Pennsylvania Intergovernmental Cooperation Authority

Staff Report
on the
City of Philadelphia's
Five-Year Financial Plan
for
Fiscal Year 2001 - Fiscal Year 2005

May 16, 2000

PENNSYLVANIA INTERGOVERNMENTAL COOPERATION AUTHORITY

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EXECUTIVE SUMMARY AND STAFF RECOMMENDATION

The City of Philadelphia (City) submitted its *Five-Year Financial Plan, Fiscal Year 2001-Fiscal Year 2005* (the Plan) to the Pennsylvania Intergovernmental Cooperation Authority (PICA) on April 25, 2000. This Plan is the first submitted by the new Street Administration, and follows many of the outlines of the previous Administration's Five-Year Plans, all of which were recommended for approval by PICA Staff. The Plan presents a reasonable prospect for balanced budgets over the life of the Plan, and anticipates ending FY2005 with a surplus of just under $5 million.

As in the past, there are a number of risks, both quantifiable and qualitative, which threaten the fiscal health of the City over the life of the Plan. In addition, a number of the new Administration's guidelines and proposals raise new risks for the City. Many of such new risks are dependent on a variety of circumstances, some of which are beyond the City's control. While the Plan often acknowledges these risks, few precautionary strategies are offered.

The Plan confronts seven significant risks, three of which are quantifiable. These risks include:

- Inclusion of unidentified "Future Target Reductions" in each of the final four years of the Plan ($60 million risk).

- An overestimation of Public Utility Realty Transfer Act (PURTA) tax revenue from the State ($20 million risk).

- Loss of PGW's annual $18 million payment to the City ($90 million), as well as potential additional City long-term liability, in light of PGW's continuing financial struggles.

- July 1, 2000 expiration of labor contracts with the City's four major municipal unions, with no explicit funding in the Plan for any costs associated with new labor contracts.

- Continued phase-in of welfare reform, including the looming Federal deadline for cessation of welfare benefits, with unpredictable effects on the City's economy and demands on its General Fund.

- An increase in the percentage of locally generated dollars that are subject to long-term commitments and the City's fast approach to its allowable debt limit, which jeopardizes the infrastructure maintenance goals of the overall Capital Program.

- A serious departure from the City's recent policy of sound financial management evidenced by a lack of detail regarding the City's Capital Program in FY2001-2002, and the commitment of $250 million in additional long-term debt.

Additionally, the Plan's success will depend greatly on a continuing strong national economy. PICA Staff believes that the City's economic projections are reasonable in the current economic climate, but the City shows little preparedness for a general economic decline.

Report Summary

As in recent years, this report focuses primarily on significant risks to the Plan, with discussion of some department-specific and other issues that have a direct relationship to maintaining fiscal stability. A Chart of Quantifiable Risks to the FY2001-FY2005 Plan appears at the end of this executive summary. PICA Staff continues to track departmental progress in numerous areas and will report on those areas as significant issues arise, as well as continuing to produce White Papers to provoke discussion on areas of concern to the fiscal health of the City.

City's Revenue Assumptions

Other than those specific risks to the revenue side (PURTA, PGW) discussed in detail below, PICA Staff found the assumptions underlying the City's revenue projections to be reasonable. In addition to the PICA Staff review, PICA convened a group of regional economists to comment on the revenue assumptions. The group's consensus was that the estimates used in the Plan were reasonable in light of the current economic outlook.

Quantifiable Risks

As mentioned earlier, the Plan confronts seven significant risks to its successful implementation. The first three of those risks are quantifiable and are included in the Chart of Quantifiable Risks at the end of this Executive Summary.

The FY2001-FY2005 Plan anticipates a cumulative total of $60 million in unspecified expenditure reductions over its final four years as a result of the continuing use of target budgets. This is the fourth year in a row that the Plan has projected significant monetary savings resulting from the use of this management tool. While applauding the City's continued use of target budgets to better manage unforeseen expenditures within a budget year, PICA Staff has reservations about the ability of the target budget process to generate significant savings over time.

As a result of deregulation in the electric generation industry, the City and School District are both at risk of experiencing a significant decline in Public Utility Realty Transfer Act (PURTA) tax revenue which is collected and distributed by the State. Simultaneously, recent changes to the PURTA tax rate and defined tax base may compound this decline in revenue. This year's Plan does account for a reduction in PURTA tax revenue, but underestimates the impact. The Plan overestimates PURTA tax revenue by as much as $20 million over its five-year period.

The Philadelphia Gas Works (PGW) continues to confront numerous financial and managerial challenges. A third consecutive mild winter has stretched its financial resources thin, and the recent installation of a new management team is the third such overhaul in the past four years. The most immediate threat to the City's General Fund is whether PGW will be able to continue to make its annual $18 million payment, totaling $90 million over the life of the Plan.

Other Significant Risks

Due to the expiration of all of the collective bargaining agreements between the City and its unionized workers at the end of this fiscal year, it is impossible to assess the impact of any future wage and benefit related cost increases over the life of the Plan. Once contract agreements have been reached, the City will be required to submit a revised Plan to PICA.

State and Federal welfare reform continues to phase in, although few sanctions have as yet been imposed. Eligibility and the level of support provided to those in need have already been altered. Some of the changes to date have led to increased demands for City services, most particularly primary health care, emergency shelter and homeless prevention. As the Federal deadline for benefits is reached in March 2002, these effects are likely to grow. Despite these concerns, the Plan's responses to the impacts of welfare reform are inconsistent.

Over the first few years of the Plan, the City will increase the percentage of locally generated dollars that are subject to long-term commitments. The risk inherent in these long-term commitments is compounded by the City's fast approach to its legal debt limit, which jeopardizes the infrastructure maintenance goals of the overall Capital Program. These risks are further heightened by the specter of a stadium deal that is certain to add to the City's long-term debt.

The Plan utilizes a change in the approach to fiscal planning which has the potential to undermine the budgeting process implemented to pull the City from the brink of bankruptcy. Approximately one-quarter of the proposed Capital Budget over the first two years of the Plan lacks details and justification. Similarly, a large-scale program that will commit the City to additional long-term annual debt costs of $18 million does not even identify the scope of the project. Finally, the uncertainty surrounding the City's financial leadership generates increased concern as to the seeming capricious nature of the planning process.

Other General Fund Concerns

While Philadelphia over the past three years has experienced its greatest amount of private sector job growth since 1988, job growth continues to lag regional and national trends. Additionally, the City continues to lose residents. Continued downsizing in the healthcare and financial industries, and in other industries as well, has had a strong negative impact on the City's economy. PICA Staff continues to stress the importance of a proactive policy directed at improving the underlying economic trends in Philadelphia.

A key element of the City's economic policy lacks any meaningful method for measuring its effectiveness. The City is unable to show that the Economic Stimulus Program (ESP) has resulted in a more effective outcome than putting the money towards other initiatives, such as tax reduction, since there are no performance measures in place for the ESP. The City does not provide performance standards or expectations for the input of dollars prior to the allocation or money, and the City does not evaluate the results after the money has been used.

The City remains somewhat at the mercy of the health of the national economy. The unprecedented length of the current expansion only increases the likelihood of a downturn during the life of the Plan. Although these are factors mainly beyond the City's control, the City has made little effort to prepare for such an eventuality. The City needs to strongly investigate the creation of a "Rainy Day" fund that can be tapped in a fiscal emergency.

The Department of Human Services has successfully and significantly increased its State and Federal funding over the past nine years. This increased "outside" funding has allowed the City to enhance service levels, while simultaneously reducing net City costs. As programmatic and funding challenges threaten to increase net City costs in the future, the City must continue working diligently with other governments to protect the funding it currently receives from them and to identify new funding streams.

The City has initiated many crime-fighting efforts that have increased the number of inmates housed in the City's prison system. Longer prison sentences have also contributed to the system being required to house more prisoners than its management goal. Even with the new women's facility currently planned, the prison system is likely to continue to face budgetary and operational challenges from overcrowding.

The Year 2000 Census has potentially grave consequences for the City. The City is not only at risk of losing a Congressional seat, but also faces probable decreasing funding levels from State and Federal programs. Though the City has taken an aggressive approach to promoting citizen participation in the 2000 Census, early indications are of low response rates from the Philadelphia area. The City must prepare fiscally for the implications of an inaccurate count of its citizens.

Staff Recommendation

The identified potential risks to the General Fund in the FY2001-FY2005 Plan constitute a real threat to the fiscal health of the City. However, the Plan is also predicated on a continuation of the previous Administration's program of small and steady cuts to the Wage and Business Privilege taxes. With this caveat in mind, the FY2001-FY2005 Plan presents a reasonable prospect for balanced budgets in each year of its term.

PICA Staff recommends that the Pennsylvania Intergovernmental Cooperation Authority approve the Plan as submitted to the Authority on April 25, 2000.

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Chart of Quantifiable Risks to the FY2001-FY2005 Plan

($ in thousands; totals may vary slightly due to rounding)

	FY2000	FY2001	FY2002	FY2003	FY2004	FY2005	TOTALS
Quantifiable Risks							
Unidentified Reductions			(12,000)	(12,000)	(18,000)	(18,000)	(60,000)
PURTA Tax Revenues		(4,000)	(4,000)	(4,000)	(4,000)	(4,000)	(20,000)
Annual PGW Payment		(18,000)	(18,000)	(18,000)	(18,000)	(18,000)	(90,000)
Other Significant Risks							
Labor Contracts							
Welfare Reform							
Long-Term Debt							
Questionable Financial Management							
Total Risks		(22,000)	(34,000)	(34,000)	(40,000)	(40,000)	(170,000)
Cumulative Total Risks		(22,000)	(56,000)	(90,000)	(130,000)	(170,000)	
City's Projections as of December 31, 1999							
Total Revenue	2,667,693	2,734,384	2,792,556	2,871,508	2,936,737	2,991,036	
Total Obligations	2,748,491	2,830,456	2,856,377	2,921,558	2,969,237	3,024,591	
Prior Year Adjustments	26,000	(54,843)	76,843	46,000	36,000	26,000	
Prior Year Fund Balance	205,713	150,915	0	13,022	8,972	12,472	
Plan Projected Fund Balance	150,915	0	13,022	8,972	12,472	4,917	
Fund Balance if All Risks Realized	150,915	(22,000)	(42,978)	(81,028)	(117,528)	(165,083)	
Value of Wage Tax Rate Reductions *		13,128	20,272	31,674	43,738	56,732	
Value of BPT Rate Reductions *		5,700	11,900	17,500	21,500	25,800	
Net Fund Balance if All Risks Realized Without Making Cuts in Tax Rates		(3,172)	8,022	19,146	47,884	82,861	

* Value of Wage Tax reduction estimated by PICA Staff; value of BPT reduction estimates provided by Office of Budget and Program Evaluation.

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STAFF REPORT
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FIVE-YEAR FINANCIAL PLAN

SECTION II:

QUANTIFIABLE RISKS

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TARGET BUDGETS AND "FUTURE TARGET REDUCTIONS"

The FY2001-FY2005 Plan anticipates a cumulative total of $60 million in unspecified expenditure reductions over its final four years as a result of the continuing use of target budgets. This is the fourth year in a row that the Plan has projected significant monetary savings resulting from the use of this management tool.

While applauding the City's continued use of target budgets to better manage unforeseen expenditures within a budget year, PICA Staff has reservations about the ability of the target budget process to generate significant savings over time.

This year's Plan anticipates a $4.9 million General Fund balance at the end of FY2005, allowing no opportunity to cover any shortfall that may result from the failure of target budgets to generate the projected $60 million in savings.

The Theory Behind Target Budgets

The target budget process was developed by the previous Administration as a way to constrain spending below budgetary levels. Following City Council's adoption of a budget, the Administration adopts target budgets for each department and cost center, typically 1.5 percent below the appropriated level. Each department and cost center is then given the opportunity to explain extenuating circumstances for a change in their assigned target budget. Any savings generated by keeping to the target budget either provides a cushion for unexpected revenue shortfalls or expenditure needs during the year or adds to the end-of-year General Fund balance. The Administration claims that target levels then become the base for the following year's budget.

Target Budgeting Results in the Short-Term

Target budgets do provide a valuable cushion for unexpected costs that may arise during the year. The current fiscal year provides examples of unforeseen problems (i.e. funding for the Firefighter Hepatitis C difficulties, sinking homes in Wissinoming) and changing Administration priorities (i.e. efforts to remove abandoned cars) which do not threaten the budget because of the cushions provided by target budgeting.

At a minimum, when they are properly used, target budgets force departments to justify their expenditure needs to the Administration during the fiscal year in two stages. First, as they need to spend above the target level, and secondly, to the degree that they need appropriation power above their target budget level. The Administration can then push departments to find offsetting efficiencies or savings elsewhere in their budget.

It is difficult to gauge the effectiveness of the target budget process and how it affects the City's overall General Fund balance. A multitude of decisions coupled with unexpected costs throughout the fiscal year affect target budgets and actual expenditures. Determining how each one affects the target budget process and the General Fund balance is a subjective effort. However, the evidence indicates that the use of target budgets has not resulted in large amounts of savings.

Target Budgeting Results in the Long-Term

Beyond the single budget year, target budgeting seems to have little impact on the overall amount of City obligations. While the stated goal of carrying over the previous year's target budget amounts as a baseline for the following year's budget should lead to an overall reduction in spending, the opposite has been true. In fact, in six of the past seven years, both the original budget, and the target budget have exceeded the previous year's actual obligations.

Original and Targeted Budget Levels have Exceeded the Previous Year's Actual Obligations all But Once in the Past Seven Years (Amounts in Thousands)

Period	Original Budget	Target Budget	Year-End Actual	Original Over Previous Year-End?	Target Over Previous Year-End?
FY1993			$2,337,303		
FY1994	$2,384,579	$2,346,741	$2,346,033	Y	Y
FY1995	$2,295,907	$2,261,845	$2,267,211	N	N
FY1996	$2,366,917	$2,353,679	$2,370,971	Y	Y
FY1997	$2,416,797	$2,378,257	$2,463,930	Y	Y
FY1998	$2,510,072	$2,473,635	$2,479,617	Y	Y
FY1999	$2,632,731	$2,607,350	$2,616,583	Y	Y
FY2000	$2,759,553	$2,748,491		Y	Y

Source: *Quarterly City Managers Reports*, First Quarter FY1993, and First and Fourth Quarters FY1994, FY1995, FY1996, FY1997, FY1998 and FY1999 and First Quarter FY2000.

While the continued rise in the City's spending is not attributable to any one factor (i.e. increase in services, higher labor costs, etc.), it is clear that any savings realized by the target budget process is more than outweighed by other factors. As discussed in PICA's White Paper No. 7 "Philadelphia Must Reduce its Need for Tax Revenues," not only has the City's obligation level continued to increase over the past eight years, it has maintained its dependence on local tax revenues. The City must reduce tax-supported expenditures, and target budgeting is not an effective means to that end.

The inability of target budgeting to achieve long-term savings is due to its disregard for the details of the business conducted by the City. It represents across-the-board reductions that have no relationship to service delivery or productivity. In order to institutionalize long-term efficiency in the City's budget process, the City must begin to tie its year-to-year budgeting to service delivery and performance goals.

Projected Savings from Efficiencies Instead of Target Budgets

Given the history of target budgets outlined above, it is questionable, or at least difficult to determine, whether they will produce the level of savings the City projects in the Plan. Of greater significance are the cost reducing efficiencies or revenue enhancements implemented during a fiscal year that do not result from the use of target budgets, but significantly contribute to meeting overall budget goals. Even though such efficiencies and enhancements are likely to occur in the future, it is difficult for PICA Staff to gauge whether the Plan's projected out-year savings are reasonable without an adequate explanation of how those savings might realistically be achieved or any attribution of reductions to particular departments.

