# Pennsylvania Intergovernmental Cooperation Authority

**Staff Report**
**on the**
**City of Philadelphia's**
**Five-Year Financial Plan**
**for**
**Fiscal Year 2013 - Fiscal Year 2017**

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**September 5, 2012**

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# I. Executive Summary and Staff Recommendation

The City of Philadelphia's *Five-Year Financial Plan* for Fiscal Year 2013 to Fiscal Year 2017 (the "FY13-17 Plan" or "Plan") was submitted to PICA on July 27, 2012, and resubmitted with addendum on August 9, 2012. The PICA staff report outlines risks to the Plan, provides analysis focused on the Plan's projections of General Fund revenues and expenditures and contains analysis of broader issues relating to the City's financial condition. The report is organized as follows:

**I.** **Executive Summary and Staff Recommendation:** This section contains an overview of the Plan, and discusses risks, concerns, and major conclusions. It also contains PICA staff's recommendation to the Board concerning action on the Plan.

**II.** **Risks to the Plan:** This section describes major risks to the Plan's projections of revenues and expenditures, and analyzes the impact of quantifiable risks.

**III.** **Analysis of Plan Projections:** This section describes changes in the Plan between the version proposed to City Council on March 8 and that submitted to PICA on July 27 and August 9. It also analyzes growth rates of major categories of revenues and expenditures over the Plan period.

**IV.** **Spending and Performance:** The Plan establishes a foundation for moving towards a program performance oriented budget that systematically relates proposed costs to expected outcomes and performance. This section of the report describes trends in obligations for major program categories, in relation to indicators of program performance.

**V.** **Indicators of Financial Health:** This section discusses quantitative measures of the City's financial health over the past decade. It addresses measures of the City's economy, fund balance, debt burden, liability for pension and other post-employment benefits, and tax competitiveness.

**VI.** **Policy and Management Issues that Impact Financial Health:** This section of the report discusses three of the City's major challenges that impact financial health: tax reform, tax enforcement, and economic development.

## Overview of the FY13-17 Plan

The FY13-FY17 Plan includes a cumulative total of $18.039 billion in projected General Fund revenues and $18.169 billion in obligations. For FY13, total General Fund revenues are $3.568 billion and FY13 total expenditures are $3.604 billion. Taxes are the largest source of revenue, comprising 81.0 percent of total revenues. Average annual General Fund revenue growth over the Plan is 0.76 percent and average annual tax revenue growth is 1.4 percent. Average obligation growth over the Plan is 1.26 percent. The FY13 projection for personal services obligations, including payroll and employee benefits, is $2.46 billion, representing 68.2 percent of total General Fund obligations. The adopted budget for FY13 plans for 22,308 full-time General Fund positions.

The FY13-17 Plan eliminates projected deficits, but by very narrow margins. The Plan projects adjusted operating deficits of $17.6 million in FY13, $26.5 million in FY14, and $14.6 million in FY15, and adjusted surpluses of $10.7 million in FY16 and $11.1 million in FY17. The Plan projects positive year-end fund balances in each year only because the projected FY12 surplus of $98.9 million is sufficient to compensate for the adjusted operating deficits in the first three years of the Plan. The fund balance is projected to increase only in the final two years of the Plan, due to the small surpluses projected for FY16 and FY17. FY17 ends with a fund balance of $61.9 million. Fund balance ranges from a low of $40.2 million in FY15 (0.29 percent of revenue) to a high of $81.3 million in FY13 (2.79 percent of revenue).

**Table 1.1 General Fund Revenue and Obligation Growth in FY13-17 Five-Year Financial Plan ($ in Millions)**

| | FY11 Actual | FY12 Est. | FY13 Est. | FY14 Est. | FY15 Est. | FY16 Est. | FY17 Est. |
|---|---|---|---|---|---|---|---|
| General Fund Revenues | 3,860.3 | 3,546.6 | 3,567.7 | 3,610.4 | 3,559.3 | 3,619.7 | 3,682.3 |
| Growth Rate | | (8.1%) | 0.6% | 1.2% | (1.4%) | 1.7% | 1.7% |
| General Fund Obligations | 3,785.3 | 3,470.4 | 3,603.9 | 3,655.4 | 3,592.4 | 3,627.5 | 3,689.7 |
| Growth Rate | | (9.1%) | 3.9% | 1.4% | (1.7%) | 1.0% | 1.7% |

## Risks to the Plan

*Labor Contracts.* The outstanding labor contracts are the single largest short-term financial risk to the Plan since the City does not include any increased costs for new contracts for the International Association of Fire Fighters (IAFF), or AFSCME District Council 33 (DC33) or District Council 47 (DC47) in the Plan. The Plan assumes no new labor costs despite three of four municipal union contracts in the negotiation/arbitration process and without a contract since July 2009. The IAFF has been awarded a contract through arbitration with potential cost of approximately $200 million over the Plan period, but the City is appealing this award. DC33 and DC47 remain in negotiations. An arbitration process that will determine wages for the Fraternal Order of Police (FOP) members in FY13 and FY14 is underway as of June 2012.

***Any contracts which require additional costs that are not assumed in the FY13-17 Plan, or do not produce savings consistent with its assumptions, will require a revision to the Plan. This revision must demonstrate that there are sufficient funds to cover these costs or unrealized savings.***

*Pension Liability.* The pension liability is the "Achilles heel" of the City budget. In FY13, the total pension payment is $629 million or 17.46% of total expenditures and the 2011 unfunded pension liability remains exorbitant, at $4.768 billion. The annual total pension payment is projected to increase to $660.4 million in FY14, or 18.07 percent of the General Fund budget. Payments are then projected to moderate somewhat during FY15-FY17, but there is some risk for increases beyond current projections. Most significantly, costs could increase over the next five years if actual investment returns fall short of the City's assumed 8.10 percent return, as occurred in FY12 with an investment return of .05 percent. While the City has reduced its assumed rate of return in recent years, the current assumption still seems somewhat optimistic. Pension payments are a large fixed cost, the Pension fund is inadequately funded and lower return on investments continues to pose risk of higher payments. The pension liability is a structural short and long term risk to City's financial stability.

*National Economy and Economic Assumptions.* The national recovery from the Great Recession of 2008-2009 has been slow and unsteady. The FY13-FY17 Plan presents a succinct outlook of national economic trends and their impact locally and assumes slow but improved growth. The Plan warns that high unemployment negatively impacts receipts from the wage and earnings tax, the City's single largest tax revenue source. Recent data from the U.S. Commerce Department showed the economy growing at a sluggish pace of 1.5 percent from April to June 2012, compared to 2.0 percent growth during the prior three months and 4.1 percent in the fourth quarter of 2011. The potential that the economy will grow slower than anticipated and impact local economic conditions, particularly revenue projections, remains a risk to the Plan.

*School District of Philadelphia.* Ongoing financial problems at the School District of Philadelphia (SDP) present an additional risk to the Plan. City Council has enacted two tax increases to provide $40 million in additional revenue to the School District in FY13 and beyond. The risk facing the General Fund is that continued deficits at SDP may require the City to further increase its support of the School District, either through direct General Fund support or increases in taxes which would diminish the City's tax competitiveness.

*Property Tax Reform.* As was the case with the FY12-FY16 Plan, one of the risks facing the FY13-FY17 Plan is the reform of the City's property tax assessment system. From a policy standpoint, this change is clearly desirable and has long been supported by PICA. The new assessment system, the Actual Value Initiative (AVI), is designed to produce property assessments that accurately reflect market value. This change should result in a more legitimate basis for one of the City's major tax revenue sources. Over the past year, movement locally and at the State level has increased the likelihood that AVI will be implemented in FY14. Nonetheless, there is some risk associated with the transition to the new assessment system.

It remains to be seen whether an acceptable tax rate under AVI will be reached. There may be additional pressure for relief measures, like homestead exemption, that will have the effect of lowering the tax base and increasing the tax rate. Additional relief measures threaten AVI because as the tax rate increases the probability of being legislatively acceptable lessens. In addition, execution of AVI will be difficult if current State law which establishes 16.75 mills, or 1.675 percent, as School District of Philadelphia tax levy, is not successfully repealed or adjusted. In absence of a solution, the total City and School District tax burden could provide significantly high and lead to a high volume of appeals or derail AVI completely. The transition to AVI could have long-term benefits for the City's fiscal stability but there are outstanding unresolved challenges.

## Concerns

*Narrow Fund Balances.* The Plan projects that FY17 will end with a General Fund surplus of $61.9 million. The projected end of year General Fund balance as a percent of revenue varies from 0.29 percent to 2.79 percent over the Plan period. This is a very tenuous position for the City given the variety of financial risks it currently races.

