property to paper over deep-rooted problems.

"Someone has to say, 'OK, I've been elected. I'm a leader and I need to roll up my sleeves and not kick the can down the road,'" Ms. Dugan said.