It is unknown whether this Administration will be able to generate the $60 million in savings anticipated in the Plan. Although it is a relatively small amount of money in relation to total five-year costs, with the Plan projecting only a $4.9 million surplus at the end of the Plan period, any inability to realize these savings could result in a budget deficit at the end of FY2005.

Target Budgets are a Management Tool Subject to Political Pressures

PICA Staff also has concerns as to whether this Administration will be able to continue to use target budgets to maintain departmental expenditures below budgeted levels. City Council has ultimate budgetary authority through its appropriation power. While the Mayor can exercise managerial discretion over how money is spent, he is limited to departmental budgets as they are approved by City Council.

Target budgets are essentially a non-mandated management tool, and are subject to ever changing political realities. City Council may in the future look unfavorably upon a mayor who systematically does not spend money as it has been budgeted, and could use its political will and public pressure to force spending of all appropriated funds.

Conclusions

PICA Staff recognizes that target budgets are an innovative and effective management tool which provide the Administration with extra leverage to ensure department accountability, and short-term flexibility. The proposed Plan projects an ending General Fund balance of $4.9 million in FY2005. This amount is insufficient to cover the $60 million in "Future Target Reductions" should those reductions not materialize.

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PENNSYLVANIA PUBLIC UTILITY REALTY TRANSFER ACT

As a result of deregulation in the electric generation industry, the City and School District are both at risk of experiencing a significant decline in Public Utility Realty Transfer Act (PURTA) tax revenue which is collected and distributed by the State. Recent changes to the PURTA tax rate and defined tax base may further accelerate this decline in revenue.

This year's Plan does recognize a reduction in PURTA tax revenue, but underestimates the impact. The Plan overestimates PURTA tax revenue by as much as $20 million over its five-year period.

Electric Deregulation and Legislative Changes have Reduced PURTA Tax Revenue

As prescribed by the Electric Deregulation Act of 1996, the Public Utility Commission has granted public utilities under its purview the ability to accelerate the depreciation of electric generation facilities. This resulted in a drop in PURTA funding for Pennsylvania local governments in FY2000; Philadelphia's loss of revenue was approximately $4.8 million.

Last year's omnibus State tax legislation, enacted in May, changed the PURTA tax base from depreciated book value of utility realty to market value. It also replaced the fixed tax rate with a floating rate. The May legislation clarified that electric generation facilities will be exempt from PURTA altogether beginning January 1, 2000. This will dramatically reduce the amount of PURTA funding available to local governments beginning in FY2001. Although the electric generation facilities will now be subject to local taxation, Philadelphia is not home to any major facility and as a result the City will suffer a significant loss in revenue.

City will lose $20 million over Five Years

The Plan projects $15.5 million in PURTA tax revenues in FY2001, and $10.5 million annually for FY2002-2005. Based on projections of statewide PURTA distributions developed by the State Department of Revenue, and what historically has been the City's share, PICA Staff projects that the City will receive approximately $7.5 million annually in PURTA tax revenue in FY2001-2005. Most if not all of the drop is attributable to the accelerated depreciation of electric generation assets.

As the Chart of Quantifiable Risks in the Executive Summary of this report illustrates, the City can now anticipate that PURTA tax revenues will be $20 million less than projected over the life of the Plan. Although a relatively small amount of money, in comparison to total Plan revenues, since the Plan projects only a $4 million surplus at the end of the Plan period, this drop in revenues standing alone could result in a budget deficit at the end of FY2005.

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Philadelphia Gas Works

The Philadelphia Gas Works (PGW) continues to be burdened by numerous financial and managerial challenges. A third consecutive mild winter has stretched its financial resources thin, and the recent installation of a new management team is the third such overhaul in the past four years.

The most immediate threat to the City's General Fund is whether PGW will be able to continue to make its annual $18 million payment. As was the case in FY1999, the City has agreed to allow PGW to delay its FY2000 payment until June. The new chief financial officer (CFO) of the utility has verbally committed the utility to making its payment in full.

In the long-term, the utility still faces the prospect of deregulation and competition and has again been evaluating various options for improving operations. It remains to be seen if PGW can remain an economically viable entity in a competitive environment.

Short-term Risk: The $18 Million Payment to the City's General Fund

Due to mild weather, PGW has experienced three years of below average revenues and poor cash flow. Efforts to lower staffing levels and improve collections have helped it to stay solvent in the short term. Yet, even with these efforts, PGW has maintained a positive cash balance only through the use of short-term debt and a delay in making its annual $18 million payment to the City. Debt service costs from a new bond issue last year, as well as the high cost of continued short-term debt strategies, will further strain PGW's finances beginning this summer.

PGW's new leadership team has verbally committed to meeting the utility's financial obligation to the City General Fund. Yet, it remains uncertain whether it can do so and how keeping that commitment would affect the utility's financial stability and credit rating. According to PGW's FY2000 financial estimate, the City payment will turn an anticipated net profit for the year into a net loss of about $17 million.

As in FY1999, PGW will be making the payment later than stipulated by the Agreement for the Management of PGW. In accordance with that agreement, in FY1999 the late payment included just over $203,000 in interest. No commitment has as yet been made to include interest with the FY2000 late payment.

Given the overall state of PGW's financial situation, as well as the difficulties detailed below, the future of the annual payment to the City is considered at high risk for all five years of the Plan. It should also be noted that the new CFO for the utility has been a long-time advocate of eliminating PGW's payment to the City. PICA Staff believes that there is a strong likelihood that City revenues will be short $90 million over the five years covered in the Plan.

A Difficult Environment for Introducing Change

The possibility of improved fiscal stability for PGW is unlikely in the face of myriad internal problems. Although mild winters have been harmful to PGW's finances, well-chronicled technology problems have also been a major problem. PGW has been unable to provide accurate financial information since August 1999. The new billing system indicates that as many as 5,000 accounts may have been unbilled for years. It is impossible to estimate how much of that unbilled revenue will ever be recovered.

In addition, the ongoing implementation of the new billing system has resulted in many accounts going unbilled for as long as eight months, and in a multitude of inaccurate bills. PGW presently acknowledges that approximately five percent of its customers either receive no bills or receive inaccurate bills. PGW's new leadership team told PICA Staff that the problem is expected to be resolved in the next two months. However, anecdotal evidence suggests that an even larger number of customers are presently not being billed or are receiving erroneous bills. PGW has indicated it is planning a complete external review of its information technology system, which makes it more likely that PGW is many months away from having a reliable, functioning billing system. These realities diminish PGW's revenue collection opportunities.

Even beyond its fiscal difficulties, PGW faces additional management and productivity difficulties. Its human resources department is unable to provide employee attendance records. There is no internal training program, and a lack of succession planning, which will be further exacerbated as more employees take advantage of early retirement programs. Customer service departments are severely overburdened. The new management team's goal to implement meaningful performance and productivity measures can best be considered a distant possibility.

Long-term Risk: The City's Liability for PGW Bonds

There are significant capital expenditures looming for PGW, particularly in regard to its Liquefied Natural Gas Plant. PGW is in the process of prioritizing its limited capital dollars, but numerous infrastructure improvement requirements have reached the critical stage. PGW currently has over $900 million in outstanding debt. It is conceivable that the combination of increasing capital demands combined with the continued loss in revenue could render PGW unable to meet its debt obligations. This scenario could occur as early as January 2002.

According to the City, there has been no official legal opinion on whether or not the City is contractually liable for repayment of PGW's bonds should PGW be unable to meet those obligations. However, considering that nearly all Philadelphia commercial and residential gas users are served by PGW, and given the City's history of coming to the aid of its citizenry even when not legally liable (i.e. Logan), the likelihood of the City assuming such liability is good. PGW's FY2000 payment for principal and interest totaled over $75 million, assuming no additional capital borrowing.

Competition in the Natural Gas Industry

Beginning in July 2000, PGW's operations will be regulated by the Commonwealth's Public Utility Commission. The General Assembly is still considering a number of proposals for allowing customers to choose a natural gas supplier. Although PGW, with a legally limited service area, expects to avoid full-fledged competition, it is likely to be included in some way in the movement toward natural gas deregulation.

PICA Staff has previously reported on the challenges PGW would face in a competitive environment, particularly as a result of its high debt load, City Council-mandated discount programs, and significant number of delinquent accounts. Significant uncertainty remains about how the industry, and how PGW itself, will look in the future. PGW's new leadership team has promised to keep PICA Staff informed as it explores options for the utility, including privatization of certain operations.

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SECTION III:

OTHER SIGNIFICANT RISKS

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LABOR CONTRACTS AND THE MUNICIPAL WORK FORCE

Due to the expiration of all of the collective bargaining agreements between the City and its unionized workers at the end of this fiscal year, it is impossible to assess the impact of any future wage and benefit related cost increases over the life of the Plan. Once contract agreements have been reached, the City will be required to submit a revised Plan to PICA.

Despite the fact that personnel costs account for 58 percent of the FY2000 budget, the Plan pays little attention to the need to rightsize the City's workforce. The growing need to hire and retain information technology workers is not addressed in the Plan, although the issue was acknowledged by City officials during conversations with PICA Staff.

Municipal Union Contracts

The largest unknown variable in the Plan is personnel costs. All of the collective bargaining agreements between the City and its unionized workers expire as of July 1, 2000, and the Plan assumes no increases in wages or benefit costs. Personnel costs account for 58 percent of the FY2000 budget; thus even a minimal increase in wages and benefit costs will have a significant impact on the City's expenditures throughout the life of the Plan.

Until contract negotiations are completed, it will be impossible to determine the full impact of any wage increases, and the costs of changes in the various benefit packages. Once contract agreements have been reached, the City will be required to provide a revised Plan that accounts for any and all changes in wage and benefit costs over the life of the Plan to PICA for approval.

Rightsizing the City Workforce

Despite the forecast of an operating deficit for three of the five years covered in the Plan, there is scant attention paid to the need to rightsize the City's workforce. The Plan correctly notes that across the board layoffs and early retirement programs will only serve to shrink the workforce without regard to the City's actual needs. The Plan also notes a few select instances where the workforce was rightsized to meet particular needs (i.e. competitive contracting initiatives and the Parking Authority).

However, the projected size of the FY2000 workforce is equal to the size of the workforce in FY1990, despite the loss of nearly 10 percent of the City's population during the same period. This period saw unprecedented increases in productivity and investments in technology, with seeming little impact on the size of the City's workforce. Further, the size and structure of the workforce are not very different from the 1950's, when the City's population was nearly *twenty-five percent* larger than it is today.

As mentioned above, personnel costs account for 58 percent of the FY2000 budget. In order to truly control its operating costs, the City must focus on determining the right size and makeup of a City workforce to meet the needs of Philadelphia in FY2001-2005. With the expiration of the municipal contracts at the end of the current fiscal year, the new Administration has an ideal opportunity to make known its goals for the composition of the workforce. It is therefore disappointing that the Plan makes no effort to identify this effort as a priority.

Skilled Information Technology Workforce

With the City's investment in technology over the past decade, there has been a substantial increase in the number of employees required to manage and maintain the new infrastructure. Similar to the private sector, the City is having difficulty in hiring and retaining those employees with the skills and expertise to meet those needs. As the City's dependence on new technologies increases, the risk for being left shorthanded increases as well. High turnover rates leave little institutional knowledge, and increase training costs. High vacancy rates result in the need to contract out for technology support services, generally a more costly solution.

The City is handicapped by antiquated job descriptions, an inability to pay higher wages, and the slow nature of the municipal hiring process resulting from legal constraints. Although this problem adversely impacts most City Departments, the problem or any potential solutions are not mentioned in the Plan. In conversations with PICA Staff, City officials did indicate that the problem was being reviewed by the Personnel Department, the Mayor's Office of Information Services, and other concerned agencies. However, the issue and potential remedies should be addressed in the Plan, in order to assure the Administration's awareness of and focus on the problem.

WELFARE REFORM

With Federal passage of the Personal Responsibility and Work Opportunity Reconciliation Act on August 22, 1996, and the subsequent Pennsylvania welfare reform law entitled Act 35 which went into effect on March 3, 1997, the impact of welfare reform on the City of Philadelphia has become a significant issue. This is the first year since Act 35 was enacted that the City has provided an entire chapter focused solely on welfare reform in the Five-Year Plan.[1] In Previous Five-Year Plans, the City discussed welfare reform in other sections of the Plan.

The City has responded to welfare reform by establishing work programs, outreach campaigns, training programs, child care services and other resources for people affected by welfare reform. Though the City has taken such measures, it has not prepared for the fiscal risks that are discussed in the Plan. The City devotes an entire Plan chapter to the potential impact of welfare reform, yet individual departmental budgets have not been adjusted. The Plan also fails to consider the fiscal impact of the five-year Federal limit that some welfare recipients will be hitting in March 2002.

The Shift from Aid to Families with Dependent Children (AFDC) to Temporary Assistance to Needy Families (TANF)

The Personal Responsibility and Work Opportunity Reconciliation Act discarded the 60-year old Federal entitlement program, Aid to Families with Dependent Children (AFDC) and implemented Temporary Assistance to Needy Families (TANF). Under broad Federal TANF guidelines, each State is tasked with planning and implementing its own welfare program through the utilization of a block grant from the Federal Government.

Act 35, Pennsylvania's welfare legislation went into effect on March 3, 1997 (it was actually signed into law in May 1996 prior to Federal enactment of the Personal Responsibility and Work Opportunity Reconciliation Act). Act 35 prescribes that after 24 months recipients of TANF cash assistance must work at least 20 hours per week to retain such TANF cash assistance. Certain exemptions from the work requirement may be made, such as mental illness or birth of a newborn; the terms and conditions of the exemption are determined by the State. If non-exempt recipients do not fulfill work requirements or other TANF regulations, the State may deem recipients ineligible for TANF benefits and an entire family may lose cash assistance and possibly other TANF benefits.

If sanctioned recipients meet TANF requirements, they may be deemed re-eligible for TANF benefits. However, if the head of a household is sanctioned three times, the State has the ability to terminate TANF benefits for life. The Personal Responsibility and Work Opportunity Reconciliation Act imposes a five-year limit on a recipient's ability to

[1] *Five-Year Financial Plan, Fiscal Year 2001 - Fiscal Year 2005,* p. 94-102.

collect TANF benefits. At the expiration of the Federal five-year lifetime limit, the sanction will be imposed. TANF recipients who have received continuous TANF benefits since March 1997 will face the five-year lifetime limit in March 2002 and will lose cash assistance.

Efforts by the City as a Response to the Shift from AFDC to TANF

Preparing for the unknown results of welfare reform has been an especially challenging task for the City, since Philadelphia has 148,831 TANF recipients, 51.6 percent of the State caseload.[2] No one could really predict the impact of the legislation creating TANF, so the City began preventive and programmatic measures to aid recipients in the move from welfare to work.

With $52 million in Federal and State money, the City created Greater Philadelphia Works (GPW). GPW was established in September 1998 to assist TANF recipients in moving from welfare to work. In conjunction with the establishment of GPW, the City spent $1.3 million on a televised outreach campaign to inform the public about the services provided by GPW. In addition to the creation of eight regional GPW offices, the City has coordinated transportation, day care and job training programs.

Families Impacted by the Work Requirement

It is estimated that in March 1999, approximately 39,000 families in Philadelphia hit the two-year limit which requires that the head of a household must be working at least 20 hours per week to continue to receive TANF benefits. From that point forward more families in Philadelphia have been reaching the two-year limit each day. The Plan estimates that in March of 2000 a total of 41,500 families will have hit the two-year deadline.[3] Based on a Daily News article in August 1999, the City surmises that 32 percent of the 41,500 families could be sanctioned for failing to fulfill TANF requirements. However the City remains unsure of the actual percentage of families that would be sanctioned should the State fully impose sanctions, citing lack of information from the Pennsylvania Department of Public Welfare (DPW).