**Table 1.2 Projected Year End General Fund Balance as a Percent of Revenue, Final FY13-FY17 Five Year Financial Plan ($ in Millions)**

| | FY12 Est. | FY13 Est. | FY14 Est. | FY15 Est. | FY16 Est. | FY17 Est. |
|---|---|---|---|---|---|---|
| Projected Fund Balance | $99.0 | $81.3 | $54.8 | $10.2 | $50.8 | $62.0 |
| Fund Balance as a Percent of Revenue | 2.79% | 2.28% | 1.52% | 0.29% | 1.40% | 1.68% |

Ultimately, the City would benefit from adopting and adhering to a Plan that more appropriately recognizes the level of risk faced by the City and other entities that are financially dependent on the City, the volatility of its revenues and expenditures, unfunded long-term liabilities, and other factors that are unique to Philadelphia's financial situation. The current Plan does not contain sufficient resources to alleviate the impact of even a mild recession.

*Controlling Expenditures.* Obligations are projected to increase at an average annual rate of 1.25 percent over the Plan period, while revenues are projected to increase at an average rate of 0.76 percent. This expenditure growth is primarily driven by factors that cannot be controlled in the short term, including pension obligations, the cost of employee health benefits, and debt service. Limiting growth in those categories of expenditures that can be controlled will be vital to maintaining financial balance over the Plan period. In the view of PICA staff, it is not sound financial planning to project growth in spending to outpace revenue growth as the Plan does with operating deficits in FY13-FY15, especially in the context of a $3.6 billion annual budget.

The FY13-17 Plan narrative includes a section entitled: "Goal 5: Philadelphia Government Works Efficiently and Effectively, with Integrity and Responsiveness: An Overview of Initiatives and Key Accomplishments." In the view of PICA staff, this section is informative about many of the City's initiatives to improve efficiency and effectiveness of operations. The Plan's projections incorporate savings from some initiatives, such as $44.5 million in savings from the Streets Department's negotiation of a new waste disposal contract and successful efforts by the Mayor's Office of Transportation and Utilities to negotiate lower utility costs. The major shortcoming of this section is that it does not contain a comprehensive list of initiatives that the City has implemented and the financial impacts of these initiatives in recent years. Nor does it project the estimated financial benefit to be achieved from initiatives currently underway or projected future initiatives such as technology investments.

A further concern is that the Plan narrative does not clarify whether the goal of improving the efficiency and effectiveness of City government is being driven from a single leadership position and how it is managed. In the context of a financial plan for City government, such information would aid greatly in the assessment of the City's progress toward achieving financial stability and its likelihood of maintaining it in the future.

*High Tax Burden.* A benchmark study that compares tax burdens across major cities is published annually by the Government of the District of Columbia. This study estimates the combined state and local taxes that would be paid by representative families at various income levels in the largest city in each of the fifty states, and in Washington, DC. Philadelphia's tax burden is generally between 50 and 65 percent higher than the median city in the comparison group. In 2010, the most recent year for which results are available, Philadelphia's tax burden was 54.5 percent above the median.

As shown in Table 1.3, many of the City's major taxes increased substantially from FY08 to FY13. Taxes that increased over this period include: the hotel tax (17 percent), the parking tax (33 percent), the real estate tax (18 percent), and the use and occupancy tax (19 percent). In addition the sales tax rate increased from 7 percent to 8 percent, although this increase is currently scheduled to expire at the end of FY14. The only tax rate decreases that occurred over this period were for the wage and earnings, and net profits taxes. The rates applied to resident income declined 7 percent and non-resident rates declined 6 percent. These reductions were primarily mandated and funded by the State with gaming proceeds.

It should be noted that these increases occurred during a period of a debilitating and dramatic economic recession, and after the City reduced expenditures by $108 million mid-year in FY09 and the SDP similarly reduced spending. Moreover, PICA staff has not developed a detailed comparison of trends in tax rates in other major cities over this period. The pattern of annual tax rate increases, which has continued through the most recent budget for FY13 is a source of concern given that most major studies suggest that Philadelphia residents and businesses face some of the highest tax burdens in the nation. The FY13-FY17 Plan incorporates planned tax reductions producing a promising shift back to the progress the City made in improving tax competitiveness from 1996 to 2008.

**Table 1.3. Trends in City and School District Tax Rates since FY08**

| | FY08 | FY09 | FY10 | FY11 | FY12 | FY13 | FY08-FY13 Percent Change |
|---|---|---|---|---|---|---|---|
| *Business Income and Receipts* | .1415 | .1415 | .1415 | .1415 | .1415 | .1415 | 0% |
| Receipts Portion | | | | | | | |
| Income Portion | 6.45 | 6.45 | 6.45 | 6.45 | 6.45 | 6.45 | 0% |
| *Hotel Room Rental* | 7.0 | 8.2 | 8.2 | 8.2 | 8.2 | 8.2 | 17% |
| *Parking* | 15.0 | 20.0 | 20.0 | 20.0 | 20.0 | 20.0 | 33% |
| *Real Estate* | | | | | | | |
| City | 3.305 | 3.305 | 3.305 | 4.123 | 4.123 | 4.462 | 35% |
| School District | 4.959 | 4.959 | 4.959 | 4.959 | 5.309 | 5.309 | 7% |
| Total | 8.264 | 8.264 | 8.264 | 9.082 | 9.432 | 9.771 | 18% |
| *Sales* | 1.0 | 1.0 | 2.0 | 2.0 | 2.0 | 2.0 | 100% |
| *Tobacco* | -- | -- | -- | .36/ounce | .36/ounce | .36/ounce | NA |
| *Use and Occupancy* | 4.62 | 4.62 | 4.62 | 4.62 | 4.62 | 5.51 | 19% |
| *Amusement* | 5.0 | 5.0 | 5.0 | 5.0 | 5.0 | 5.0 | 0% |
| *Liquor Sales* | 10.0 | 10.0 | 10.0 | 10.0 | 10.0 | 10.0 | 0% |
| *School Income* | 3.98 | 3.9296 | 3.928 | 3.928 | 3.928 | 3.928 | (.013%) |
| *Wage, Earnings, and Net Profits* | | | | | | | |
| Resident | 4.2395 | 3.9550 | 3.9296 | 3.9280 | 3.9280 | 3.9280 | (7%) |
| Non-Resident | 3.7400 | 3.5196 | 3.4997 | 3.4985 | 3.4985 | 3.4985 | (6%) |

Source: *Summary Schedule of Tax Rates since 1952*, Department of Revenue, City of Philadelphia.

The FY13-17 Plan projects that the City will resume annual reductions in the wage, earnings, and net profits taxes. Under the Plan, from FY13 to FY17, the resident wage tax will decrease from 3.928 percent to 3.814 percent, and the non-resident rate from 3.4985 percent to 3.397 percent. The Plan includes very modest to nominal rate reductions in FY14 and FY15, and more significant reductions in FY16 and FY17. In addition, the Plan projects significant business tax reforms resulting from Administration and City Council efforts. Under the Plan, business income and receipts tax (BIRT) revenues are projected to decline in FY15 and FY16 due to these reforms, notably the exclusion from taxation of the first $100,000 from the gross receipts portion of BIRT, and single sales factor apportionment for the net income portion of BIRT. In addition, the one-time business privilege license fee of $300 was eliminated and new companies may apply for exemption from BIRT and certain license fees for first two years in business.

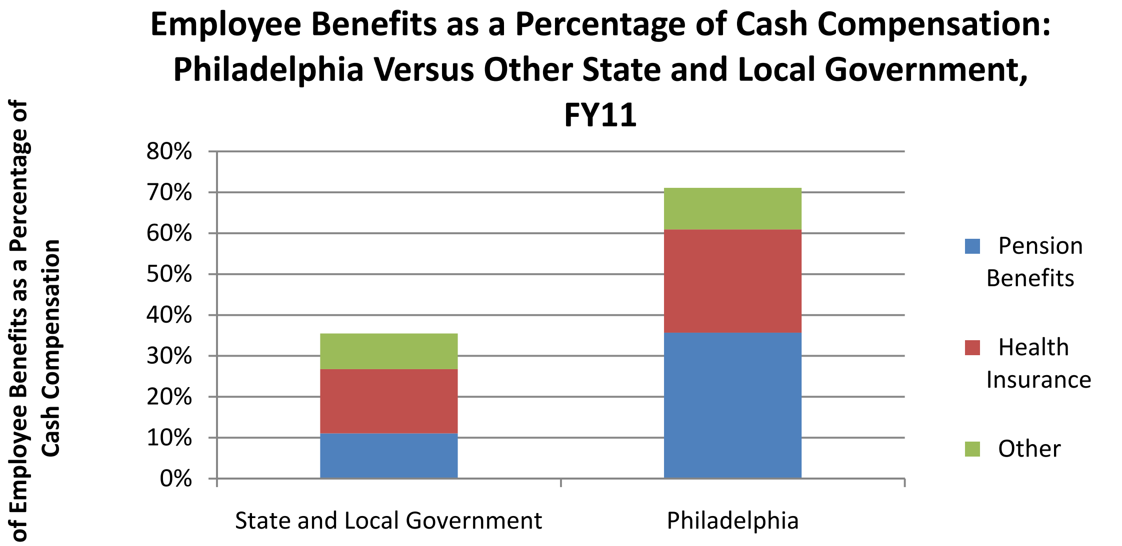
One concern related to the projected reductions in the rates of the wage and business tax reforms is that the Plan narrative does not clearly present these changes and their fiscal cost to the City. Arguably, these are one of the most significant economic development initiatives that the City is planning to implement over the next five years, and they are among the few initiatives that are specifically incorporated into the Plan's financial projections. As such, a detailed discussion of these changes in the Plan narrative is warranted but there is no discussion beyond a few sentences. As a document that communicates a financial and strategic plan for the City, the Plan narrative should show the rate of reductions, the new tax rates, benefit of the policy and the cost of the reductions.