In meetings with PICA Staff, DHS officials stated that the City is receiving notice of sanctions on a case by case basis from the State. Upon notification of a pending sanction, a City caseworker is assigned to extend outreach to the individual in risk of being sanctioned. The caseworker attempts to aid the individual, so that the individual will comply with TANF regulations and avoid being sanctioned.

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[2] *Five-Year Financial Plan, Fiscal Year 2001 - Fiscal Year 2005,* p. 96.
[3] *Five-Year Financial Plan, Fiscal Year 2001 - Fiscal Year 2005,* p. 94.

Only a Few Families have Faced Sanctions by the State

The State has been reluctant to enforce sanctions on families. The DPW informed the City that as of December 1999, only about 100 families living in Philadelphia have been sanctioned. The unknown of when, and even if, the State will impose sanctions on families has left the City in a precarious position**.**

The City has yet to experience the impact that it anticipated from the initial two-year deadline in March 1999. City resources have not been drained by the sanctions on the 100 families. The potential significant drain on the City's fiscal stability due to an increase demand for shelter, medical and social services has not come to fruition. The reluctance of the State to enforce sanctions has led City Operating Departments to become somewhat confident that wide-reaching State sanctions are unlikely. At the same time, the welfare reform chapter in the Plan presents a more foreboding picture for the City, one that is in stark contrast to the static service level projections in the City's Operating Departments that provide social services.

The Potential Impact on the City and the Contradictions Inherent in the Plan

The Plan approximates that, "for each 1,000 families that receive City-provided shelter, medical care, and foster care services, the City incurs costs of $10.8 million annually."[4] The discussion provided in the welfare reform chapter of the Plan under the heading "Potential Estimated Impact on the City of Philadelphia" states that, "With a projected 41,500 households expected to hit the 24-month work requirement deadline by March 2000, assuming optimistically that as many as half of the heads of household comply with the work requirements, the City would still face the loss of cash benefits for 20,750 households."[5] If the State enforces sanctions after March 2000, according to the City's own "optimistic" approximation that 20,750 households would be sanctioned, the potential annual impact to the City would be $224.1 million. This annual impact of $224.1 million would most certainly derail the City's fiscal stability and place the City in a crisis mode. The March 2000 deadline has come and gone with barely 100 sanctions enforced to date.

The three City Operating Departments that would feel the greatest impact of sanctions through an increase in demand for services would be the Department of Human Services (DHS), the Department of Public Health (DPH), and the Office of Emergency Shelter and Services (OESS). In fact, the City arrived at the estimated incurred annual cost of $10.8 million by totaling the fiscal impact on DHS, DPH and OESS. Providing shelter services for 1,000 families would incur an increased cost to the City of $7 million. DPH would require an increase of $1 million to provide for an additional 1,000 families and "should

[4] *Five-Year Financial Plan, Fiscal Year 2001 - Fiscal Year 2005,* p. 97.
[5] *Five-Year Financial Plan, Fiscal Year 2001 - Fiscal Year 2005,* p. 96.

the children of 1,000 TANF families be placed in care with foster families, the City could face additional unreimbursed costs of at least $2.8 million."[6]
Despite the emphasis placed on the negative potential impact of welfare reform in the Plan verbiage, the only Operating Department projecting a fiscal impact from welfare reform is DPH. The static service projections anticipated by DHS and OESS may be a result of a phenomenon that PICA Staff noted in the *Fiscal Year 2000 - Fiscal Year 2004 Staff Report*. PICA Staff stated that as a result of welfare reform, "Of City departments, DPH's District Health Centers have felt the greatest impact so far, with much greater numbers of uninsured clients and visits. Homeless services have seen a gradual rise in demands too, while DHS caseloads have not seen the growth that the department had initially projected."[7] However, a grave inconsistency lies within the Plan, whereby on one hand the City estimates a tremendous potential impact from welfare reform dedicating an entire chapter to discussion of the impact on the City. On the other hand City Operating Departments that would be intensely impacted by TANF sanctions have projected static service levels in FY2000 and FY2001 and have discontinued the budget practice of adjusting for the potential impact of welfare reform.

<u>DPH</u>

The noticeable impact from welfare reform on the DPH can be seen in the increased number of uninsured visits to District Health Centers. In FY95, the year before Act 35 was signed into law, there were 128,741 uninsured visits to City health centers, 44 percent of all visits. In FY99, there were 202,892 uninsured visits to health centers, 63 percent of all visits. The number of uninsured visits from FY95 to FY99 grew by 36.5 percent.

The fiscal impact on the City has been an increase in the unreimbursed cost of providing medical care, a direct result of the increase in uninsured patient visits. As the City points out in the Plan, unreimbursed costs are fully supported by taxpayer dollars. The unreimbursed costs increased from $8.8 million in FY96 to $12.8 million in FY99. Hence, the City realizes that, "The growing imbalance resulting from an increasing number of uninsured patient visits threatens the DPH's ability to continue to provide the same level of service".[8]

The DPH projects that the number of uninsured visits will continue to rise in FY2000 and FY2001, reaching 203,840 uninsured visits in FY2000 and 206,720 uninsured visits in FY2001. Simultaneously, the DPH predicts that "the number of visits by patients with some type of insurance will *decrease* 28 percent from 161,800 in FY96 to 116,280 in FY2001.[9] The growth in the number of uninsured visits made to District Health Centers

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[6] *Five-Year Financial Plan, Fiscal Year 2001 - Fiscal Year 2005,* p. 97.
[7] Pennsylvania Intergovernmental Cooperation Authority. *Staff Report on the City of Philadelphia's Five-Year Financial Plan for Fiscal Year 2000 - Fiscal Year 2004*. June 1999.
[8] *Five-Year Financial Plan, Fiscal Year 2001 - Fiscal Year 2005,* p.171.
[9] *Five-Year Financial Plan, Fiscal Year 2001 - Fiscal Year 2005*, p. 171.

is a real impact of welfare reform. Based on the current projections provided by the DPH, as to the rising number of uninsured visits and the impact to date, the impact has not been and will not prove to be a strain on General Fund dollars. To date, the City has been able to handle the increased budgetary demand resulting from the costs of unreimbursed care.

The slight increased projections provided by the DPH in its selected service level performance measurements does not reflect any preparation for the magnitude of new demand predicted in the welfare reform chapter of the Plan. The DPH projects an increase of roughly 1,000 uninsured visits from FY1999 to FY2000 and an increase of roughly 3,000 uninsured visits from FY2000 to FY2001. These projections are inconsistent with the "optimistic estimate" that 20,750 families could lose cash assistance should the State implement sanctions. The DPH is not prepared for the fiscal impact that 20,750 families would have on its resources.

DHS

In a meeting with PICA Staff, DHS officials indicated that the past year's budgetary increases in anticipation of the aftermath of welfare reform would be eliminated from the FY2001 needs based budget. Not only will DHS exclude requests for increases due to welfare reform but DHS will also make cuts in the requested increases made in prior years. PICA Staff was surprised by this DHS decision since the welfare reform chapter of the Plan details such striking budgetary affects on the City and City social service agencies should sanctions be enforced.

Understanding that DHS has not been impacted to the degree anticipated by TANF sanctions and understanding that DHS has reported working with very limited information from the State, the decision to cut requests is disturbing given the potential, albeit unknown, impact of State sanctions outlined in the Plan.

Further contradiction is found in the Plan, whereby it is stated that, "The Department's projections for FY2001 - FY2005 assume that welfare cuts will lead to an increase in demand for services...".[10] Yet, in the Selected Service Level Performance Measurements produced by the DHS, projections in the Children and Youth Division demonstrate FY2001 service levels remaining constant or decreasing in comparison to FY1999 service levels. In comparing FY1999 actuals to FY2001 projections the only increase anticipated in service levels for the Children and Youth Division is in adoptions finalized and children in institutional placements. The actual total number of children receiving services in FY1999 was 23,322. The projected number of children anticipated to receive services in FY2000 is 23,740 and FY2001 is 23,322.[11]

If sanctions should occur, DHS plans to look for increased State money to cover the increased costs of providing services to TANF sanctioned families. "The Plan assumes

[10] *Five-Year Financial Plan, Fiscal Year 2001 - Fiscal Year 2005*, p. 144.
[11] *Five-Year Financial Plan, Fiscal Year 2001 - Fiscal Year 2005*, p. 147.

that DHS General Fund obligations will grow by $63.6 million from FY2001 to FY2005, which is predicated on a sufficient level of State funding. If the State fails to provide its required funding, reductions in critical DHS services to families and children will be necessary".[12]

DHS projects static service levels. In meetings with PICA Staff, DHS officials indicated that certain budgetary requests to the State will be cut as a result of the impact of welfare reform. Yet, the language of the Plan cites a growth in General Fund obligations from FY2001 to FY2005 due to welfare reform. The chapter on welfare reform estimates a potential of 20,750 families being sanctioned, and estimates that DHS could face unreimbursed costs of $2.8 million for services to children of each additional 1,000 families. The annual fiscal impact to DHS should 20,750 families be sanctioned is $58.1 million. The contradiction between the chapter on welfare reform and the verbal testimony and service levels projected is not only confusing, but has profound negative consequences that can not be overlooked by PICA Staff.

<u>OESS</u>

In meetings with PICA Staff, the Office of Emergency Shelter and Services (OESS) officials stated that even an additional 100 families would be difficult for the system to accommodate. Yet, in the Homeless Programs section of the Plan, the implication of welfare changes is discussed as a constraint. "For example, as a result of Federal and State welfare changes, from March 1999 through February 2000 more than 41,000 local households will have hit the 24-month welfare-to-work deadline and are at risk of losing Temporary Assistance to Needy Families (TANF). For many of these households, the loss of TANF, or any of the host of other benefits on the chopping block, could eventually lead to homelessness by threatening their ability to pay for housing".[13] OESS recognizes the possible impact of welfare reform, yet would be unprepared for 100 additional families coming into the system. The City has greatly improved its services to the homeless population in recent years, and must prepare for the possible fallout of welfare reform.

OESS officials told PICA Staff that they are "hedging their bets," meaning that welfare reform could go either way. Currently an uneasy calm prevails, since welfare reform has not had the impact on homeless services that was expected. OESS is riding this wave and essentially keeping their fingers crossed that the State doesn't impose sanctions. However, should sanctions be imposed OESS would be in a reactive position, struggling to provide expanded services.

The average number of year round emergency shelter beds rose from an actual count of 2,318 beds in FY1999 to a target projection of 2,450 beds in FY2000 and in FY2001. The current projection for FY2000 is expected to fall to 2,216 beds. Given that OESS

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[12] *Five-Year Financial Plan, Fiscal Year 2001 - Fiscal Year 2005*, p. 144.
[13] *Five-Year Financial Plan, Fiscal Year 2001 - Fiscal Year 2005*, p. 136.

recognizes the pending impact of welfare reform as a constraint it is inconsistent that service levels are projected to remain constant. OESS is hoping that the impact of welfare reform will not be felt by the emergency shelter services. The Plan states, "The average bed level of 2,300 beds in FY99 was down significantly from the more than 6,500 shelter beds funded during the 1980s."[14] OESS like, DHS and DPH has inconsistent service level projections when compared to the City's dire warnings as to the impact of welfare reform. All three Departments have yet to feel a serious impact from welfare reform and this is driving their static projections in the out years of the Plan.

Clearly, the impact of welfare reform is an unquantifiable risk to the City, since the City can not determine how many families would be sanctioned should the State decide to fully implement sanctions. However, the City cannot suggest a possible annual fiscal impact of $224.1 million and in the same Plan depict Departmental service level projections to remain static. PICA Staff is disturbed by the City's contradictory indications through out the Plan, and strongly advises that the City fiscally prepare for the impact of welfare reform.

The City has Failed to Emphasize the March 2002 Five-Year Federal Limit

The Federal welfare law established a five-year life time limit for TANF recipients. TANF recipients who have been receiving aid since March 1997 will face a Federal life time sanction. The City has not determined the fiscal impact that the Federal restriction could have on DHS, DPH and OESS. The Plan does not even discuss the approaching deadline of March 2002.

The City can not afford to be lackadaisical in its preparation for the Federal sanctions in FY2002. It must be proactive and take appropriate measures to determine the possible impact of Federal sanctions on Philadelphia before such sanctions are enacted. However, simply determining the impact is not enough. The City must make fiscal preparations for the pending impact on social services. PICA Staff encourages the City to assess the impact of the five-year March 2002 limit and make appropriate adjustments based on the assessed impact.

[14] *Five-Year Financial Plan, Fiscal Year 2001 - Fiscal Year 2005*, p. 132.

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INCREASING DEBT SERVICE COSTS

Over the first few years of the Plan, the City expects to increase its overall borrowing significantly, reversing the trend of the past few years, and increasing the percentage of locally generated dollars that are subject to long-term debt service commitments. The risk inherent in these long-term commitments is compounded by the City's fast approach to its allowable debt limit, which jeopardizes the infrastructure maintenance goals of the overall Capital Program. These risks are further heightened by the probability of sports stadium debt issuance, debt which may be exempt from allowable debt limit problems, but which nonetheless adds to the City's annual debt service costs.

Increasing Reliance on Long-Term Debt

During the last few years of the Rendell Administration, the City was able to slowly reduce the percentage of locally generated dollars that were devoted to long-term debt costs. As the chart below details, the new Administration's Plan reverses that trend. In fact, by the second year of the Plan, this percentage will once again approach 13 percent, higher than in FY95.

Fiscal Year	**Locally Generated Dollars**[1]	Total Fixed Costs[2]	**Fixed costs as a % of Locally Generated**
1995	1,998,355,000	256,919,307	12.86%
1996	2,048,305,000	259,989,423	12.69%
1997	2,099,164,000	258,893,561	12.33%
1998	2,149,455,248	253,322,174	11.79%
1999	2,267,505,000	254,263,652	11.21%
2000 (Target/ Revised Estimate)	2,243,338,000	276,188,175	12.31%
2001	2,276,489,000	287,458,368	12.63%
2002	2,325,814,000	301,241,637	12.95%

[1] Locally Generated Dollars includes City Tax Revenues, PICA Tax Revenues, Locally Generated Non-Tax Revenues, and Revenue from Other Funds of the City.

[2] Total Fixed Costs includes Debt Service payments, PICA Debt payments, Long Term Leases, and the Convention Center Subsidy.

The increasing reliance on long-term debt is a concern in light of the other risks highlighted within the Plan and in this report. The cost of long-term obligations are dedicated monies that cannot be rebudgeted. Should there be a national economic downturn, revenues will not increase as projected; should welfare reform lead to an increased need for services, additional monies will be required in the appropriate service agencies; if revenues fall short of projections, or if other unbudgeted costs arise, the City will be forced to reallocate from among a smaller pool of funds.

While it is true that after FY2002 the percentage of locally generated dollars that are subject to long-term commitments will begin to fall, that is due in large part to PICA's refinancing of past loans on behalf of the City, and not as a result of the City's management of its other long-term debt. In addition, the farther ahead the projection (in this case, the last few years of the Plan), the greater the likelihood that the economic landscape will differ from the outlook today. The result is an increased risk of a probable downturn in the City or national economy, as well as the potential for increased pressure on locally generated dollars.

It is a generally accepted sound budgeting axiom that the time for a municipality to pay down debt is when that municipality has surplus funds. This Plan takes the opposite approach, by increasing the City's reliance on long-term debt during a period of relative fiscal health. Following seven straight years of balanced budgets and another record surplus, the City should be using this opportunity to put its financial house in order, reduce its long-term obligations, and attain the fiscal flexibility needed to meet unforeseen challenges.