The City's anticipated return to a pattern of reform and reduction for the wage and business taxes is an achievement. If the City is successful in continuing to plan for and implement reductions in these taxes, which studies suggest are particularly damaging to the city economy, it will again send a signal to firms and households that Philadelphia is on a path toward greater economic competitiveness.

*Budgetary Stabilization Reserve Fund.* Since November 2000 and in PICA staff reports on almost every *Five-Year Financial Plan* since, PICA staff has advocated that the City establish a rainy day fund. History is a useful lesson only if we learn from it. The deficits of the early 1990s and the recent experience of climbing out of one of the toughest recession in decades would seem to have taught the lesson for the need to plan and save for periods of financial stress. In the past year, City Council voted to amend the Home Rule Charter to create a budget stabilization fund. This amendment was approved by Philadelphia voters. However, the FY13-FY17 Five-Year Plan projects that the General Fund will not have sufficient resources to contribute to the fund.

The City's continued survival on narrow fund balances and inability to finance its newly established rainy day fund is a major concern. This year, PICA staff's concern is not the lack of a legal mandate that the City contribute to a reserve fund, but that the City lacks the financial means to do so.

*Growing Cost of Health Benefits.* As shown in the figure below, in FY11, the total cost of all benefits for City employees was 71 percent of wages, compared to a national average of 33 percent for state and local government employees. The FY13-17 Plan assumes that health benefits for police will rise by 10 percent year over year increasing the City's cost by $56.2 million per year in FY17 compared to FY13 projections. The City cannot sustain this high cost and remain competitive. Furthermore, the City's comparatively high inordinate cost of health benefits pulls tax dollars away from providing core services. The City's level of health care costs is certainly not competitive with other state and local governments, and likely unsustainable over the long term. The City must pursue reforms to the way it manages and pays for health benefits, as well as the level of health benefit provided, if it is to achieve a more economically competitive cost structure for its workforce.



Source: Employer Cost for Employee Compensation, Bureau of Labor Statistics, average of quarterly data for FY11 period; FY13-FY17 *Five-Year Financial Plan*, City of Philadelphia.

*Collection of Delinquent Taxes.* Tax delinquency is a problem which has been increasing over time and currently stands at a total of $1.0 billion in unpaid taxes. In a context where Philadelphia's tax burden is high in comparison to other municipalities and where the City has low projected fund balances, the high rate of tax delinquency in Philadelphia is a major concern. From a financial standpoint, it diminishes revenue available to the City and shifts the economic burden of supporting government unfairly. The City estimates that $250 million of the $1.0 billion in unpaid taxes is collectible.

*Implementation of Fire Study.* In FY11, PICA contracted with Berkshire Advisors, Inc. to perform a comprehensive study of the efficiency and effectiveness of services provided by the Philadelphia Fire Department (PFD). The study was conducted in consultation with representatives of the Administration, City Council and the International Association of Firefighters (IAFF) Local 22. In January 2012, Berkshire Advisors issued its report. The study was widely praised as the first of its kind for the PFD. The Department has taken some action as a result of the report. It remains to be seen if execution of the majority of the report's substantial recommendations will occur.

*Vacant Property.* In November 2010, the Philadelphia Redevelopment Authority commissioned a report on vacant land management in Philadelphia. The report estimated that vacant parcels cost the City, $3.6 billion in lost household wealth, over $20 million in City maintenance costs annually and at least $2.0 million annually in uncollected property taxes. The report notes that of 40,000 vacant parcels in the City, over three-quarters of the 40,000 vacant parcels are privately controlled. The City has shown leadership of this problem through the Managing Director and Finance Director's Office as lead with multiple city and quasi governmental agencies. The challenge will be to keep focused leadership driving continued action.

*Fuel Costs.* Fleet Management had a historically strong track record of negotiating fixed cost of fuel as an effective management against variations in price. In FY12, Fleet Management did not successfully negotiate a fixed price and fuel costs were $5.0 million over budget.

*Funding for 4601 Market Street.* The City is requesting $9.0 million from PICA to fund initial design work for Public Property for a new police headquarters, city morgue and health offices to be co-located at 4601 Market Street. While the design work will provide the City with a better estimate of total project costs and total project costs are currently unknown, it is a questionable omission by the City to not include full funding of the project in either the operating or capital budgets or the FY13-FY17 Five-Year Plan. The City also does not show any revenue from sale of assets (the current PPD headquarters), which is one of the assumed predicators of the project.

*Economic Development Plan.* In recent years, Philadelphia has taken strides toward greater competitiveness in several areas. With several specific initiatives and reforms, the City is beginning to create some of the ingredients of a successful twenty-first century city. They include a reorganized workforce development system; a new comprehensive plan; an updated zoning code; improvements to the development review process; and a strategic plan for environmental sustainability, *Greenworks Philadelphia*. Nonetheless, challenges remain.

Progress towards continued improvements in the City's economic competitiveness could be facilitated by a strategic plan focused on economic development. Such a plan could help coordinate the City's various economic development activities, set concrete goals and serve as a public measure of accountability. Most important, such plan could directly impact the growth and development of the City.

*Revenue Projection Methodology.* The PICA Act states that "[a]ll 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."[1] One concern related to the revenue projections in FY13-FY17 Plan is that Plan projections do not consistently incorporate the impact of recent revisions to the FY12 tax revenue estimates. While FY12 revenue estimates for the business income and receipts tax, real estate transfer tax, parking, and amusement tax were changed prior to the submission of the final Plan to PICA, only in the case of the parking tax did the city apply its originally projected FY13-17 growth rates to the revised FY12 base. A uniform methodology would have applied the Plan projected growth rates to all of the revised FY12 estimates. The impact of the current practice has the effect of reducing projected revenues in the final Plan.

While the City's current practice is conservative and preferable to using an inflated tax base, it raises a larger concern that if not standardized or documented, the City may be tempted to perform damaging practices of inflating revenue projections at some point in the future.
PICA Staff recommends use of a mechanical or standard application for the tax base. At minimum if the City chooses to adjust a tax base standard then sound explanation should be provided in the Plan.

[1] Section 209.c.1 PICA Act (Act of June 5, 1991, P.L. 9, No.6).

*City Controller's Opinion*

As in past years, and as required by the PICA enabling legislation, PICA Staff requested of the City Controller an opinion or certification prepared in accordance with generally accepted auditing standards, the attestation standards established by the American Institute of Certified Public Accountants (AICPA), with respect to the reasonableness of the assumptions and estimates in the City's FY12-FY16 Five-Year Plan.

On August 8, the City Controller presented PICA with an auditor's report on the City of Philadelphia's forecasted financial statements dated July 27, 2012. The Controller's Office opined through independent audit that the forecasted statements were not presented in conformity with guidelines for presentation of forecasted information established by the AICPA American Institute of Certified Public Accountants because management's assumptions did not provide a reasonable basis for management's forecast. The Controller urged PICA to reject the Plan since the Plan did not include any potential changes in costs related to the IAFF appeal. As stated by the Controller, "City of Philadelphia management asserts that the arbitrator's award imposes more than $203 million in new wage and benefit costs over the life of the Plan, and has not included provision for covering these costs in the event of an unfavorable outcome of the latest appeal. We do not believe the assumption that the city will prevail is reasonable." Furthermore, the Controller asserted that the forecast statements do not include potential changes from ongoing negotiations with unions representing the city's non-uniformed workers. The Controller also outlined questionable items such as debt service projections, lack of capital appropriation for the new Police Headquarters and the risks associated with the financial challenges of the School District of Philadelphia.

Upon the City's submission of the August 9 Plan with addendum, the City Controller re-examined the management's assumptions used in the Plan and provided another report on August 23. The Controller's independent accountant's report found that the assumptions used in the Plan provide reasonable basis for City of Philadelphia management's forecast and for the City of Philadelphia management's supplemental projections assuming the implementation of the IAFF award and the reduction of expenditures. The Controller's Office also noted sensitive assumptions, in particular, that the financial statements do not include any of the potential new costs of more than $203 million associated with the IAFF interest arbitration since the City expects a favorable outcome. The Controller also reiterated that the statements do not include any potential change in costs or achieved savings resulting from ongoing negotiations with unions representing the city's non-uniformed workers. The Controller also highlighted areas of concern on the supplemental projected statements or Plan addendum. A full copy of both the August 8 and August 23 Controller's reports with cover letter are included in the appendix of this report.

*Staff Recommendation*

PICA staff recommends that the PICA Board approve the FY13-FY17 Five-Year Financial Plan with Addendum as submitted to the Authority on August 9, 2012.

The basis of the recommendation is that the City's inclusion of a potential strategy in the event of significant adverse events provides assurance that options exist to maintain Plan balance. PICA staff expresses no opinion on the appropriateness of particular budget reductions contained in the addendum and recommendation to approve the Plan is not an endorsement of the reductions.

In addition, delays in hiring or filling new positions, increased revenues from asset sales, reduction in debt service payments due to later than anticipated issuance of new General Obligation debt, delay of planned tax reductions, savings from lower than projected interest rates on variable debt, and other measures as outlined on page 24 of this report provide further options to maintain balance. A final factor that staff has considered is the City's ability to take necessary steps to maintain Plan balance during other previous periods of fiscal distress.

# II. Risks to the Plan

This section provides a discussion of major risks to financial balance over the next five years, and analysis of the impact of those risks that are quantifiable. The Plan faces five significant risks: economic assumptions, fiscal stress at the School District of Philadelphia, unresolved labor contracts for City workers, property tax reform, and the unfunded pension liability. Each of these risks is discussed below. The final section discusses the implications of these risks for the Plan and describes potential actions that could be implemented to maintain financial balance over the Plan period.

## Discussion of Major Risks

*Labor Contracts.* In the proposed FY13-17 Plan, the City does not include amounts for wage increases that are not mandated under currently resolved labor contracts. What distinguishes this year from most prior years of PICA's history, however, is the level of risk this practice creates for the Plan. Wage increases for each of the four major municipal unions [Fraternal Order of Police (FOP), International Association of Fire Fighters (IAFF), District Council 33 (DC33) and District Council 47 (DC47)] remain unresolved for each of the five years of the Plan. Accordingly, the Plan does not include wage increases in any of its years for members of these unions.[2] There is a significant risk that wage increases for these employees could result from arbitration or collective bargaining, and that their cost will not be fully offset by savings from other contractual changes.

There is a contract in force through FY14 for Police officers and employees of the Sheriff's Office and Register of Wills represented by the FOP. However, wage increases, if any, for these bargaining units in FY13 and FY14 are at this time still undetermined. They will be known only after the completion of separate reopener arbitration processes. The Plan, accordingly, does not include wage increases for these employees. The Plan also includes no wage increases for employees represented by DC33 and DC47 as the City's stated position is that any increase in wage costs will be offset from other employee costs.

In October 2010, an arbitration panel awarded employees of the International Association of Fire Fighters (IAFF) wage increases of 3 percent in FY11, FY12, and FY13. The provisions of the award, with the exception of portions relating to pensions and vacation scheduling, was appealed by the City to the Court of Common Pleas. In its appeal, the City argued that the arbitration panel did not, as the PICA Act requires, consider and give weight to the City's Five-Year Financial Plan and its ability to pay for any increase in wages or fringe benefits without adversely affecting service levels. The Court upheld the City's appeal and remanded the award to the arbitration panel.

[2] Wage increases are included in the Plan for Local 159 of District Council 33, which includes 2,000 correctional officers, youth detention counselors, and security guards. Under a March 2012 arbitration award, these employees will receive 2.5 percent wage increases in FY13 and FY14. The Plan includes an additional $2.4 million in FY13 and $2.5 million in FY14 in the Prisons budget to cover these wage increases. In addition, the Plan includes $0.8 million in additional funding in the First Judicial District beginning in FY14 to cover the cost of an arbitration award for Local 810.

In July 2012, the panel issued an essentially identical award which included the same wage increases that it had previously awarded, retroactive to the beginning of FY11. The IAFF award has again been appealed by the City and the FY13-FY17 Plan includes no additional wage increases for IAFF-represented employees.

The City has stated its position that any increased wage costs resulting from new contracts should be balanced through other employee costs (health benefits, overtime, furloughs). Savings from pension restructuring will be realized primarily over the long term, if the City seeks only to create a new less costly hybrid pension program for new hires. Substantial savings from increased employee pension contributions, however, could occur in the short term, if all employees are required to increase their contributions, and not only newly-hired employees. Increased contributions from employees result in immediate budgetary savings for the City since they apply to the City's State-mandated minimum contribution to the Pension Fund and reduce current costs. Still, even these savings may not be enough to offset the impact of wage increases.

In terms of health benefits, savings are possible through changes to the administration of health plans, but the level of savings that is achievable is unclear. Conversion to self-insurance resulted in some short term initial savings in the cost of the FOP and City-administered health plan. However, it is unclear whether these savings will recur in future years, especially given the City's current projection of 10 percent year over year FOP health insurance increases.

The potential risk of the unresolved labor contracts is amplified given that the City may face costs associated with retroactive pay raises, such as those awarded the IAFF under the July 2012 arbitration award. While this award remains under appeal and the other awards remain in negotiation, the outcome is uncertain. ***Any contracts which require additional costs that are not assumed in the FY13-17 Plan, or do not produce savings consistent with its assumptions, will require a revision to the Plan. This revision must demonstrate that there are sufficient funds to cover these costs or unrealized savings.***

*Pension Liability.* The pension liability is the "Achilles heel" of the City budget. In FY13, the total pension payment is $629 million or 17.46% of total expenditures. This payment is projected to increase to $660.4 million in FY14, or 18.07 percent of the General Fund budget. Payments are larger in FY13 and FY14 due to the deferral of pension costs from FY10 and FY11.

The actuarial analysis that underlies the Plan projection assumes a rate of return on pension investments of 8.1 percent. This assumption has been reduced in recent years, but remains relatively high in relation to other municipal pension plans. Moreover, the actual return in FY12 was 0.05 percent. The revised Plan incorporates higher payments in FY15 through FY17 to reflect the actuary's estimate of the impact of actual FY12 investment performance.

**Table 2.1. Projected General Fund Pension Payments as a Percent of Total Obligations, FY13-FY17 Five-Year Financial Plan ($ in Millions)**

| | FY13 Est. | FY14 Est. | FY15 Est. | FY16 Est. | FY17 Est. |
|---|---|---|---|---|---|
| Projected Pension Payments (includes pension obligation bonds) | | | | | |
| Amount | 629.1 | 660.4 | 567.6 | 589.0 | 606.2 |
| As a Percent of Total Obligations | 17.46% | 18.07% | 15.80% | 16.24% | 16.43% |

While the funded ratio of the Pension Fund as measured by the annual actuarial valuation report increased slightly from 47.0 percent in 2010 to 49.7 percent in 2011, the 2011 unfunded liability remains extremely high, at $4.768 billion. The City will face significant pension related costs for decades in the future as result of the State requirement to amortize the cost of the unfunded liability over a thirty year period. The Plan incorporates reasonable projections of the City's total pension costs, based on actuarial analysis. Nonetheless, there is the potential that costs could increase beyond those currently projected.

Most significantly, costs could increase if actual investment returns fall short of the City's assumed 8.10 percent return over the next five years. While the City has reduced its assumed rate of return in recent years, the current assumption still seems somewhat optimistic. Nationally, there has been increasing attention to rates of return assumed by public pension funds. Some have suggested that the even an assumption of an average return of 7 percent is overly optimistic.[3] Any shortfall from the projected rate of return will result in an increase in pension contributions beyond that currently projected. In addition, any of the other demographic or economic assumptions that determine the Plan projected pension costs could deviate from actual experience in any year over the Plan period. The net impact of these deviations on the actuary's calculation of the City's required pension contribution could result in a significant increase in pension contributions from the current projection.

The City's high pension costs, and the dramatic increases in pension obligations in recent years, underscore the need for pension reform. The City has made progress toward implementing a fiscally sustainable pension plan through the arbitration process, with contracts with the IAFF and FOP now requiring higher contributions or participation in a hybrid defined contribution-defined benefit plan for new hires. Under new contracts for correctional officers, Deputy Sheriffs, and court and Register of Wills newly-hired employees are required to participate in the City's hybrid pension plan. City Council has also taken steps to reduce the cost of the Deferred Retirement Option Program (DROP). Similar reforms are needed for pension plans for non-uniformed unionized and non-represented workers. PICA staff hopes to collaborate with the City on further action to address this structural long-term risk.

*Economic Assumptions.* The Plan assumes steady growth in all of the City's major tax bases over each of the next five years. Table 2.2 presents the Plan-projected growth rates in the tax bases of major General Fund taxes. These economic assumptions form the basis of the Plan

[3] Mary Williams Walsh and Danny Hakim, "Public Pensions Faulted for Bets on Rosy Returns," *New York Times*, May 27, 2012.

revenue projections, which also take into account assumptions about tax rate changes, tax structure, and collection rates. The City based its initial projections of tax base growth on a single-equation econometric model developed by IHS Global insight. These projections were modified based on feedback from an annual PICA meeting of local economists to form the tax base growth assumptions contained in the Plan. While these assumptions are generally reasonable, there is some risk associated with certain assumptions.