The City is Quickly Approaching its Legal Debt Limit

At the end of FY2000, the City's general obligation debt borrowing capacity will be down to just over $288 million. As a result, the City's Capital Budget for FY2005 is expected to be under $30 million, less than one-quarter of the average Capital Program from FY1993-FY2001. This shrinking of the Capital Program places at risk the routine construction and renovation necessary to maintain the City's buildings, facilities, and infrastructure. Additionally, much of the State and Federal construction monies that the City receives is dependent on the local matching of funds. Without the availability or capital fund dollars to provide these matching funds, the City risks losing tens of millions of dollars in State and Federal funds for SEPTA infrastructure, highway repair, etc. The City will also be unable to make commitments to long-term projects (City Hall, the Art Museum, etc.), commitments which are often used to gain private funding to complete a project.

Although the Plan acknowledges the approaching debt limit constraint, there is no defined approach to solving the problem. While the Plan states that "the City will pursue strategies that will allow it to maintain a reasonable sized Capital Program," the City has not even updated its own Debt Policy Statement, published most recently in December 1997. As an example, a stated policy is that the Debt Service on Net Direct Debt of the City of Philadelphia will not exceed 6.9 percent of the total General Fund obligations of the City. Yet in the very first year of the policy, FY1997, this ratio was 7 percent.

PICA Staff does agree with the City that the formula for determining the City's debt limit is not equitable with other municipalities in the State. However, before seeking redress from the State Legislature, or even putting itself within danger of reaching the current debt limit, the City should observe the directive found in the introduction to the most recent Debt Policy Statement: "This Debt Policy is intended to be a dynamic, not a static document. Therefore it should be annually reviewed and updated."

While the City looks to pursue other strategies regarding the debt limit, the current Capital Program exacerbates the problem. The program is front loaded with two very high years of spending followed by four years of steadily dwindling capital spending. Ideally the City should be doing the opposite: reprioritizing capital spending in light of the debt limit, reserving as much funding as possible for true emergencies which may arise, and completing its new strategy before the limit is reached. The City's proposal is simply counterintuitive.

Current Debt Projections will be Higher if Agreement is Reached on New Stadiums

The City is in negotiations with the Phillies and Eagles for new sports stadiums. Should an agreement be reached, it will presumably involve additional long-term debt obligations by the City. During testimony before City Council, the Administration indicated that should such a scenario be realized, the money will be borrowed through an Authority, so as not to count against the City's debt limit. However, those funds would still raise the City's annual fixed costs, further raising the percentage of locally generated revenue dedicated to long-term obligations.

While the City correctly argues that the $80 million in the Capital Budget would no longer be required for Veteran's Stadium repairs, as discussed elsewhere in this report (see the Questionable Budgeting Practices section) there is no assurance given that these monies will not be used for other purposes. The City has also stated that the proceeds from the new Car Rental tax will help pay for new stadiums. However, the Plan currently includes those proceeds in its revenue calculations (dedicated to debt repayment), yet does not include debt repayment costs associated with new stadiums.

Conservatively, it is expected that the City will have to at least match the State's contribution towards new stadiums - $170 million. If the City were to reduce the Capital Budget over the next two years by $80 million, that would result in an additional $90 million in long-term debt, or repayment of approximately $6 million a year. If the $80 million were spent on other Capital projects, the City would add $170 million in long-term debt, or an annual repayment of over $12 million. Either way, the City's reliance on long-term debt is certain to increase.

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A RETURN TO QUESTIONABLE BUDGETING PRACTICES

In its February 2000 report card on financial management in Philadelphia, *Governing* magazine described the situation the City faced in 1991. "Deficit spending was endemic; budgeting was a joke. In 1991, Philadelphia skirted the edge of bankruptcy." The establishment of a sound budgeting process is the central tool that has enabled the recovery the City has enjoyed since 1991. The annual Five-Year Financial Plan not only establishes financial and programmatic priorities, but also states goals and assesses progress.

The greatest risk posed by the Plan is its step backward in the area of sound financial management policy. Approximately one-quarter of the proposed Capital Budget over the first two years of the Plan lacks both details and justification (i.e. Veterans Stadium Rehabilitation). A large-scale program (i.e. the Saving Neighborhoods Campaign) that will commit the City to additional long-term annual debt service costs of $18 million also fails to identify the scope of the project.

Risks Associated with a Non-specific Capital Program

Nearly twenty-five percent of the proposed Capital Program for FY2001-FY2002 is devoted to "the rehabilitation of Veterans Stadium." In contrast to other capital projects, no details for how this $80 million is to be spent appear in the Capital Program. The only extant description of the needs for Veteran's Stadium is an independent assessment detailing approximately $24 million in repairs over the period 2001-2005. In response to PICA Staff requests, the City was able to provide only a laundry list of types of repairs, without any demonstration of need or specific cost estimates for each type of repair. The lack of specificity in the Capital Program leaves the City open to serious questions about its system of prioritization. By not providing any justification, the Plan indicates that political expediency is the basis for capital expenditure, rather than an objective, well-managed approach to maintaining the City's infrastructure.

Although the $80 million dollars in Stadium repairs is a contingency plan in case no agreement is reached on new stadiums, it remains a possibility that these repairs will be required. In discussions with PICA Staff, parties involved in negotiations with the Eagles and Phillies indicated that as of early March, the negotiations were back at the initial stages, leaving November as an achievable, but challenging, deadline.

Further, even if a deal on new stadium construction is reached, there remains an $80 million authorization for capital projects at a time when the City is fast approaching its legal debt limit (see the Growing Debt Service section of this report for further details). On page 264, the Plan indicates that the goal is not to use these funds for repairs to Veterans Stadium. At the same time, there is no mention of what the authorized $80 million in capital funds will be used for in the event they are not needed for stadium repairs. Will the City seek to have those funds de-authorized, or reprogram the $80 million to be used for any number of capital projects? Neither the Five-Year Plan, nor repeated questioning by PICA Staff, revealed any thoughts regarding this eventuality.

Lack of Planning not Limited to Stadiums

The Plan also briefly describes the proposed Saving Neighborhoods Campaign, a community stabilization plan proposed to be funded through a $250 million bond issue. During a period of rising long-term obligations (see the Growing Debt Service section of this report for further details), this proposal will add an estimated $17 million to the City's debt service costs in FY2002, and $18.8 million to the City's debt service costs in the subsequent years of the Plan.

Despite the significant nature of this investment, the Plan offers no detail regarding the uses of these borrowed funds. The stated goals of the program are too general (though noble: to address blight, stabilize neighborhoods, and create development opportunities) with no details on how the monies will be spent. There are no discussions of the efforts needed for long-term rehabilitation of these neighborhoods, or even the specific measures that will be used to assess the impact of the program.

The lack of specificity is not limited to the goals of the Saving Neighborhoods Campaign. There is no discussion of whether all, or merely some, areas of the City will be included in this effort. The Plan does not address the issue of whether or not the $250 million will be enough to combat neighborhood blight. During discussions with PICA Staff, City officials were unable to even accurately address the scope of the problem, admitting to conflicting accounts of the numbers of vacant lots and buildings in the City.

Uncertain Financial Leadership

The leadership of the City's financial planning is currently in a state of flux. Although the Plan represents the priorities of the Administration, its implementation is dependent on the City's finance officials. At the time of submission of the Plan to PICA, the City's Budget Director and Deputy Budget Director, both primary architects of the Plan, had resigned and the newly appointed Finance Director had yet to assume her position. Although assurances were given regarding PICA Staff concerns about the financial plans discussed above, those assurances were given by individuals no longer in the City's employ.

This situation heightens PICA Staff concerns. PICA Staff encourages the new finance leadership to meet with PICA and address the deficiencies described herein. The new leadership must view questionable practices as the exception, rather than as precedent for future Five-Year Plans.

Conclusion

If nearly one-quarter of the proposed Capital Budget can be allocated without demonstrated need, if the City can propose to take on so much additional debt without any demonstrated program, then the eventual possibility of a Capital Program devoid of planning, justification, and demonstrable goals is forseeable. While no quantifiable "dollar risk" can be attributed to these projects, this approach to budgeting sets a dangerous precedent, and begs a response from the City's financial policy designers. It is our hope that the new City Finance Director and Budget Director will act quickly to meet with PICA Staff and address these concerns. In 1992, PICA borrowed over $400 million as part of the effort to reconstitute the City's Capital Program; PICA Staff does not want to find the City back where it started when PICA came into existence.

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Pennsylvania Intergovernmental
Cooperation Authority

STAFF REPORT
ON
FY2001-FY2005
FIVE-YEAR FINANCIAL PLAN

SECTION IV:

OTHER GENERAL FUND CONCERNS

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ANALYSIS OF THE CITY'S ECONOMY

According to data released by the Bureau of Labor Statistics (BLS), the number of jobs in Philadelphia has increased from year to year since 1997. The job increases come on the heels of Wage and Business Privilege tax cuts in FY1996 that have been continued through FY2000, a strong national economy, a stabilized property tax assessment base, and a FY1999 General Fund balance of $205.7 million. The potential impact of welfare reform has yet to bear a fiscal burden on the City. The hospitality and service sectors have grown stronger in Philadelphia while personnel cuts in the financial and healthcare sectors continue to foreshadow a decline in some of the industries that are Philadelphia's largest non-governmental employers.

The City's fiscal stability is at the mercy of underlying threats. The effects of mergers and acquisitions on Philadelphia's economy, the downsizing in the healthcare and financial industries and Philadelphia's failure to fiscally prepare for a downturn in the national economy are among the host of threats that push and pull on the City's economy. Philadelphia's unemployment rate has been declining since 1993 but at a slower pace than its surrounding suburbs, a sign that Philadelphia is slow to rise out from recessionary periods. Cautiously, in observance of Philadelphia's past fiscal history and in recognition of underlying threats, the City projects a decline in employment through FY2005, and the City adequately estimates a slight growth in property assessments.

Job Growth Continues in Philadelphia

According to the BLS, the total number of jobs in Philadelphia had steadily declined from 1990 to 1997. In 1998 the figures reported by the BLS illustrated the first job growth of the decade and 1999 figures illustrated continued job growth above 1998. The BLS reported that the annual total number of nonagricultural jobs for calendar year 1999 stood at 685,300. The 1999 number was an increase of 10,000 jobs from 1998, a growth rate of about 1.5 percent. The growth rate between calendar year 1997 and 1998 was about 1.2 percent.

From 1990 through 1997, the City lost 79,200 jobs, 32,900 of which were lost from 1990 to 1991. The average change in employment over the seven-year period was at a rate of -1.6 percent.[15] Despite the job growth of the past two years, the steady job rate decline in the majority of the 1990s and underlying threats to the City's fiscal stability have led the City to forecast further job decline through FY2005 at an average rate of 0.3 percent.[16] The Plan states that, "...the Five-Year Plan forecast assumes that employment will decline slightly during the plan period because of the uncertainty surrounding welfare reform and the outlook for the health services industry and the continuing concern regarding a possible national recession."[17]

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[15] U.S. Bureau of Labor Statistics

[16] *Five-Year Financial Plan, Fiscal Year 2001 - Fiscal Year 2005,* p. 7.

[17] *Five-Year Financial Plan, Fiscal Year 2001 - Fiscal Year 2005,* p. 6.

The City is hesitant to predict continued job growth but there is the possibility that the City's economy has improved beyond the official statistics, specifically that BLS is not accurately measuring recent job growth in Philadelphia. BLS has been questioned in the past on its ability to accurately count jobs in certain sectors, particularly in the rapid-growth technology related fields. Over the past ten years, there has been a significant exodus of population from the City; those who still work in the City are now paying the lower, non-resident Wage tax rate. Over the past six years the City has been steadily cutting the Wage tax rate, while at the same time wage growth has been relatively slow. Despite these three factors, FY2000 is estimated to be another year of record Wage tax revenue for the City. The only logical conclusion is that job growth in the City is greater than what is described by the BLS data.

Indications of the City's Slow Recovery from an Economic Recession

The City's first sign that the bleeding of jobs had stopped and was rebounding slightly was at the end of calendar year 1998 when the City realized a growth of 7,800 jobs from 1997. The Philadelphia Primary Metropolitan Statistical Area (PMSA) started to pull out of job loss in calendar year 1992.[18] BLS data reveals that the Philadelphia PMSA showed the first job growth from 1992 to 1993 and growth in the region as a whole has continued consistently through 1999. The City did not share in the region's rebound until a good five years later, when its first job growth occurred.

Comparison of unemployment rates is another indicator of the City's weakness in recovering from a recessionary period. The chart below lists the unemployment rate for Philadelphia, the nation and Philadelphia's Pennsylvania suburbs. Philadelphia, in part because of the City's high concentration of poverty, has the highest rate of unemployment in each year. In 1993 when the unemployment rate, across the nation and in the noted suburbs, dropped from 1992, Philadelphia's unemployment rate slightly increased.

Year	Philadelphia County	National	Bucks County	Chester County	Delaware County	Montgomery County
1990	**6.3**	**5.6**	**4.3**	**3.3**	**4.0**	**3.8**
1991	**8.8**	**6.8**	**7.0**	**4.7**	**5.9**	**5.4**
1992	**9.4**	**7.5**	**7.4**	**5.3**	**7.0**	**6.3**
1993	**9.5**	**6.9**	**6.5**	**4.7**	**6.4**	**5.6**
1994	**8.0**	**6.1**	**5.2**	**4.0**	**5.4**	**4.9**
1995	**7.7**	**5.6**	**5.1**	**3.9**	**5.5**	**4.5**
1996	**7.1**	**5.4**	**4.4**	**3.3**	**4.8**	**3.8**
1997	**7.0**	**4.9**	**4.2**	**3.2**	**4.6**	**3.7**
1998	**6.2**	**4.5**	**3.6**	**2.7**	**3.9**	**3.2**

Source: Bureau of Labor Statistics. Above unemployment rates are not seasonally adjusted.

[18] The Philadelphia PMSA consists of Bucks, Chester, Delaware and Montgomery Counties in Pennsylvania and Burlington, Camden, Gloucester and Salem Counties in New Jersey.

The average rate of decline for Philadelphia's unemployment rate, from 1993 to 1998, was 9 percent . Bucks, Chester, Delaware and Montgomery counties all hovered around a 12 percent average rate of decline for the years from 1993 to 1998. The difference in the rate of decline between Philadelphia and the surrounding suburbs demonstrates Philadelphia's slow recovery from an economic recession. The higher rates of unemployment in Philadelphia versus the nation and the suburbs in the above chart, portray Philadelphia's weakness resulting from the loss of jobs and population over the past decade and the City's high concentration of poverty.

Philadelphia's Largest Non-Governmental Employers and the Impact of Mergers, Acquisitions and Downsizing on the City's Economy

A survey of the largest non-governmental employers reveals a snapshot of the industries driving Philadelphia's economy. Eight of the top twenty-five non-governmental employers in the City are hospitals, two are financial institutions and two are insurance companies. Though the City still maintains a manufacturing sector, the dominance of the sector has shriveled and in its place the City has turned towards the service sector and tourism and marketing.