**Table 2.2. Projected Annual Tax Base Growth, Major General Fund Taxes, FY13-FY17 Five-Year Financial Plan**

| Tax | FY13 Est. | FY14 Est. | FY15 Est. | FY16 Est. | FY17 Est. |
|---|---|---|---|---|---|
| Wage and Earnings | 3.4 | 3.4 | 3.4 | 3.3 | 3.1 |
| Net Profits | 2.5 | 2.5 | 2.5 | 2.5 | 2.5 |
| Real Estate | -- | -- | 3.0 | 3.0 | 3.0 |
| Business Income and Receipts | 2.5 | 2.5 | 2.5 | 2.5 | 2.5 |
| Sales | 3.5 | 4.7 | 5.5 | 5.0 | 3.5 |
| Real Estate Transfer | 5.2 | 9.0 | 9.0 | 9.0 | 3.0 |
| Parking | 2.5 | 2.5 | 2.5 | 2.5 | 2.5 |
| Amusement | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 |

The estimated annual growth in the wage and earnings tax base in FY12 was 1.9 percent, a decline from 3.1 percent in FY11.[4] The FY13-FY17 Plan projections range from 3.1 to 3.4 percent annually. There is some risk associated with this assumption, given the slow pace of the ongoing recovery from the 2008-2009 recession. Similarly, the FY13-17 Plan projects annual sales tax base growth rates ranging from 3.5 percent to 5.5 percent, rates that are higher than the estimated 4.2 percent growth rate in FY11 and the 0.9 percent rate in FY12. As in the case of the wage tax projection, the sales tax projection generally assumes a more rapid economic growth rate in the city in each of the five years of the Plan than has occurred in the most recent two years. There is some risk in this projection.

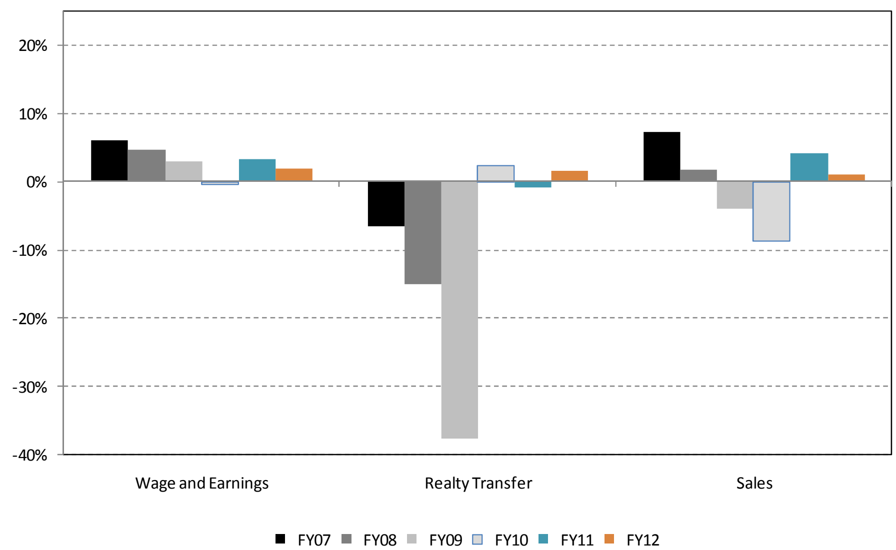
The Plan projections of business income and receipts, net profits, and parking taxes assume 2.5 percent base growth in each year. The amusement tax base is projected to grow at a 2.0 percent annual rate. These more modest growth rates are more in keeping with the generally slow pace of economic recovery in the City, and appear to pose little risk to the Plan.

The most concrete revenue risk relates to the projected base growth of the real estate transfer tax, which increases 5.2 percent in FY13, 9.0 percent from FY14 through FY16, and 3.0 percent in FY17. The City prudently avoided aggressive double digit growth rates as suggested by the consultant, IHS Global and the revenue assumptions remain lower than pre-recession height of returns. There is still some risk since the rate of recovery in the housing market since FY09 has been modest, with the estimated real estate transfer tax base increasing 2.3 percent in FY10,

[4] Estimates of growth rates of particular tax bases in FY12 and prior years in this report are PICA staff estimates based on City monthly cash collections reports and information on past tax rates.

declining 0.9 percent in FY11, and increasing 1.4 percent in FY12. While economists expect recovery in the housing market, the timetable over which this will occur is unclear. The Plan projected growth rates for real estate transfer tax are considerably higher than for other General Fund taxes and pose the clearest risk to the Plan. If revenue grows at 5.0 percent a year compared to current Plan projections the result is a reduction of $49.0 million in revenue over the Plan period.

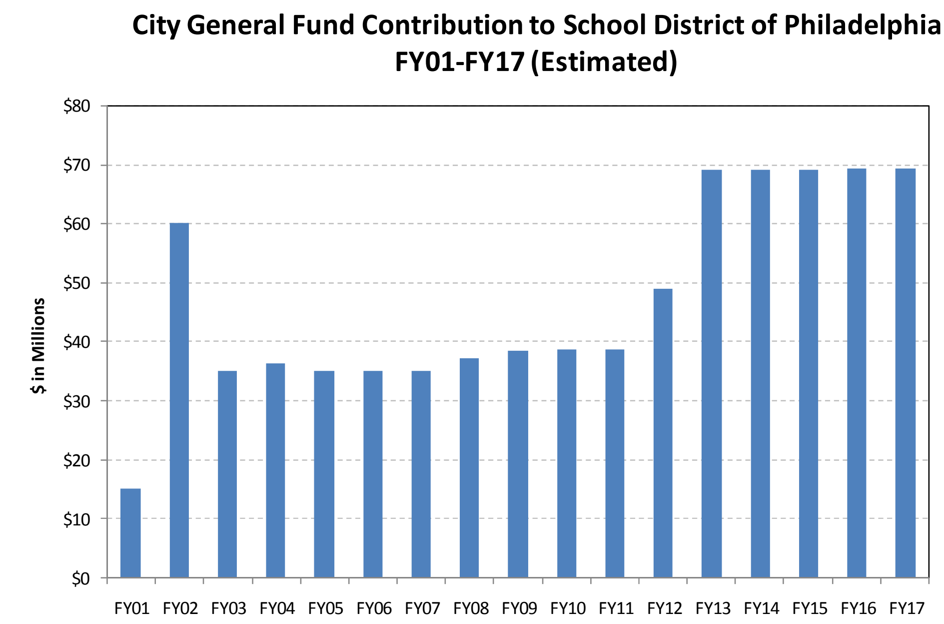
**Annual Tax Base Growth, Major General Fund Taxes, FY07-FY12 (Estimated)**




Source: PICA staff estimates based on monthly reports of tax revenue collections contained in *Monthly Comparative Statement of Net Revenue Collections*, Department of Revenue, City of Philadelphia, and published information on tax rates.

*School District of Philadelphia.* The School District of Philadelphia (SDP) is one of the fundamental pillars of the City of Philadelphia. The financial stability of SDP and its ability to provide a safe, high quality education for enrolled students is vital to Philadelphia's sustenance and prosperity. The SDP is faced with a projected budget deficit for the 2012-2013 year in the range of $255 to $282 million.

In its report on the FY12-16 *Five-Year Financial Plan*, PICA staff recognized SDP's fiscal problems as "an indirect but serious risk for the City's General Fund and a direct and serious threat to the City's tax base." At the end of FY12, City Council enacted an increase in the City real estate tax with the stated purpose of funding a $20 million grant to the School District. The City Council also authorized an increase in the School District's Use and Occupancy tax – a tax levied on the occupants of commercial real estate – to provide an additional $20.0 million of School District revenue. The Use and Occupancy tax was levied by the School Reform Commission in June 2012. The chart below presents past and projected levels of City General Fund support to SDP.




Note: FY01 through FY11 figures are actual. FY12 through FY17 figures are estimated.
Source: *Supplemental Report of Revenues and Obligations*, Office of Director of Finance, City of Philadelphia; FY13-FY17 *Five-Year Financial Plan*.

Under State Act 46 of 1998, as long as SDP is under a declaration of distress, any financial assistance provided directly from the City to SDP, or taxes authorized by the City to be levied by SDP, must be maintained at a level at least equal to highest level of the previous three fiscal years. As a result, the $69.0 million City General Fund contribution to SDP in FY13 represents a new minimum contribution that cannot be reduced for as long as SDP is officially considered a distressed school district under State law.[5] In addition, the new higher use and occupancy tax rate of 5.51 percent in FY13 cannot be reduced while SDP is considered distressed.

The City is not obligated under Act 46 to increase direct General Fund assistance to SDP, or authorize increased local tax rates dedicated to SDP, after FY13. However, the risk to the City's finances is that continued budgetary stress at SDP would lead City officials to increase further the City's support of SDP. If this support were provided by the General Fund it would have a direct impact on the Plan.

Certain City taxes and SDP taxes are levied on the same set of taxpayers – a situation that is not unique to Philadelphia and exists across the Commonwealth. The Charter requires that City

[5] In fact, the Plan projects a slight increase in the General Fund contribution to SDP to $69.2 million in FY17, due to the City's obligation to compensate SDP for the financial impact of projected reductions in the rate of the school income tax. This tax is levied at the resident wage, earnings, and net profits tax rate. Since the Plan projects reductions in this rate beginning in FY14, the City is required to compensate for lost school income tax revenue through the General Fund appropriation to SDP.