The healthcare sector is a crucial part of Philadelphia's economy, as demonstrated by its dominance in the top twenty-five largest non-governmental employers. Recent downsizing trends in the healthcare sector has had a direct impact on the City in terms of job losses and lost Wage tax revenue. The City's economy is threatened by the contraction of the sector. In an article published by the Philadelphia Inquirer on October 31, 1999 the bleak outlook for the University of Pennsylvania Health System became apparent. According to the article the Penn Health System over the previous year, had "been losing more than $16 million a month - or $542,000 a day".[19] The direct effect on Philadelphia is felt in the form of layoffs and the resultant loss of Wage Tax revenue. The Inquirer article stated that, "Penn is in the midst of removing 2,800 positions, or about 20 percent of its workforce, by June. Tomorrow, Penn will lay off 515 people and eliminate 1,100 positions at its four hospitals, marking the second large layoff this year".[20]

Allegheny Health System filed for bankruptcy in July 1998 with a $1.5 billion debt and had laid off about 1,700 workers in 1997. "Temple University Health System had operating losses of $42.5 million in 1999 on revenue of $665 million. Investment income narrowed that loss to about $15 million".[21] Tenet Healthcare bought eight of Allegheny's hospitals in the region. Tenet, a for-profit system, is now planning consolidation and

[19] Stark, Karl and Gerlin, Andrea, "Penn's Hospitals Try Drastic Medicine Tomorrow, A Second Round of Cuts Begins, Mainly at HUP," *The Philadelphia Inquirer,* October 31, 1999, p. A01.
[20] Stark, Karl and Gerlin, Andrea, "Penn's Hospitals Try Drastic Medicine Tomorrow, A Second Round of Cuts Begins, Mainly at HUP," *The Philadelphia Inquirer,* October 31, 1999, p. A01.
[21] Stark, Karl, "A Strategy for Survival Decisions Made in the Mid-1990s by the Jefferson Health System Were Derided but now Appear to Have Been Sound," *The Philadelphia Inquirer,* December 19, 1999, p.E01.

layoffs and plans to close the City Line Avenue Hospital on May 1, 2000. Tenet expected a larger profit than it turned. Restructuring and consolidations will be the alternative in order to cut losses and stimulate increased profits. The healthcare sector blames cuts in Medicare and Medicaid as forces creating financial losses in the industry.

The finance, insurance and real estate sector (FIRE) showed a significant job decline in Philadelphia between 1990 and 1997. As stated in the Five-Year Plan, Fiscal Year 2000 - Fiscal Year 2004, between 1990 and 1997 the "sector declined by 10.9 percent in Philadelphia while simultaneously growing by 6.6 percent in the suburbs".[22] The acquisition of CoreStates Financial Corporation by First Union in 1999 resulted in a net loss to the City of 3,700 jobs. The acquisition of Prime Bank by Summit Bank in February of 1999 resulted in cut of Prime Bank's "300 worker payroll by about 20 percent" and a shift of an operation center from inside the City to Bethlehem, PA.[23] Jefferson Bank recently sold out to Hudson United Corporation. Roughly 29 percent of Jefferson's workforce in the Philadelphia area will be cut, mostly in the Downingtown area. Reliance Insurance, with 1,200 employees in the Philadelphia area and three Center City offices, is vulnerable to a takeover because of large financial losses in 1999. The mergers and acquisitions in the financial sector and the likelihood of mergers in the insurance sector present challenges to the City. The financial sector in Philadelphia provides a significant amount of Wage Tax revenue to the City. Lost jobs through financial consolidations place a burden on the City's economy.

The impact of mergers, acquisitions and downsizing on the City's economy extends beyond the healthcare, insurance and financial sectors. Though the impact ranges in magnitude, Philadelphia has yet to realize the results from the buyout of SmithKline Beecham Pharmaceuticals by Glaxo Wellcome P.L.C. and the PECO Energy merger with Unicom Corporation. The City diligently reacted to news of the PECO merger and worked through a negotiated agreement to keep PECO jobs in the City for as long as possible. PECO committed to retaining at least 1,100 jobs at the Center City office through 2008, with a phase out of jobs occurring in the interim.

The City rightly acknowledges the threats posed by the downsizing in the healthcare and financial sectors and the mergers in other large industries as indicated by the following statement, "While the country's economy is strong Philadelphia's economic strength is threatened. The downsizing of its health-care and financial sectors; the continued long-term decline in manufacturing; and the prospect of perhaps 40,000 former welfare recipients thrown into a job market where the unemployment rate is nearly twice that of neighboring Montgomery County pose serious impediments to Philadelphia's viability as a dynamic urban center."[24] PICA Staff encourages the City to devise a proactive plan, in conjunction with the current reactive efforts, directed at improving the underlying economic trends in Philadelphia.

[22] *Five-Year Financial Plan, Fiscal Year 2000 - Fiscal Year 2004,* p. 51.
[23] DiStefano, Joseph S., "Merger's Toll: 200 Jefferson Bank Area Jobs," *The Philadelphia Inquirer,* February 13, 2000, p. E01.
[24] *Five-Year Financial Plan, Fiscal Year 2000 - Fiscal Year 2004,* p. xxi.

The City's Projections for Property Tax Assessments are Reasonable

The estimates for the Real Property Tax revenue are significant since the property tax is the second largest source of tax revenue. Property assessments determine the amount of revenue to be realized by the City. Real estate tax assessments for commercial, industrial and residential properties have grown for each respective year since 1997. The average rate of growth since 1997 has been .81 percent.[25]

The pattern of slight but consistent growth rate increases in real property assessments can be expected to continue. The Philadelphia real estate market has shown stability. The Center City market has rebounded from the early 1990s to such an extent that occupancy rates for business class space in 1998 was 87.3 percent and currently rests above 90 percent.[26] Small increases in residential assessments, the addition of taxable property from Tenet Healthcare, and a lower rate of adjusted assessments give support that property assessments have stabilized and will continue along the slight growth pattern evidenced over the past three years.

The City projects that commercial assessments will grow by 1.4 percent annually and residential assessments will grow by 1.3 percent annually through 2005.[27] PICA Staff believes that the City's projections are justified based on the past three years of property assessment growth and property tax revenue. PICA Staff feels that it is necessary to stress that the current property tax assessment estimates are founded on a continuation of the strong national economy.

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[25] *Five-Year Financial Plan, Fiscal Year 2001 - Fiscal Year 2005,* p. 8.

[26] Data obtained from the website of the Center City District, produced by the Central Philadlephia Development Corporation (CPDC). Grubb & Ellis Company released the occupancy rate data for CPDC in 1998.

[27] *Five-Year Plan, Fiscal Year 2001 - Fiscal Year 2005,* p. 9.

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THE CITY'S ECONOMIC POLICY LACKS MEANINGFUL PERFORMANCE MEASURES

PICA Staff released White Paper No. 8 on March 27, 2000, entitled "Good Policy Demands Better Measurement: Philadelphia's Economic Development Program." The paper focuses on the City's Economic Stimulus Program (ESP) and the fact that the program has evolved into a six year, roughly $7 billion program, without a comprehensive performance measurement system in place to measure its effectiveness. The public dollar investment into the ESP, that began in FY1994, has been an estimated $4.34 billion.[28] Given the massive public investment and the City's decision to continue the program throughout the life of the Plan, PICA Staff feels compelled to reiterate the issues discussed in White Paper No. 8 in this Staff Report.

Opportunity Cost

The City's decision to allocate General Fund dollars to the ESP leaves open the discussion of the opportunity cost and alternative uses of the General Fund dollars. The City has yet to publicly demonstrate that the ESP has been the most effective use of public dollars mainly because there are no performance measures in place for the ESP. While the City claims that the ESP produced a positive outcome in terms of retained and increased wage tax revenue, the City also notes the impact of wage tax reduction on retaining residents and employers and attracting businesses, thus retaining and increasing wage tax revenue.

It is impossible to determine the best use of funds without a clear, verifiable, accurate system of measuring ESP outcomes. The City does not provide performance standards or expectations for the input of dollars prior to the allocation of money, and the City does not evaluate the results after the money has been used. While the City does have defined criteria for some loan programs (only one piece of a total performance measurement system), PIDC and Commerce Department Officials in meetings with PICA Staff, stated that there are currently no standardized expectations for the outcomes from General Fund expenditures in the ESP (estimated $104 million from 1994-1999).[29] Simply put, it is impossible to determine the value gained by the citizens of Philadelphia for every dollar invested in the ESP.

The Quarterly Economic Stimulus Report

PICA Staff reviewed the only two sources of information made available on the ESP, the *Economic Stimulus Report* and the Economic Development chapter of the Five-Year Plan (for each respective year since FY 1995). The quarterly *Economic Stimulus Report* is published by the Philadelphia Commerce Department in cooperation with the

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[28] *Five-Year Plan, Fiscal Year 2001 - Fiscal Year 2005,* p. 64.
[29] See PICA White Paper No. 8 for a full listing of the funding programs included in the ESP.

Philadelphia Industrial Development Corporation. The stated objective of the *Economic Stimulus Report* is that it is "designed to both illustrate and measure the specific efforts and effectiveness of the Economic Stimulus Program."[30] PICA Staff reviewed the *Economic Stimulus Report* and concluded that the report as currently presented is ineffectual as a management tool because each report differs in the type of information reported, the data is inconsistent from report to report, and often, the numbers within a quarterly report contain mathematical errors. PICA Staff urges the City to reevaluate its reporting procedures and in conjunction with the institution of a performance measurement system, revise the *Economic Stimulus Report* so that it serves as a valuable management tool or, alternatively, devise and make public a new report to serve such purposes.

Determining a Focus for the Economic Stimulus Program

PICA Staff encourages the City to form a focus for the ESP that is consistent with strategic planning processes and serves as a guideline and strategy rather than the current broad parameters that fail to articulate a clear vision or directive to follow.

The focus of the ESP has remained the same over the six-year existence of the program. The focus has been divided into four areas: neighborhood economic development, business retention and attraction, hospitality and tourism, and defense conversion. It is unclear, based on documentation afforded in the *Economic Stimulus Report* and Five-Year Financial Plan, as to whether the City has regularly reevaluated the areas upon which to focus. It is clear however that while the City had begun efforts to capitalize on the biotech, high tech and e-commerce industries, the focus of the Economic Stimulus Plan did not change. Furthermore, the Five-Year Plan, Fiscal Year 2001 - Fiscal Year 2005, indicates that the ESP will retain its original four components but that "the efforts of the Program will be refocused on small and emerging businesses."[31] The contradiction of keeping the four components of the past six years and the determination that the ESP should be refocused sends a confusing message.

The new Administration will receive various suggestions on where to focus the ESP. It would benefit the City to redefine a strategy for the ESP based on the city-wide economic development which has changed within the past six years. Once this focus is determined, the new Administration will be able to evaluate success only through the creation and implementation of performance standards.

Creating an Efficient Performance Measurement System for the ESP

Performance measurement systems extend beyond simple tracking of outputs. Performance measurement systems are a comprehensive approach to measuring programs and services. Leadership, a defined focus and strategic plan, expected outcomes prior to

[30] *City of Philadelphia Economic Stimulus Report for the Calendar Year 1994,* p. 3.
[31] *Five-Year Financial Plan, Fiscal Year 2001 - Fiscal Year 2005,* p. 50.

implementation of resources, defined criteria, follow up upon implementation of input of resources, tracking of outputs and outcomes, a comparison of expected and final results and possible adjustments made upon those results are each integral parts of a complete performance measurement system. The City of Philadelphia does not have such a comprehensive system for the ESP, a program that boasts a combined total source dollar investment of $7.0 billion from 1994-1999.

The City may choose to turn to other large cities for ideas on establishing performance measurements for the ESP. The City of Indianapolis serves as a pioneer in holding companies to job creation, retention and wage standards in exchange for economic development incentives. In a program called "Tax Abatements with Accountability," the City will revoke a tax abatement or put a company on probation if a company fails to achieve stated job creations or wage levels. Indianapolis requires every company receiving a tax abatement to file an annual survey documenting the activity of the company.

The Street Administration Plans to Continue the Economic Stimulus Program

The Street Administration has decided to continue the ESP despite the fact that the program has not demonstrated specific quantifiable results. The fiscal implications of the decision to extend the program are unclear since the Five-Year Plan, Fiscal Year 2001 - Fiscal Year 2005 (which includes Fiscal Year 2000) fails to document the funding sources and levels of the ESP. The new Administration does offer some insight into proposed changes in the ESP but does not state any intentions to establish a process of performance measurement for the program. There remains no promise of accountability for the tax supported dollars allocated to the Economic Stimulus Program.

Conclusion

Given the significant public investment of the Economic Stimulus Program, the lack of performance measurements and established expectations for spending should no longer be tolerated. Inadequate evaluations of the efficiency and effectiveness of the Economic Stimulus Program raise serious questions as to the relative value of the program in comparison to other uses of the General Fund dollars involved in its continuance. Performance measurement systems will not serve as an effective tool to evaluate the Economic Stimulus Program if it is not deemed a priority by the new Administration.

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LACK OF PREPARATION FOR FISCAL RISKS IN THE EVENT OF A DOWNTURN IN THE NATIONAL ECONOMY

The City is riding the wave of a strong national economy with rising revenues and a growing job market. Philadelphia, however, was slow to share in the benefits of the strong national economy, as it took years for the City to emerge from the recession of the early 1990s. Factors such as a high poverty concentration, a high local tax burden and a shrinking population, make Philadelphia vulnerable to a fast hit should the economy begin to slow. Though the threat of a national recession is mentioned throughout the Plan, the City bases all revenue projections and future assumptions on a strong national economy. Based on the City's slow recovery from the most recent recession and the City's admission to its own weakness should a national recession occur, the City is placing itself in a tenuous position if it does not prepare for a possible downturn in the national economy.

At the end of FY1999, the City had accumulated a $205.7 million fund balance, even after the tax reduction program begun in FY1995. Though management and productivity initiatives are to be credited with reducing costs, the strong national economy is a major factor driving the positive fund balance. Due to the City's dependence on the strong national economy as a foundation for the relative fiscal stability, the Plan makes the assertion that, "...there is no question that the City's economy still lags behind the national economic recovery and remains vulnerable to almost any downward economic trend."[32]

The City has failed to make any preparations for a possible downturn in the national economy. The City has not documented any preparation efforts in the Plan, despite recognition of its own vulnerability. When forecasting revenue projections for the out years of the Plan the City notes in the Plan that, "Most significantly, these estimates do not presume any significant downturn in the regional, national or international economies during the period of the Five-Year Plan. Any economic downturn would likely lead to far lower revenues for the City than the Plan projects."[33] PICA Staff feels that the City is making a habit out of highlighting fiscal risks while failing to show any fiscal preparation should the risks come to fruition. The City can not afford to be caught unprepared should a national recession come to pass. While the economy is hard to predict, the City can be taking measures that would at least lessen the blow that a national recession would have on Philadelphia.

The threat of a downturn in the national economy is just one of many risks highlighted by PICA Staff throughout this report. The fiscal impact should TANF sanctions be enforced, the sporadic spikes in prison overcrowding, and unknown labor costs, all have the potential to seriously derail the City's fiscal stability. The FY1999 fund balance of $205.7 million may appear to be a cushion for these risks, however, the fund balance is projected to decrease to just under $5 million by FY2005 and this projection is without any employee wage increases.

[32] *Five-Year Financial Plan, Fiscal Year 2001 - Fiscal Year 2005,* p. xix.
[33] *Five-Year Financial Plan, Fiscal Year 2001 - Fiscal Year 2005,* p. 2.

Use of a Rainy Day Fund

A rainy day fund as defined by *Governing* magazine is, "reserves set aside to be used in the event of a recession or other unpredictable fiscal surprises."[34] Many municipalities resorted to utilization of a rainy day fund after learning hard lessons from recessions in the early 1980s and the early 1990s. The creation of a rainy day fund is one option for the City of Philadelphia, though not necessarily an easily achieved option. While the Philadelphia Home Rule Charter of 1951 seems to prevent the City from setting money aside into a rainy day fund or a budget reserve or contingency fund, it may be possible to find another way to appropriate a reserve fund. Even if a Home Rule Charter amendment is required, the City may conclude that it is worth the attention, time, effort and deliberation.