Council authorize taxes for levy by the SDP to enable the SDP to balance its budget each year. That duty and the powers and discretion which the City Council and Mayor possess with respect to providing local revenue to the SDP, as constrained by state law, creates a risk to the City and the SDP's shared taxpayers should the City and City Council increase SDP revenue by increasing taxes.

In the FY2012-13 SDP Budget in Brief, School Reform Commission Chair, Pedro Ramos writes in part, "Our public schools are certainly in a crisis of multiple dimensions…These are the two simple goals this School Reform Commission has set: provide safe, high quality public schools throughout the city, and bring the budget back into balance." In *A Blueprint for Transforming Philadelphia's Public Schools*, the SDP predicts long-term deficits if nothing is done and outlines five reform strategies, one of which is right-sizing and streamlining operations to deliver better performance at a lower cost. The SDP clearly makes balancing the FY14 budget a priority and is currently in the process of producing a five-year financial plan for achieving long term financial balance.

The strategic direction, leadership and action under a fairly new SRC as well as the hire of a new superintendent are encouraging and positive steps. The attention to the problem at hand is apparent. Until SDP's structural balance is restored, its financial problems will continue to present a risk to the City's finances.

*Property Tax Reform.* As was the case with the FY12-FY16 Plan, one of the risks facing the FY13-FY17 Plan is the reform of the City's property tax assessment system. From a policy standpoint, this change is clearly desirable and has long been supported by PICA. The new assessment system, the Actual Value Initiative (AVI), is designed to produce property assessments that accurately reflect market value. This change should result in a more legitimate basis for one of the City's major tax revenue sources. Moreover, it should set the stage for a long-term transition toward greater reliance on the property tax as a local tax revenue source by the City, a goal advocated by the 2003 Tax Reform Commission and the 2009 Task Force on Tax Policy and Economic Competitiveness. AVI should promote long-term financial stability by helping the City create a more stable revenue structure that is less damaging to local economic growth. Nonetheless, the successful transition to the new assessment system presents a short-term financial risk.

Under recently enacted City and State legislation, the City is required to implement AVI beginning with the 2014 tax year. On June 28, 2012, City Council adopted two bills – 120175-AA and 120173 – that would provide increased funding for SDP, while delaying implementation of AVI until 2014. State Act 131 was passed by the legislature on June 30 and signed into law by the Governor on July 5. Act 131 provides for a homestead exemption and requires the City to use FY11 assessed values in FY13 and beginning in FY14 to assess property at actual market value. The legislation also addresses concerns over the risk of revenue losses due to assessment appeals resulting from a recent change to the State Tax Equalization Board's Common Level Ratio for Philadelphia. These losses were initially estimated to cost the City and SDP between \$50 and \$100 million in lost revenue. By establishing that 2013 tax appeals must be based upon the 2011 predetermined ratio plus improvements, additions to properties and new construction, the bill eliminated the risk of substantial appeal losses for the 2013 tax year. The Plan, however, assumes that STEB-related appeals based upon 2012 assessments will cost the City $4 million in FY13 and $6 million in FY14.

An outstanding issue that will affect the implementation of AVI is how the City will adjust real estate tax rates dedicated to SDP. Senate Bill 1303, introduced in October 2011 but not yet enacted, would give the City authority to adjust the SDP real estate tax rate following AVI implementation subject to the requirement that revenue generated by the real estate tax for SDP at least equal the highest level of the three years prior to AVI. Because of restrictions on the City's ability to lower tax rates dedicated to SDP under current State law, the provisions of SB 1303 are needed to prevent an unintended revenue windfall to SDP and unacceptable tax burdens for Philadelphia property owners. The bill would also change provisions of State law that currently authorize SDP to levy real estate taxes at certain rates without City authorization. Currently, provisions of State law authorize a total of 16.75 mills of real estate tax for SDP, while 36.34 mills of the tax is imposed under City ordinance. Without a repeal of the State tax authorizations, or a limitation of SDP's ability to levy tax under these provisions, the City will not be able to implement AVI without significant, unanticipated increases in tax burdens.

In February 2013, the City's Office of Property Assessment (OPA) plans to release new assessed values for the City's approximately 563,000 taxable properties which will be the basis of the 2014 real estate tax. These values are expected to track more closely the actual market value of property. They should improve the overall accuracy and equity of city property assessments, as measured by such standard measures as the coefficient of dispersion and the price related differential.[6] In addition, the new assessment processes should allow assessments to rise and fall over time in a manner consistent with actual trends in the real estate market. City policy-makers, in turn, will be required to set annual tax rates for the City and School District based on the new assessed values, with tax rates set based on anticipated revenue needs. Accountability for tax burdens will be appropriately lodged with elected officials, and fiscal stability will be promoted to the extent that lawmakers are willing to set tax rates consistent with the annual financial requirements of a balanced budget for both the City and the School District.

The Plan projects that aggregate assessed value in the city will increase to $80.6 billion in 2014 under AVI. Reductions in assessed value due to a homestead exemption are projected at $9.2 billion, for a net taxable assessed value of $71.5 billion. Under these assumptions, the tax rate to meet the Plan projected real estate tax revenue for the City will be 7.84 mills, and the rate necessary to meet projected FY14 revenue for SDP will be 9.81 mills, for a combined rate of 17.65 mills, or 1.765 percent. There is some question as to whether this rate will be politically acceptable based on the public City Council discussion relative to AVI during the FY13 budget process. Further, the potential political pressure for additional tax relief measures beyond those assumed in the Plan could result in the need for an even higher tax rate to offset the impact of relief measures on the tax base. Finding the right combination of targeted tax relief and an affordable tax rate will be a challenge. The currently unknown real estate tax rate and potential pressure for further tax relief presents some risk about the City's ability to generate the level of real estate tax revenue anticipated in the Plan under AVI.

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[6] See International Association of Assessing Officers (IAAO), *IAAO Standard on Ratio Studies*, (Kansas City, MO: IAAO, 2007) for definitions of these industry standard measures of assessment accuracy and equity.

**Implications of Risks for the Plan**

The financial risks currently faced by the City suggests a significant possibility of General Fund deficits over the next five years absent additional measures that are not contained in the Plan. At the same time, other factors that are not incorporated into the Plan's projections could have positive effects on the General Fund. The net impact of any events on the Plan will depend upon the timing and size of additional unaccounted costs, as well as other positive factors such as stronger than anticipated revenues or efficiencies that lower costs. In the view of PICA staff, it is likely that the City will be required to take additional actions to maintain financial balance that are not included in the Plan. Examples of the types of actions that may be required are contained in the addendum to the Plan submitted to PICA on August 9. The addendum describes various possible expenditure reductions with a total annual savings that ranges from $23.5 million to $52.1 million. These actions may not represent the City's most likely response to adverse events but it is also not the prerogative of PICA staff to direct or determine how the City expends funds. The Plan addendum provides an indication of possible actions to maintain budget balance and is further discussed in Section III of this report.

PICA staff has outlined significant risks to maintaining Plan balance and it is uncertain if the options in the Plan addendum, particularly since some are questionable, cover the potential cost should all risks materialize. In addition to the kinds of budget cuts described in the addendum, the City has other options for maintaining positive fund balances over the Plan period. They include, but are not limited to, the following;

- New taxes or increased rates of existing taxes
- Increased revenues from service charges, regulatory fees, or fines
- Increased revenues from payments in lieu of taxes from institutions that are exempt from the real estate tax
- Increased revenues from initiatives to improve voluntary tax compliance and enforce tax laws
- Increase collections of fees and fines
- Delays in Plan-projected reductions in the rates of the business income and receipts tax or the wage, earnings and net profits taxes
- Delays in hiring or filling new positions, with exception of public safety critical positions
- Reductions in debt service due to later than anticipated issuance of new General Obligation debt
- Reductions in pension and health benefit costs
- Increased revenues from asset sales
- Better interest rates than budgeted on variable debt
- A major privatization initiative that generates revenue that can be dedicated to reducing the unfunded pension liability or other long-term obligations
- Declines in unreimbursed costs associated with the Department of Public Health's District Health Centers due to the impact of federal health care reform on insurance coverage
- Declines in utility costs resulting from initiatives to increase the energy efficiency of City owned buildings

- Declines in net costs of sanitation due to increased recycling and reduced overall levels of waste generated
- Increases in worker productivity due to technology which allows substantial reduction in personnel costs
- Additional specific cost savings beyond those contained in the addendum to the Plan provided by the City

The fact that none of these options are incorporated into the Plan does provide some assurance that the City has options to maintain balance. In addition, the City has repeatedly shown the ability to rebalance in the face of financial challenges. Nonetheless, in PICA staff's opinion, it would have been preferable if the City had incorporated some combination of these or other options into the Plan. This would have expanded the Plan's usefulness as a forecast document and management tool.

Furthermore, the Plan as presented to PICA falls short of some of the most important characteristics of a long-term financial plan. According to a recent monograph published by the Government Finance Officers Association: "A long-term financial plan uses technical analysis to identify long-term imbalances in financial position and then develops strategies to counteract those imbalances…What separates a strong financial planning process from weaker ones is its ability to generate solutions to future issues and its long-term focus on structural balance."[7] In PICA staff's view, a major weakness of the Plan as submitted is that it does not clearly identify long-term financial imbalances and strategies to correct them.

To be sure, the City has underway a number of initiatives that hold promise of improving the City's financial position. They include efforts to evaluate the feasibility of privatizing the Philadelphia Gas Works, a task force examining the potential to sell various City assets, investment in technology, and a study to examine the potential to reduce the utility costs at City buildings. But these initiatives are not incorporated into the Plan's financial projections. Nor is there analysis of the size of the potential financial gap the General Fund is facing and how these initiatives, and others, might address it.

The structure of New York City's multi-year financial plan provides an example of a long-term plan that provides detailed information on initiatives to promote financial balance. The Financial Plan for fiscal years 2012 to 2016 presents, for each City agency, a baseline expenditure projection for the current fiscal year and the next four fiscal years. The Plan also presents adjustments to the baseline due to initiatives to reduce expenditures. These initiatives are presented as part of a "program to eliminate the gap." New York's financial plan also presents the size of the currently estimated budget gap that must be closed in years after the first fiscal year of the Plan.[8] While the PICA Act requires that Philadelphia's Five-Year Financial Plan present balanced budgets in each year, the structure of the New York City plan nonetheless could be adapted to the Philadelphia context.

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[7] Shayne C. Kavanagh, *Financial Policies* (Chicago: Government Finance Officers Association of the United States and Canada, 2012), pp. 157, 161.

[8] New York City's Financial Plan for fiscal years 2012 to 2016 is available at www.nyc.gov/html/omb/html/publications/publications_2012.shtml

# III. Analysis of Plan Projections

**Changes in Plan Projections from Proposed to Final**

Table 3.1 presents an overview of the Mayor's proposed FY13-FY17 Five-Year Financial Plan, issued on March 8, 2012 and the final Plan submitted to PICA on July 27, 2012. The differences reflect updated estimates of revenues and obligations in FY12, and other changes to reflect City Council's changes to the Mayor's revenue and expenditure proposals. Table 3.1 summarizes the changes. Tables 3.2 and 3.3 provide details on the changes in revenues and obligations, respectively, between the March proposed and July final versions of the Plan.

Overall, revenues increased $87.0 million from the proposed to final Plan, while obligations increased $106.8 million. The projected operating surplus in FY12 increased $30.4 million, while the projected operating surpluses or deficits in FY13 to FY17 changed modestly. The final Plan presents operating deficits in FY13 through FY15, with relatively small operating surpluses in FY16 and FY17. The FY17 fund balance projected in the final Plan is $62.0 million, a $10.7 million increase from the FY17 fund balance projected in the initial Plan proposal. The projected $62.0 million fund balance for FY17 in the final Plan is 0.3 percent of the combined FY13-FY17 projected obligations.

**Table 3.1. Summary of Changes from Proposed to Final FY13-FY17 Five-Year Financial Plan ($ in Millions)**

| | FY11 Actual | FY12 Est. | FY13 Est. | FY14 Est. | FY15 Est. | FY16 Est. | FY17 Est. | FY13-FY17 Total |
|---|---|---|---|---|---|---|---|---|
| **Initial Plan** | | | | | | | | |
| Revenues | 3,860.3 | 3,536.2 | 3,555.2 | 3,598.0 | 3,539.5 | 3,599.0 | 3,660.6 | 17,952.4 |
| Obligations | 3,785.3 | 3,490.4 | 3,589.2 | 3,635.9 | 3,569.2 | 3,603.3 | 3,664.5 | 18,062.1 |
| Prior-Year Adjustments | 39.1 | 22.7 | 18.5 | 18.5 | 18.5 | 18.5 | 18.5 | 92.5 |
| Operating Surplus/(Deficit) | 114.1 | 68.4 | (15.5) | (19.4) | (11.2) | 14.3 | 14.7 | (17.2) |
| Prior-Year Fund Balance | (114.0) | 0.1 | 68.5 | 53.0 | 33.6 | 22.4 | 36.6 | -- |
| Year-End Fund Balance | 0.1 | 68.5 | 53.0 | 33.6 | 22.4 | 36.6 | 51.3 | -- |
| **Final Plan** | | | | | | | | |
| Revenues | 3,860.3 | 3,546.6 | 3,567.7 | 3,610.4 | 3,559.3 | 3,619.7 | 3,682.3 | 18,039.4 |
| Obligations | 3,785.3 | 3,470.4 | 3,603.9 | 3,655.4 | 3,592.4 | 3,627.5 | 3,689.7 | 18,168.9 |
| Prior-Year Adjustments | 39.1 | 22.7 | 18.5 | 18.5 | 18.5 | 18.5 | 18.5 | 92.5 |
| Operating Surplus/(Deficit) | 114.1 | 98.9 | (17.6) | (26.5) | (14.6) | 10.7 | 11.1 | (37.0) |
| Prior-Year Fund Balance | (114.0) | 0.1 | 99.0 | 81.3 | 54.8 | 40.2 | 50.8 | -- |
| Year-End Fund Balance | 0.1 | 99.0 | 81.3 | 54.8 | 40.2 | 50.8 | 62.0 | -- |
| **Change from Initial to Final Plan** | | | | | | | | |
| Revenues | -- | 10.4 | 12.5 | 12.3 | 19.8 | 20.6 | 21.7 | 87.0 |
| Obligations | -- | (20.0) | 14.6 | 19.5 | 23.2 | 24.2 | 25.2 | 106.8 |
| Prior-Year Adjustments | -- | -- | -- | -- | -- | -- | -- | -- |
| Operating Surplus/(Deficit) | -- | 30.4 | (2.2) | (7.1) | (3.4) | (3.6) | 3.5 | (19.8) |
| Prior-Year Fund Balance | -- | -- | 30.4 | 28.3 | 21.2 | 17.8 | 14.2 | -- |
| Year-End Fund Balance | -- | 30.4 | 28.3 | 21.2 | 17.8 | 14.2 | 10.7 | -- |

**Table 3.2. Changes in Projected General Fund Revenues from Proposed to Final FY13-FY17 Five-Year Financial Plan ($ in Millions)**

| | FY12 Est. | FY13 Est. | FY14 Est. | FY15 Est. | FY16 Est. | FY17 Est. | FY13-FY17 Total |
|---|---|---|---|---|---|---|---|
| **Taxes** | | | | | | | |
| Real Estate | 7.0 | 23.4 | 22.7 | 29.6 | 30.5 | 31.4 | 137.6 |
| Business Income and Receipts | 5.0 | -- | -- | -- | -- | -- | -- |
| Sales | -- | 0.2 | 0.2 | 0.1 | 0.1 | 0.1 | 0.6 |
| Real Property Transfer | 2.5 | -- | -- | -- | -- | -- | -- |
| Parking | (1.0) | (1.0) | (1.1) | (1.1) | (1.1) | (1.1) | (5.4) |
| Amusement | 2.0 | -- | -- | -- | -- | -- | -- |
| Other | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.2 |
| *Total* | 15.5 | 22.6 | 21.9 | 28.6 | 29.5 | 30.4 | 133.0 |
| **Locally-Generated Non-Tax** | | | | | | | |
| Managing Director’s Office | 0.1 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 1.5 |
| Streets | (2.6) | (3.4) | (3.4) | (3.4) | (3.4) | (3.4) | (16.9) |
| Fire | (9.5) | 0.2 | (1.8) | (1.8) | (1.8) | (1.8) | (7.0) |
| City Treasurer | (0.1) | (0.5) | (2.0) | (2.1) | (2.6) | (2.6) | (9.9) |
| Sheriff’s Office | (2.3) | (2.5) | (2.5) | (2.6) | (2.6) | (2.6) | (12.7) |
| First Judicial District | (0.4) | (0.5) | (1.3) | (1.5) | (1.8) | (1.5) | (6.5) |
| Other | 9.5 | (3.2) | 0.1 | 0.3 | 0.9 | 0.8 | (1.1) |
| *Total* | (1.1) | (9.5) | (10.5) | (10.8) | (10.9) | (10.8) | (52.5) |
| **Revenues from Other Governments** | | | | | | | |
| Police | (0.2) | (0.2) | (0.2) | (0.2) | (0.2) | (0.2) | (0.9) |
| Fire | 0.3 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.9 |
| Revenue | 0.4 | 2.0 | 2.0 | 3.0 | 3.0 | 3.0 | 13.0 |
| Property Assessment | (7.0) | (3.5) | -- | -- | -- | -- | (3.5) |
| First Judicial District | (1.0) | (1.0) | (1.0) | (1.0) | (1.0) | (1.0) | (5.0) |
| Other | 3.8 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.1 |
| *Total* | (3.7) | (2.5) | 1.0 | 2.0 | 2.0 | 2.0 | 4.6 |
| **Revenues from Other Funds** | (0.2) | 1.9 | -- | -- | -- | -- | 1.9 |
| **Total** | 10.4 | 12.5 | 12.3 | 19.8 | 20.6 | 21.7 | 87.0 |

The final Plan’s projected tax revenues increased $133.0 million from the March proposal. This increase primarily reflects higher projected real estate tax revenues, due to a tax rate increase. City Council chose to increase the City portion of the real estate tax from 41.23 mills in 2012 to 44.62 mills in 2013, and provide the additional $20.0 million per year resulting from the higher tax rate to provide financial relief to the School District of Philadelphia (SDP).