Set Parameters for a Rainy Day Fund

Rainy day funds are composed of general fund revenue or tax supported dollars. The annual percentage of general fund dollars to be allocated into the fund, the purposes for which the money can be spent and the maximum amount of money that may accumulate in the fund are issues for which each respective municipality must set strict parameters. Debates and criticisms usually arise such as suggesting that balances be used instead to reduce taxes, pay for liability, and other operating expenses. Cities are forced to remain insistent that the funds are for a downturn in the economy or unknown risks. The City may set a parameter such that after four consecutive quarters of revenue decline the rainy day fund may be tapped to ensure continuation of City services. Also, a neutral party may be utilized to operate the rainy day fund, such as the Office of the City Controller or PICA.

Local Municipalities Across the Country Utilize a Rainy Day Fund

There are currently 45 states with rainy day funds or some type of stabilization fund. Pennsylvania is projecting a balance exceeding $1.1 billion in its rainy day fund in FY2000 - FY2001. In the February 2000 issue of *Governing* magazine, in a report published by the Maxwell School of Citizenship and Public Affairs at Syracuse University and *Governing* magazine, 16 of the 35 cities were cited as having rainy day funds or reserve surplus funds. Though most of the accumulated balances in the rainy day funds could not fully sustain a city's economy in the event of a national downturn, the funds are thought to be a proactive fiscal step towards preparing for the blows that a volatile economy delivers. The rainy day fund is a reserve that can serve as source of revenue that will minimize the likelihood that a city would be forced to raise taxes, increase debt, or cut services in order to survive a downturn in the economy.

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[34] "Grading The Cities: A Report Card on Urban Management". *Governing.* February 2000, p. 31.

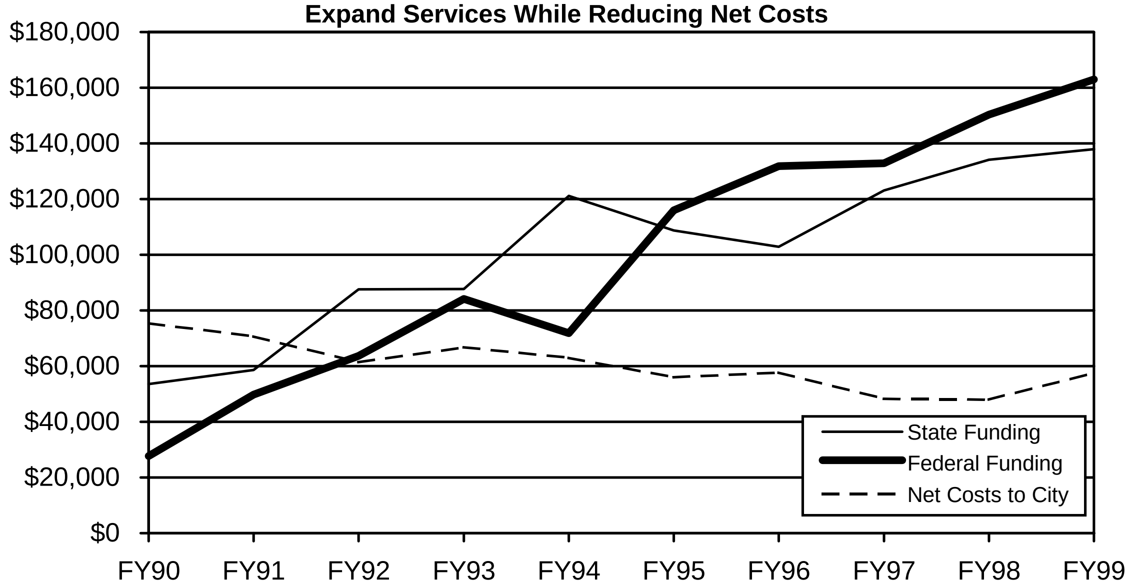
DEPARTMENT OF HUMAN SERVICES

The Department of Human Services (DHS) has successfully and significantly increased its State and Federal funding over the past nine years. This increased "outside" funding has allowed the City to enhance service levels, while simultaneously reducing net City costs. Programmatic and funding challenges threaten to increase net City costs in the future. The City must continue working diligently with other governments to protect the funding it currently receives from them and to identify new funding streams.

Increased State and Federal Funding has led to Service Enhancements and Reduced Net City Costs

In the early 1990s, as a result of legal and political pressure, the State initiated a Needs-Based Budget process to determine appropriate levels of State funding for human service functions. While serious problems with the State's Needs-Based Budget Process still need to be addressed, the process has resulted in increased State funding for City-provided Children and Youth and Juvenile Justice Services. Simultaneous to this change, the City and the State also began pursuing additional Federal funding for these services.

DHS Obtained Increased State and Federal Funding Allowing the City to Expand Services While Reducing Net Costs



(Figures are not adjusted for inflation, numbers in ooo's)

As the above graph illustrates, while the City locally funded 47 percent of DHS General Fund costs in FY90, by FY99 the City locally funded less than 16 percent of these costs. Over that same time period, the Federal government went from the smallest funding source (14 percent) to the largest (45 percent). The State's contribution has bounced around between 32 percent and 47 percent of total costs over the past ten years, but in FY99 it was again close to its FY89 contribution level of 39 percent of total costs.

Throughout the life of the Plan, the City share of DHS costs is projected to drop even further, to 12 percent; a highly commendable achievement if proven accurate.

These increased revenues from other governments have allowed DHS to enhance service levels. As an example, the number of dependent children in placement increased from 5,903 in 1990 to 8,172 in FY99.

Increased State and Federal Funding Creates a Strong Financial Dependency

The City's success at obtaining increased State and Federal revenues for DHS services is a double-edged sword. While it has reduced the demand those services place on locally-generated revenues, it has also increased the City's dependence on decision-makers in Harrisburg and Washington, DC.

The City's vulnerability to legislative and regulatory decisions at both the State and Federal levels has already been exposed. Constant change in various Federal programs (such as Title IV-A and TANF) has provided a constantly shifting landscape of available funds. The City, in conjunction with the State, has managed to identify new sources of available Federal funding that have continued to shift DHS costs to the Federal level, even after taking into account the changes mentioned above.

However, the City cannot take for granted the continuance of these funding streams. It is especially important that the City continue to work closely with the State to maintain current State and Federal funding levels and to identify new opportunities for enhanced funding.

In discussions with PICA Staff, DHS outlined specific steps it is prepared to take in order to preserve the current levels of funding. The "carrot and stick" approach has been successful to date, and DHS also has a triage plan of last resort, in case funding was to be drastically cut. Given the current funding circumstances, particularly with large surpluses at the State and Federal level, the outlook for funding over the next few years is fairly secure.

Continuing Problems with the Act 30 Needs-Based Budget Amendments to Act 148

The Needs-Based Budget process continues to suffer from serious inequities and muddled processes. PICA Staff has previously discussed these problems (see *Staff Report on State Funding of the Philadelphia Department of Human Services*, December 15, 1995). As the Plan explains, as a result of the confusion surrounding the process, Philadelphia has repeatedly pressed the State to increase the FY99 certified level of funding for Philadelphia. The certification is still under appeal.

DHS takes major issue with three aspects of the current Needs-Based Budget process. Each one potentially leads to State underfunding. When calculating the appropriate level of State funding for a particular year, the State Department of Public Welfare uses:

(1) Uniform, Statewide caps on rates of increases for costs of purchased services without regard to actual costs or differences in costs among counties;

(2) Uniform Statewide caps for salaries and benefits which ignore cost of living differences among counties; and

(3) "Certified" funding amounts from the previous year, rather than actual costs or mid-year estimates.[35]

To date, increased Federal funding has obscured the flaws in the Needs-Based Budget process. However, these flaws are likely to become more significant if Federal funding either levels off or declines.

Conclusion

DHS has been remarkably successful at obtaining much greater levels of State and Federal funding, allowing it to enhance its service levels and reduce net City costs. This success, though, makes it imperative that the City continue to be proactive in order to protect the gains it has made and seek out new potential revenue streams.

[35] See *City of Philadelphia, Annual Plan for Fiscal Year 2000*, Philadelphia Department of Human Services and the First Judicial District of Pennsylvania, August 1, 1998, p. V-1.

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PHILADELPHIA PRISON SYSTEM

The population in the Philadelphia Prison System (PPS) has grown from 4,799 inmates in FY1994 to 6,296 inmates in FY1999, with a projected increase to 6,891 inmates in FY2000 and FY2001.[36] The rise in population has necessitated an annual corresponding rise in the prison system budget. The evident correlation between prison population and budget appropriation, as well as the unpredictable sporadic spikes in the population are the reasons that PICA Staff continues to draw attention to the prison population as an issue that can fiscally impact the City.

Handling the Prison Population

As a result of two class action lawsuits, *Jackson v. Hendrick* (1971) and *Harris v. City of Philadelphia* (1982), PPS has been required to implement certain planing processes, improve prison conditions for inmates and enact a prison population cap. The lawsuits that produced court decrees have placed the PPS under the ever-watchful eye of the Federal Court and under "court management of important aspects of the Philadelphia's criminal justice system."[37]

The prison cap was declared "stayed" by the Courts in November 1995, from which point the prison population has steadily increased. Between 1982 and November 1995 the prison population had been capped at 5,700 inmates due to the Harris decree. In meetings with PICA Staff on March 9, 2000, Prison officials stated that the prison population stood at 6,700 inmates.

In 1995, to address the prison population problem, the City opened the Curran-Fromhold Correctional Facility (CFCF), a 2,016 bed facility. In addition to the opening of CFCF, PPS turned to alternative-to-incarceration programming as an attempt to control the growing prison population. Substance abuse treatment support through the Forensic Intensive Recovery (FIR), expanded use of the electronic monitoring system, and a contract with a private provider of minimum custody housing have been used as alternatives to incarceration in the PPS.

In Spring 2001, a new correctional facility for women will be opened on the grounds of the House of Corrections. The prison will be a 384-cell facility, housing two inmates per cell. This facility will open an estimated 482 beds in the PPS and further alleviate the prison over-population.

Cost Burden on the City

In order to deal with the problem caused by limited facilities and a rising inmate population, the PPS has resorted to out of county housing and, for a temporary period of

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[36] *Five Year Financial Plan, Fiscal Year 2001 - Fiscal Year 2005,* p. 165.
[37] *Five Year Financial Plan, Fiscal Year 2001 - Fiscal Year 2005,* p. 162.

time, housing inmates three to a cell. In a meeting with PICA Staff, PPS officials stated that the City spent $995,619 in FY1999, and will spend a projected $5.7 million in FY2000 and FY2001 for housing inmates out of county. Given the limited prison capacity, the City is forced to continue to utilize out of county housing of inmates and thus, will continue to bear a financial burden for the alternative housing.

City officials indicated to PICA Staff that 80 inmates were housed three to a cell for four days in FY1999. Since triple celling has been prohibited under court orders, the City agreed to pay prison inmates $33 per day as recompense for each day they were housed three to a cell. Based on the estimate that 80 inmates were housed three to a cell for four days, with an agreement that the City would pay each inmate $33 a day, the illegal triple-celling added an additional cost of $10,560 on the City in FY1999.

PPS Projects the Prison Population will begin to Stabilize

The PPS projects the prison population to level off at 6,891 inmates in FY2000 and remain at that level through FY2001. PPS officials informed PICA Staff that as of March 2000 the prison population had been stable for the past three months. The static projection for population from FY2000 to FY2001 is primarily due to the projection by the Philadelphia Police Department (PPD) that arrests will stabilize at 80,000 in FY2000 and FY2001. The number of arrests in FY1998 and FY1999 rose significantly from the number of arrests in FY1997. The PPS has contended that the rising prison population was a direct result of the increased number of arrests.

Better Coordination among Criminal Justice Partners will Cut Costs

In meetings with the City, PICA Staff posed the same question to the District Attorney's Office (DA), the PPS, the PPD and the First Judicial District (FJDP). In reference to the Plan's statement that, "All of the partners in the criminal justice system must work together to prevent the PPS budget from threatening the City's already precarious fiscal stability or, worse, from bankrupting the City," PICA Staff asked each department to comment on the working relationship among departments in the criminal justice system[38].

One official suggested that a City criminal justice coordinator be appointed to facilitate coordination among departments and focus efforts towards cost cutting initiatives. Poor communication and coordination among criminal justice partners has given rise to problems such as an increase in the number of continuances in court, rising overtime costs in the PPD, problems with the presentation of discovery evidence at trials, miscommunication in regards to transportation of prisoners from State prisons and problems with recidivism. Though these problems, in part, arose from the increased number of arrests over the past few years, the coordination problems among the criminal justice partners exacerbates a financially strained system.

[38] *Five-Year Financial Plan, Fiscal Year 2001 – Fiscal Year 2005,* p. 165.

The criminal justice partners must strive to overcome internecine conflicts and realize the potential benefits of coordination. An example of the potential benefits can be found in the "hearsay program." Instituted as a pilot program, in cooperation between the DA, PPD, and the FJDP, the "hearsay program" is an attempt to cut the overtime costs borne by the PPD from requiring officers to appear in court as witnesses for the preliminary trial. The "hearsay program" allows one officer to appear as a witness, rather than mandating that all witnessing officers to the crime appear in court. The lone officer reads the testimony of the other officers and such testimony is accepted as evidence at the trial. The pilot program, initiated in September 1999, has proven successful in cutting the overtime costs for the PPD. However, the pilot program is limited to one courtroom and has yet to be implemented system wide. The Public Defender's Association has also raised concerns about the program. Despite the challenges ahead, the "hearsay program" demonstrates that better coordination among criminal justice partners is an effective cost cutting measure that also provides for the delivery of a more efficient criminal justice system.

Sporadic Spikes in the Prison Population Continues to Pose a Fiscal Risk to the City

While the PPS population is projected to stabilize, it is the unpredicted spiking of the prison population that continues to threaten the City fiscally. In meeting with PICA Staff, PPS and City Budget Office officials agreed that a major concern is how to deal with the sporadic spiking in the prison population, that surpassed 7,000 inmates for a brief period of time in FY1999. The fiscal impact on the City to date, as a result of the increased population, is noted in the Plan, "…the increase in the PPS' spending forced reductions in spending elsewhere in the City's budget."[39] While the City has acknowledged the risks posed by sporadic spikes in the prison population, there is little discussion of strategies to combat these spikes. Better coordination and communication among criminal justice partners could potentially improve the situation. At the same time, the City must find ways to absorb fiscally the results of the sporadic spikes in the prison population.

[39] *Five-Year Plan, Fiscal Year 2001 – Fiscal Year 2005*, p. 165.

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THE YEAR 2000 CENSUS

PICA Staff recognizes the City's efforts to promote citizen participation in the year 2000 Census. PICA Staff suggests that the City, in conjunction with its current marketing measures, begin to prepare for a worst case scenario should the participation drives fall short of desired results.

The Ramifications of Census Undercount

The City appropriately acknowledges the ramifications of a 2000 Census count should the count fall below the 1990 population level. The Plan aptly states that in addition to the possibility that State and Federal funding would be reduced there is a real threat that the City could lose one of its three seats in Congress. As stated in the Plan, "The accuracy of the census population is critical because it partially determines the levels of State and Federal funding the City will receive over the next ten-year period."[40] The devastating impact likely from a loss of a Congressional seat and decreased funding leads the City to claim that, "One of the most immediate and important challenges facing Philadelphia is the decadal 2000 census."[41]

The City estimates that "the 1990 census undercounted residents by 130,000 and cost Philadelphia approximately $140 million in State and Federal aid."[42] An example of a direct impact, resulting from the U.S. Census Bureau population estimates over the past decade, has been a decrease in revenue to the Philadelphia Department of Health (DPH). The DPH is awarded funding through the County Health Act. The funding is derived from a formula based on county population. As a result of the formula, "Since FY94, the City has lost a total of approximately $1.05 million in County Health Act funding due to an estimated 140,000-person decrease in Philadelphia's population."[43]

The City is making a Proactive Effort

The City's efforts to induce every Philadelphia household to fill out a census form is a proactive attempt to eliminate the undercounting that the City claims existed in past census counts. The City has allocated $420,000 towards the formation of a Census 2000 Committee. The committee has been charged with raising the awareness of the census and promoting public participation in the census count. The City's intent is to impress upon the citizens of Philadelphia that completion of the census form is critical and that poor census participation may impact the services received by the citizens of Philadelphia. The past mayoral Administration, dissatisfied with the 1998 population

[40] *Five-Year Financial Plan, Fiscal Year 2001 – Fiscal Year 2005*, p. 63.
[41] *Five-Year Financial Plan, Fiscal Year 2001 – Fiscal Year 2005*, p. 63.
[42] *Five-Year Financial Plan, Fiscal Year 2001 – Fiscal Year 2005*, p. 63.
[43] *Five-Year Financial Plan, Fiscal Year 2001 – Fiscal Year 2005*, p. 175.

estimate produced by the U.S. Census Bureau, had formally challenged the results. The challenge foreshadowed the significance that was to be placed on the 2000 Census.
Conclusion

The outcome of the 2000 Census is an unpredictable risk that may fiscally impact the City in the immediate future. Though the City has taken valiant steps to promote citizen participation in the 2000 Census, PICA Staff warns that the City must also fiscally prepare for the implications of a census count that undercounts the current population in Philadelphia.

Pennsylvania Intergovernmental Cooperation Authority

STAFF REPORT ON FY2001-FY2005 FIVE-YEAR FINANCIAL PLAN

SECTION V:

APPENDICES

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APPENDIX A

Statutory Background, Plan Review Methodology and Summary of Events

Overview

The General Assembly created PICA in June of 1991 by its approval of The Pennsylvania Intergovernmental Cooperation Authority Act for Cities of the First Class (Act of June 5, 1991, P.L. 9, No. 6). As in previous PICA Staff reports concerning the City's prior five-year financial plans, rather than re-state in the body of this Staff Report the principal provisions of the PICA Act and the Intergovernmental Cooperation Agreement, PICA Staff has included such information in this Appendix.

A brief summary of events to date including comments as to PICA's future focus, a summary of PICA Staff's Plan review methodology and a compilation of required future City reporting to PICA is also included herein.

Statutory Basis -- The PICA Act

The mission of the Authority, as stated in the PICA Act (Section 102), is as follows:

> Policy.--It is hereby declared to be a public policy of the Commonwealth to exercise its retained sovereign powers with regard to taxation, debt issuance and matters of Statewide concern in a manner calculated to foster the fiscal integrity of cities of the first class to assure that these cities provide for the health, safety and welfare of their citizens; pay principal and interest owed on their debt obligations when due; meet financial obligations to their employees, vendors and suppliers; and provide for proper financial planning procedures and budgeting practices. The inability of a city of the first class to provide essential services to its citizens as a result of a fiscal emergency is hereby determined to affect adversely the health, safety and welfare not only of the citizens of that municipality but also of other citizens in this Commonwealth.
>
> Legislative intent.--
>
> (1) It is the intent of the General Assembly to:
>
> (i) provide cities of the first class with the legal tools with which such cities can eliminate budget deficits that render them unable to perform essential municipal services;

(ii) create an authority that will enable cities of the first class to access capital markets for deficit elimination and seasonal borrowings to avoid default on existing obligations and chronic cash shortages that will disrupt the delivery of municipal services;

(iii) foster sound financial planning and budgetary practices that will address the underlying problems which result in such deficits for cities of the first class, which city shall be charged with the responsibility to exercise efficient and accountable fiscal practices, such as:

> (A) increased managerial accountability;
>
> (B) consolidation or elimination of inefficient city programs;
>
> (C) recertification of tax-exempt properties;
>
> (D) increased collection of existing tax revenues;
>
> (E) privatization of appropriate city services;
>
> (F) sale of city assets as appropriate;
>
> (G) improvement of procurement practices including competitive bidding procedures;
>
> (H) review of compensation and benefits of city employees; and

(iv) exercise its powers consistent with the rights of citizens to home rule and self government.

(2) The General Assembly further declares that this legislation is intended to remedy the fiscal emergency confronting cities of the first class through the implementation of sovereign powers of the Commonwealth with respect to taxation, indebtedness and matters of Statewide concern. To safeguard the rights of the citizens to the electoral process and home rule, the General Assembly intends to exercise its power in an appropriate manner with the elected officers of cities of the first class.

(3) The General Assembly further declares that this legislation is intended to authorize the imposition of a tax or taxes to provide a source of funding for an intergovernmental cooperation authority to enable it to assist cities of the first class and to incur debt of such authority for such purposes; however, the General Assembly intends that such debt shall not be a debt or liability of the Commonwealth or a city of the first class nor shall debt of the authority payable from and secured by such source of funding

create a charge directly or indirectly against revenues of the Commonwealth or city of the first class.

The PICA Act establishes requirements for the content of a five year financial plan, and Sections 209 (b)-(d) of the statute and the Cooperation Agreement provide:

(b) Elements of plan. -- The financial plan shall include:

(1) Projected revenues and expenditures of the principal operating fund or funds of the city for five fiscal years consisting of the current fiscal year and the next four fiscal years.

(2) Plan components that will:

(i) eliminate any projected deficit for the current fiscal year and for subsequent years;

(ii) restore to special fund accounts money from those accounts used for purposes other than those specifically authorized;

(iii) balance the current fiscal year budget and subsequent budgets in the financial plan through sound budgetary practices, including, but not limited to, reductions in expenditures, improvements in productivity, increases in revenues, or a combination of these steps;

(iv) provide procedures to avoid a fiscal emergency condition in the future; and

(v) enhance the ability of the city to regain access to the short-term and long-term credit markets.

(c) Standards for formulation of plan:

(1) All projections of revenues and expenditures in a financial plan shall be based on reasonable and appropriate assumptions and methods of estimation, all such assumptions and methods to be consistently applied.

(2) All revenue and appropriation estimates shall be on a modified accrual basis in accordance with generally accepted standards. Revenue estimates shall recognize revenues in the accounting period in which they become both measurable and available. Estimates of city-generated revenues shall be based on current or proposed tax rates, historical collection patterns, and generally recognized econometric models. Estimates of revenues to be received from the state government shall be based on

historical patterns, currently available levels, or on levels proposed in a budget by the governor. Estimates of revenues to be received from the federal government shall be based on historical patterns, currently available levels, or on levels proposed in a budget by the president or in a congressional budget resolution. Non-tax revenues shall be based on current or proposed rates, charges or fees, historical patterns and generally recognized econometric models. Appropriation estimates shall include, at a minimum, all obligations incurred during the fiscal years and estimated to be payable during the fiscal year or in the 24-month period following the close of the current fiscal year, and all obligations of prior fiscal years not covered by encumbered funds from prior fiscal years. Any deviations from these standards of estimating revenues and appropriations proposed to be used by a city shall be specifically disclosed and shall be approved by a qualified majority of the board.

(3) All cash flow projections shall be based upon reasonable and appropriate assumptions as to sources and uses of cash, including, but not limited to, reasonable and appropriate assumptions as to the timing of receipt and expenditure thereof and shall provide for operations of the assisted city to be conducted within the resources so projected. All estimates shall take due account of the past and anticipated collection, expenditure and service demand experience of the assisted city and of current and projected economic conditions.

(d) Form of plan. -- Each financial plan shall, consistent with the requirements of an assisted city's home rule charter or optional plan of government:

(1) be in such form and shall contain:

(i) for each of the first two fiscal years covered by the financial plan such information as shall reflect an assisted city's total expenditures by fund and by lump sum amount for each board, commission, department or office of an assisted city; and

(ii) for the remaining three fiscal years of the financial plan such information as shall reflect an assisted city's total expenditures by fund and by lump sum amount for major object classification;

(2) include projections of all revenues and expenditures for five fiscal years, including, but not limited to, projected capital expenditures

and short-term and long-term debt incurrence and cash flow forecasts by fund for the first year of the financial plan;

(3) include a schedule of projected capital commitments of the assisted city and proposed sources of funding for such commitments; and

(4) be accompanied by a statement describing, in reasonable detail, the significant assumptions and methods of estimation used in arriving at the projections contained in such plan.

The Cooperation Agreement (at Section 4.04(a)-(h)), and similar provisions of the PICA Act, also require the following as supporting data for the Plan:

(a) a schedule of debt service payments due or projected to become due in respect of all indebtedness of the City and all indebtedness of others supported in any manner by the City (by guaranty, lease, service agreement, or otherwise) during each fiscal year of the City until the final scheduled maturity of such indebtedness, such schedule to set forth such debt service payments separately according to the general categories of direct general obligation debt, direct revenue debt, lease obligations, service agreement obligations and guaranty obligations.

(b) a schedule of payments for legally mandated services included in the Financial Plan and due or projected to be due during the fiscal years of the City covered by the Financial Plan;

(c) a statement describing, in reasonable detail, the significant assumptions and methods of estimation used in arriving at the projections contained in the Financial Plan;

(d) the Mayor's proposed operating budget and capital budget for each of the Covered Funds for the next (or in the case of the initial Financial Plan, the current) fiscal year of the City, which budgets shall be consistent with the first year of the Financial Plan and which budgets shall be prepared in accordance with the Home Rule Charter;

(e) a statement by the Mayor that the budgets described in section 4.04(d) hereof:

(i) are consistent with the Financial Plan;

(ii) contain funding adequate for debt service payments, legally mandated services and lease payments securing bonds of other government agencies or of any other entities; and

(iii) are based on reasonable and appropriate assumptions and methods of estimation.

(f) a cash flow forecast for the City's consolidated cash account for the first fiscal year of the City covered by the Financial Plan;

(g) an opinion or certification of the City Controller, prepared in accordance with generally accepted auditing standards, with respect to the reasonableness of the assumptions and estimates in the Financial Plan; and

(h) a schedule setting forth the number of authorized employee positions (filled and unfilled) for the first year covered by such Financial Plan for each board, commission, department or office of the City, and an estimate of this information for the later years covered by the Financial Plan. The schedule required under this paragraph (h) shall be accompanied by a report setting forth the City's estimates of wage and benefit levels for various groups of employees, such information to be presented in a manner which will allow the Authority to understand and effectively review the portions of the Financial Plan which reflect the results of the City's labor agreements with its employees, and an analysis of the financial effect on the City and its employees of changes in compensation and benefits, in collective bargaining agreements, and in other terms and conditions of employment, which changes may be appropriate in light of the City's current and forecast financial condition. The parties agree to cooperate such that the form of the report required under this paragraph (h), and the subjects covered, are reasonably satisfactory to the Authority.

City Reporting and Variances

The PICA Act (Section 209) and the Cooperation Agreement (Section 409(b)) require submission of quarterly reports by the City on its compliance with the Plan within 45 days of the end of a fiscal quarter. If a quarterly report indicates that the City is unable to project a balanced Plan and budget for its current fiscal year, the Authority may by the vote of four of its five appointed members declare the occurrence of a "variance", which is defined in Section 4.10 of the Cooperation Agreement as follows:

(i) a net adverse change in the fund balance of a Covered Fund of more than one percent of the revenues budgeted for such Covered Fund for that fiscal year is reasonably projected to occur, such projection to be calculated from the beginning of the fiscal year for the entire fiscal year, or (ii) the actual net cash flows of the City for a Covered Fund are reasonably projected to be less than ninety-five percent (95%) of the net cash flows of the City for such Covered Fund for that fiscal year originally forecast at the time of adoption of the budget, such projection to be calculated from the beginning of the fiscal year for the entire fiscal year.

As defined in Section 1.01 of the Cooperation Agreement, the City's "Covered Funds" are the General Fund, General Capital Fund, Grants Revenue Fund and any other principal operating funds of the City which become part of the City's Consolidated Cash Account.

The statute mandates the submission of monthly reports to PICA by the City after determination by the Authority of the occurrence of a variance.

As provided in Section 210(e) of the PICA Act, there are legal consequences flowing from a determination by the Authority that a variance exists, and in addition to the City's additional reporting responsibilities, it also is required to develop revisions to the Plan necessary to cure the variance. The remedies which PICA has available to it to deal with a continuing uncorrected variance are to direct the withholding of both specific Commonwealth funds due the City, and that portion of the 1.5 percent tax levied on the wages and income of residents of the City in excess of the amounts necessary to pay debt correction of the variance.

Plan Review Methodology

<ins>Staff Report</ins> - The Plan, as approved by City Council on March 30, 2000, was submitted to PICA by the Mayor on April 25, 2000 and the PICA Act provides a 30 day period for review which expires May 25, 2000. Authority Staff has consulted with the City, both on the departmental level and otherwise, since the Plan was initially submitted to City Council by the Mayor on January 25, 2000 and has referred to material presented to City Council and the Controller’s Office, as well as information included in reports submitted by the City to PICA and other data developed by PICA Staff. This report includes reference to materials received by the Authority through April 25, 2000.

Under Section 5.07 of the Cooperation Agreement, PICA agreed not to disclose information provided to it in confidence by the City with respect to negotiation of collective bargaining agreements and ongoing arbitration proceedings, and the Authority has consistently followed that requirement.

<ins>Relationship to Future Plan Revisions</ins> - The City is obligated under the both the Cooperation Agreement and the PICA Act to submit a revised Plan in the event it enters into a collective bargaining agreement, or receives a labor arbitration award, at variance with that which was assumed in the Plan. The Cooperation Agreement anticipates that the Plan must be revised to deal with such matters within 45 days after declaration of a “variance” by PICA.

Apart from labor-related revisions, or those required by declaration by PICA of a variance in the Plan in the future, the Plan is subject to mandatory revision on March 23, 2001 (100 days prior to the end of FY2001). At that time, the City is required to add its Fiscal Year 2006 to the Plan and make any other alterations necessary to reflect changed circumstances. Under the PICA Act, the City may determine to revise the Plan at any time and submit the revision to the Authority for its review.

Accounting Concerns

The PICA Act requires that a modified accrual accounting system be used in preparation and administration of the Plan, in accordance with generally accepted accounting standards. Specifically, the Cooperation Agreement (at Sections 4.02(a) and (b)) provides:

> Estimates of revenues shall recognize revenues in the accounting period in which they become both measurable and available….
>
> Appropriation estimates shall include, at a minimum, all obligations incurred during the fiscal year and estimated to be payable during the fiscal year or in the twenty-four (24) month period following the close of the current fiscal year….

The Plan as submitted meets the requirements of the PICA Act and Cooperation Agreement.

Summary of Events to Date/Future Focus

PICA's creation was an action taken by the Commonwealth of Pennsylvania in direct reaction to Philadelphia's financial crisis. Accordingly, PICA's primary focus during its initial years of existence has been to assist the City to avoid insolvency; to provide the funds directly required for that purpose and for essential capital programs; and to oversee the City's efforts to lay a sound foundation for its return to fiscal stability. The negotiation of the Cooperation Agreement to set out the basic terms of the City-PICA relationship, the PICA sponsored effort resulting in the establishing of the format and content of the Five-Year Financial Plan process, and the issuance of bonds to provide funds to assist the City to stabilize its finances were all major accomplishments. Successful defense against challenges to the constitutionality of the PICA Act was another vital PICA process component. PICA's annual assessment of Plan progress, successful challenges to overgenerous prior Plan revenue estimates and suspect methodologies, evaluations of City reporting, and analysis of City practices and programs have assisted in the ongoing City improvement as envisioned by the PICA Act.

PICA also provides continuing oversight as to the encumbrance by the City of PICA provided capital funds for capital projects deemed required to rectify emergency conditions or necessary for Plan operational success.

PICA has provided in excess of $1,121 million in funding to assist the City, allocated to the following purposes:

Purpose	Amount (thousands)
Deficit Elimination/Indemnities Funding	$ 256,200
Productivity Bank	20,000
Capital Projects	463,882
Retirement of Certain High Interest City Debt	381,300
TOTAL	*$1,121,382*

PICA's authority to issue new money debt has expired. PICA anticipates that its future activities with respect to the City will focus more closely on oversight on the City's efforts to maintain financial balance, further institutionalize management reforms (both those initiated to date and those still to be made) and to implement ongoing operations changes in accordance with the City Strategic Plan.

The City had taken full advantage of the tools PICA made available to it. It is anticipated that the PICA/City relationship will continue to be a catalyst for further City operational improvements.

Whether PICA will also become involved in the financial oversight of the School District of the City Philadelphia is a matter that presently is in the hands of the Appellate Courts of the Commonwealth.

Future City Reporting to PICA

Absent the occurrence of a variance, receipt of an arbitration award which is at variance with the Plan or a determination by the City that further revisions to the Plan are necessary, the City will not submit a revised Plan to the Authority until March 2001. During future months, the Authority will receive quarterly reports on the City's performance under the Plan, together with other data.

The reporting system established in the Cooperation Agreement and the PICA Act anticipates a regular flow of data to PICA, and the reporting system which has been established by agreement between the City and PICA under the provisions of the PICA Act is divided into several groups, which are described below:

> Quarterly Plan Reports. The Authority receives reports from the City on a quarterly basis (45 days after the end of each fiscal quarter) concerning the status of compliance with the Plan and associated achievement of initiatives. The remaining quarterly reporting deadline for FY2000 is August 15, 2000. Quarterly reporting deadlines for FY2001 are November 15, 2000, February 15, 2001, May 15, 2001 and August 15, 2001. The Cooperation Agreement also requires that the City provide reports to PICA concerning Supplemental Funds (*i.e.*, the Water and Aviation Funds) on a quarterly basis.
>
> Grants Revenue Fund Contingency Account Report. The Cooperation Agreement provides that a report on the Grants Revenue Fund Contingency Account be prepared and submitted, by department, not later than 20 days after the close of each fiscal quarter, and still to be received relating to FY2000 is the report due July 20, 2000. For FY2001, the reporting dates are October 20, 2000, January 22, 2001, April 20, 2001 and July 20, 2001. This report details the receipt and use of federal and Commonwealth funds by the City, as well as the eligibility for fund withholding by the Commonwealth at PICA's direction in the event the City cannot balance the Plan after an extended period of intensive reporting and PICA review of proposed corrective efforts.
>
> Prospective Debt Service Requirements Reports. The Cooperation Agreement requires submission of a report detailing prospective debt service payments by the City, as well as lease payments, 60 days prior to the beginning of a fiscal quarter. The dates for submission of such reports for FY2001 are August 2, 2000, November 2, 2000, February 1, 2001 and May 3, 2001.

APPENDIX B

Schedule of Findings, Office of the City Controller

In accordance with Section 4.04(g) of the Intergovernmental Cooperation Agreement between PICA and the City, the City Controller's Office submitted to PICA its report upon the Forecasted Statements of General Fund Revenues, Obligations and Changes in Fund Balance for the Fiscal Years Ending June 30, 2001 and June 30, 2002, included in the Plan. That report included the Controller's Office opinion that the underlying assumptions provide a reasonable basis for City management's forecast. At the request of the PICA Board, the City Controller's Office also prepared a report upon the results of agreed upon procedures with respect to the Plan. PICA Staff is grateful for the assistance provided by the Controller's Staff in evaluating this Plan.

The Schedule of Findings of the Controller's Office resulting from its work with respect to the Plan, formally reported to PICA May 12, 2000 (as a component of the Controller's report upon the performance of agreed upon procedures) is reproduced in this Appendix. Certain of such findings have been previously discussed in this report from a PICA Staff perspective. PICA Staff believes the reader will gain added value from a review of the Office of the Controller perspective on such matters.

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City Controller's Office
REVIEW OF THE FIVE - YEAR FINANCIAL PLAN
FOR THE FISCAL YEARS 2003 THROUGH 2005
SCHEDULE OF FINDINGS

ECONOMIC AND GENERAL FUND REVENUE FORECASTS

The Controller's economic and General Fund revenue forecasts appear to be consistent with the Plan's estimates. The key underlying assumptions for both projections include (1) continuation of Wage and Business Tax reductions proposed throughout the life of the Plan, and (2) continued growth in the national economy but at a slower pace. It has been assumed that the City will maintain a relatively stable economic base throughout the life of the Plan.

Wage and Earnings Tax
City payroll employment will continue to be shaped by forces such as the City's proposed tax reduction, City's economic development programs, local industry restructuring, and welfare reform. Although the City's non-farm payroll employment increased in 1999, this momentum may not carry through the out years. The main reason is that the City's underlying economic structure has not changed. Based on past experience, the positive impact on the City's employment from the tax cuts and economic development programs has not surpassed the negative impact generated by the City's population decline and job losses due to mergers and acquisitions. Mergers and acquisitions will continue to occur, which, in most cases, will have adverse effects on the City's employment. Unknown impact of welfare reform could also pose potential threats to employment and the average wage in the City. Overall, it is assumed that the negative impact will prevail, causing City payroll employment to decline slightly through the next three years. Consistent with the Plan, it is assumed that growth in average wages will keep Wage Tax base growth above the inflation rate over the next three years.

Real Estate Tax

The Controller's Office assumes that the commercial and industrial real estate markets will continue to be shaped by two patterns. First, industry restructuring and technological improvements in the labor and capital markets will continue to reduce the demand for space. Second, favorable prices generated by the slack demand induce some modest improvement in the real estate market, hotel sector, condos, and rentals, in particular. In an effort to be conservative, we assume that the two forces will completely offset one another, yielding flat market values throughout the life of the Plan. The assessment appeals have dropped in the past two years due to strong economy and improvement in assessment. Given the assumption of continuance of strong national economy, we expect a continued decline in appeal losses. Therefore, our Office agrees with the Plan on the possibility of modest improvement in real estate market activity throughout the life of the Plan.

A recent report from the Controller's Office notes that City has been, and may continue to be, forced to substitute better real estate tax liens and/or cash for poor liens that the private servicers, who purchased the liens as part of the City's 1997 tax-lien sale, have been unable to collect upon. The impact of these substitutions on future City prior year Real Estate Tax collections could be material. The Plan assumes that the prior year Real Estate Tax collections will be, on average, approximately $24 million each year throughout the life of the Plan. Because of the potential substitution, it appears that the Plan overestimates prior year collections.

Business Privilege Tax

The Business Privilege Tax (BPT) is volatile and contingent upon economic conditions. As the gross receipts portion of BPT rate reduction continues, the percentage of BPT tax revenues derived from net income will likely increase. This intensifies volatility of BPT because collections of net income component depends not only on corporate profits, but also on the use of net losses that businesses are allowed to carry forward into a succeeding year to offset tax liabilities. Given the assumption of continuation of strong national economy, the Plan's estimates of modest BPT growth for FY 2001 to FY 2005 appear reasonable.

Revenue from Other Governments

Department of Human Services (DHS)

In the past few years, DHS has received a considerable amount of State and Federal funds, especially from Federal program Title IV-E and State program Act 148. The Plan assumes a 3.5 percent annual growth for Title IV-E and a 3.7 percent annual rate for Act 148 for FY 2001 to FY 2005. Given the assumption of continuance of strong national economy and the fact of sizable surpluses at the State and Federal level, the Plan's assumption of funding levels of Title IV-E and Act 148 appears reasonable.

Public Utility Realty Transfer Act (PURTA)

Based on projections of statewide PURTA distributions developed by the State Department of Revenue, the impact of the elimination of the electric generating plants from the PURTA tax base will result in statewide PURTA distributions of $43.4 million on average for FY 2001 to FY 2005.

Assuming the City's PURTA allocation will be reduced proportionally to the state's collection, we have estimated the City will collect an annual average of $6.6 million in PURTA tax revenue for FY 2001 to FY 2005 versus the Plan's estimates of $11.5 million. Our estimate is conservative because we did not take into account the recent changes to the PURTA tax rate and defined tax base, which may further decrease this revenue. Therefore, we believe that the Plan overestimates this tax revenue by at least $24.7 million over its five-year period.

Philadelphia Gas Works (PGW)
PGW has experienced some financial difficulties because of billing system failure and low demand for gas resulting from mild winters in the past three years. Poor management and lack of benchmarks at PGW negatively impacted its financial stability. Recent natural gas deregulation places PGW in a highly competitive environment. While PGW is implementing management reforms and looking for ways to improve operations, the outlook for PGW to remain economically viable remains in doubt. Hence, the Plan's assumption that PGW will continue to make its annual $18 million payment throughout the life of the Plan may be optimistic.

Locally Generated Non-Tax

Stadium
The Plan estimates that there will be roughly $18 million of Veterans Stadium-related revenues each year for FY 2003 to 2005. Given the likelihood that the City will allow Veterans Stadium tenants out of their current leases and help build a new football stadium and baseball ballpark by FY 2004, it is unlikely that the City will be receiving any Veterans Stadium-related money during FY 2004 and 2005. Depending on the terms of the new contract the City may negotiate with the teams, the City may or may not receive stadium-related revenues.

GENERAL FUND OBLIGATIONS

Base Methodology

The City's General Fund Obligation growth assumptions as presented in Appendix V – Base Methodology of the Five-Year Plan – appear to be deficient and may be misleading. The projected General Fund obligations as presented in Appendix III of the Plan are at variance with the obligation growth rates shown in Appendix V.

In particular, the projected growth rates for Class 500 (Contributions and Indemnities), Class 800 (Payments to Other Funds), and Class 900 (Advances and Miscellaneous Payments) are inconsistent. The base methodology shows Class 500 obligations increasing by 1.5 percent annually over the life of the Plan. However, Appendix III shows these obligations to be increase at a smaller amount of approximately 0.8 percent on average over the life of the Plan. Additionally, the base methodology in Appendix V shows Class 800 and 900 obligations to grow at 1.5 percent annually over the life of the Plan; Appendix III shows the Class 800 obligations to be relatively stable and Class 900 obligations decreasing by .7 percent over the life of the Plan.

Payroll

All unionized employee contracts expire on June 30, 2000. However, the Plan makes no provision for salary increases for uniformed and non-uniformed employees. The Street administration has stated that the unionized work force deserves fair contracts. Even if these employees do not receive a base salary increase in the first year of the new contract, FY 2001, it is unlikely that they will not receive salary increases over the life of the Plan.

While we are not able to predict the outcome of the upcoming labor negotiations, any salary increases for employees will have significant financial impact on the City's budget over the life of the Plan.

Debt Service

Based upon our review of the current General Fund General Obligation Bond maturity registers and related debt service schedules, we estimate General Fund Debt Service Obligations to be over-estimated throughout the life of the Plan.

Debt Service obligations include principal and interest payments for General Obligations Bonds issued in each year of the Plan, as well as the Blight Removal Bonds. While it is possible that the Administration will authorize and sell General Obligation (GO) bonds during the life of this Plan, it is highly unlikely that they will sell GO bonds each year. As for the Blight Removal bonds, it is unlikely the City will market these bonds. Instead, one of the City's quasi-governmental agencies will likely issue this debt and the City will be responsible for some type of service agreement payment. In any case, we believe that the amounts budgeted exceed the actual costs.

The Plan includes commitment fees and arbitrage payments of $1.75 million and $850,000, respectively, over the next five years. The City has not utilized any type of credit enhancement for the last four short-term note sales. It appears the City will not need, or use, any credit enhancement for its short-term borrowings in the future. Furthermore, it is unlikely the City will be subject to any arbitrage payments over the life of the Plan. In addition, the Plan budgets $1.3 million for Sinking Fund Reserve Payments. For the last two fiscal years this payment has been less than $500,000.

Blight Removal

The Street Administration included a $250 million Blight Removal initiative in the Plan. This initiative, as is stated in the debt service section above, is to be funded through a bond sale.

Consequently, the Street Administration has made no direct appropriation for either building demolitions or the Mayor's Office of Community Services. According to Administration officials, these costs are to be funded through the blight initiative. However, according to these same officials, there has been little, if any, planning done to determine how this initiative will be accomplished.

Unspecified Future Target Reductions

As the Rendell Administration did in the past, the Street Administration continues to include $60 million in unspecified future spending cuts over the life of the Plan. However, the Plan makes no mention of how or where these cuts will be made. Failure to attain these cuts will put the City's budget at a risk equal to the amount of the cuts.

CAPITAL PLAN

Capital Budget

We reviewed the FY 2001 Capital Budget included in Appendix VI of the City's Five-Year Plan. Our review consisted of agreeing the Plan amounts to the City Planning Commission's six-year funding schedule for FY 2001-2006 and verifying the mathematical accuracy of both. In addition, we reviewed all projects in the FY 2001 Capital Budget to determine whether they were capital in nature.

Included in our review was a computation of the current and future legal debt capacity. We also compared potential debt service costs associated with the Capital Plan with projected debt service costs shown in the General Fund section of the Plan. Again, as stated in the Debt Service section of this schedule, it appears that debt service obligations are over-budgeted throughout the life of the Plan.

The City is fast approaching its legal debt limit. As FY 2000 draws to a close, the City has slightly more than $288 million in debt capacity remaining. At a time when the City is struggling to stay within its legal debt margin, the Plan offers no solution to how the City will combat this problem. The FY 2001 and FY 2002 capital budgets are seeking funding of $157.4 million and $129.8 million respectively. Included in each of these budgets is $40 million in funding specifically for Veterans Stadium. With the Capital Plan burgeoning in the first two years, and dwindling to a mere $29 million in FY 2005, the City is at risk of being unable to make match state and federal dollars available for projects in the out years. As a result, millions of dollars for capital improvements from outside agencies may be lost.

OTHER FUNDS

Aviation Fund

Based upon the assurances from Aviation Fund officials, it appears unlikely the City will be required to make a General Fund subsidy payment for the Outside Terminal Area (OTA) and the International Gates.

The Division of Aviation continues to achieve surpluses from the OTA. These surpluses are carried in the Aviation Fund Unrestricted Cash Account. For FY 2001 the amount is projected to be $26.7 million. Division of Aviation representatives have stated that these holdings plus any interest earned, may be sufficient to prevent the General Fund from contributing to the Aviation Fund over the life of the Plan.

Water Fund

Water Department officials continue to assure PICA officials that there is minimal risk that the General Fund will not receive the annual transfer of approximately $4 million. The Water Department continues to cut costs at both their wastewater treatment and biosolids recycling center. In addition, the Water Department realized significant cost savings in its energy bill through successful implementation of multiple energy savings initiatives. As a result of these cost cutting measures, energy initiatives, and increased delinquent collections through the enforcement of the Utility Services Tenant's Rights Act, Water Department management believes that the $4 million annual transfer to the General Fund will continue over the life of the Plan.

CASH FLOWS

The cash flows presented in Appendix IV of the Plan for FY 2000 and FY 2001 agreed with the estimates for General Fund revenues and obligations as presented in Appendix III of the Plan. The forecast for the monthly distribution of revenues and obligations were materially consistent with historical patterns.