The City increased its FY12 estimate of tax revenues for real estate ($7.0 million increase), business income and receipts ($5.0 million increase), real estate transfer ($2.5 million increase), amusement ($2.0 million increase), and parking ($1.0 million decrease). The City adjusted its FY13-17 projections of the parking tax to reflect the lower FY12 base, but did not do so for the other taxes.

The FY13-17 projection of locally-generated non-tax revenue declined $52.5 million due to various small reductions. They included lower projections of Streets Department commercial property trash collection fees ($18.0 million reduction over the Plan period), a reduction in Fire Department emergency medical services fees ($8.0 million), lower projected interest earnings on City investments ($9.9 million over the Plan period), a $12.7 million reduction in Sheriff's Office fees and interest earnings, and a $6.5 million reduction in traffic fine revenue received by the First Judicial District (FJD).

Overall revenue from other governments increased $4.6 million. This change primarily reflects a projected $13 million increase in revenue from the Philadelphia Parking Authority (PPA) due to proceeds of on-street parking operations, offset by a reduction of $5.5 million in State reimbursement for FJD adult probation programs, and a reduction of $3.5 million of SDP reimbursements for the cost of property assessments which will continue through FY13.

Table 3.3 presents changes in projected obligations from the initial to the final Plan. The most significant changes include $20 million in increased City contributions to SDP. These increased contributions are shown in the City Council budget in FY13, and in a separate line item Finance Contribution to the School District in FY14 -FY17. The FJD obligations are projected to be $40.9 million lower over the life of the Plan due to a transfer of $8.8 million in annual court-appointed counsel fees to the Managing Director's Office, offset by $0.8 million increase due to an arbitration award. Streets Department obligations decline $40.0 million due primarily to reductions in the cost of contractual services for waste disposal.

**Table 3.3. Changes in Projected General Fund Obligations from Proposed to Final FY13-FY17 Five-Year Financial Plan ($ in Millions)**

| Agency/Cost Center | FY12 Est. | FY13 Est. | FY14 Est. | FY15 Est. | FY16 Est. | FY17 Est. | FY13-FY17 Total |
|---|---|---|---|---|---|---|---|
| City Council | -- | 20.5 | 0.5 | 0.5 | 0.5 | 0.5 | 22.5 |
| Commerce | -- | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.8 |
| Contribution to School District | -- | -- | 20.0 | 20.0 | 20.0 | 20.0 | 80.0 |
| Debt Service | (15.8) | -- | -- | -- | -- | -- | -- |
| Director of Finance | -- | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.9 |
| Fire | 1.2 | -- | -- | -- | -- | -- | -- |
| First Judicial District | -- | (8.8) | (8.0) | (8.0) | (8.0) | (8.0) | (40.9) |
| Fleet Management | -- | (0.5) | -- | -- | -- | -- | (0.5) |
| Free Library | -- | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 1.6 |
| Innovation and Technology | (0.5) | 1.9 | -- | -- | -- | -- | 1.9 |
| Managing Director | -- | 9.0 | 9.8 | 9.8 | 9.8 | 9.8 | 48.4 |
| Other Employee Benefits | -- | 2.2 | 2.2 | 2.2 | 2.2 | 2.2 | 10.8 |
| Pension Payments | -- | -- | (1.2) | 3.1 | 3.9 | 6.2 | 11.9 |
| Police | -- | -- | 1.4 | 1.4 | 2.2 | 2.3 | 7.5 |
| Prisons | 1.1 | (1.3) | 1.1 | 1.1 | 1.1 | 1.1 | 3.2 |
| Property Assessment | (1.0) | -- | -- | -- | -- | -- | -- |
| Revenue | (0.5) | -- | -- | -- | -- | -- | -- |
| Social Security Payments | -- | -- | -- | -- | -- | (0.2) | (0.2) |
| Streets | (4.5) | (8.7) | (6.7) | (7.3) | (7.9) | (9.4) | (40.0) |
| **Total** | (20.0) | 14.6 | 19.5 | 23.2 | 24.2 | 24.9 | 106.4 |

## Analysis of Final FY13-17 Plan Revenues and Obligations

Table 3.4 presents the Plan projected General Fund revenues by category. Overall tax revenues are projected to increase through FY14 and then decline in FY15 due to the reduction of one percent of the sales tax. Real estate tax revenues are projected to increase in each year of the Plan, due to a combination of projected assessment growth of 3.0 percent in FY15 through FY17 and properties returning to the tax rolls after the expiration of tax abatements. Wage and earnings tax revenue is projected to increase steadily, reflecting base growth offset by modest reductions in tax rates beginning in FY14. Under the Plan, the resident wage tax rate will decrease from 3.928 percent in FY13 to 3.814 percent in FY17, and the non-resident rate from 3.4985 percent to 3.397 percent over the same period.

Business income and receipts tax (BIRT) revenues are projected to decline in FY15 and FY16 due to the implementation of business tax reforms, notably the exclusion from taxation of the first $100,000 from the gross receipts portion of BIRT for all taxpayers, and the implementation of single sales factor apportionment for the net income portion of BIRT. The exclusion will first impact revenues in FY15, with an estimated reduction of $18.4 million. Single factor apportionment is expected to impact revenues beginning in FY16, with a reduction of $19.5 million in revenue.

Real estate transfer tax revenues are projected to grow 40.4 percent from FY12 to FY17, a reflection of the relatively high base growth rates assumed in the Plan. The risk presented by the large growth percentage is tempered by the fact that the City is not projecting actual returns to the high levels as experienced before the economic downturn. This projection assumes a rapid recovery in the real estate market. Parking, amusement, and other taxes are projected to grow modestly over the Plan period.

The FY13-17 projected locally-generated non-tax revenues are not significantly changed from the FY11 actual and current FY12 estimated. Significant changes within revenue from other governments include the phasing out of Department of Human Service grant revenue due to the shift of all reimbursed obligations to the Grants Revenue Fund beginning in FY12.[9] Finance Department revenues are unusually high in FY12 due to several one-time revenue sources: an increase in State pension aid due to underpayments from multiple prior years ($33.1 million); and a reimbursement of prior year debt service paid by the City on behalf of a Center City parking garage ($12.8 million).

[9] The DHS revenue amounts shown in FY12 and FY13 represent reimbursements of General Fund obligations from FY11 and prior years.

**Table 3.4. Projected General Fund Revenues in FY13-FY17 Five-Year Financial Plan ($ in Millions)**

| | FY11 Actual | FY12 Est. | FY13 Est. | FY14 Est. | FY15 Est. | FY16 Est. | FY17 Est. | FY13-FY17 Total |
|---|---|---|---|---|---|---|---|---|
| **Taxes** | | | | | | | | |
| Real Estate | 482.7 | 498.5 | 514.9 | 525.9 | 544.0 | 557.4 | 571.2 | 2,713.4 |
| Wage and Earnings | 1,134.3 | 1,168.4 | 1,207.8 | 1,246.9 | 1,287.3 | 1,307.6 | 1,322.6 | 6,372.2 |
| Business Income and Receipts | 376.9 | 391.4 | 394.9 | 402.9 | 393.9 | 379.4 | 383.0 | 1,954.1 |
| Sales | 244.6 | 250.2 | 259.3 | 271.5 | 143.2 | 150.4 | 155.6 | 980.1 |
| Real Property Transfer | 116.6 | 118.4 | 124.5 | 135.8 | 148.0 | 161.3 | 166.1 | 735.7 |
| Parking | 71.6 | 73.3 | 75.1 | 77.0 | 78.9 | 80.9 | 82.9 | 394.9 |
| Other | 32.3 | 37.1 | 37.8 | 38.5 | 39.2 | 39.8 | 40.4 | 195.6 |
| *Total* | 2,459.1 | 2,537.1 | 2,614.4 | 2,698.5 | 2,634.5 | 2,676.7 | 2,721.9 | 13,346.0 |
| **Locally-Generated Non-Tax** | | | | | | | | |
| Innovation and Technology | 24.8 | 19.3 | 19.3 | 20.5 | 22.1 | 23.7 | 25.4 | 110.9 |
| Streets | 16.7 | 21.2 | 19.1 | 19.1 | 19.1 | 19.1 | 19.1 | 95.7 |
| Fire | 35.2 | 27.7 | 37.4 | 35.4 | 35.4 | 35.4 | 35.4 | 179.0 |
| Licenses and Inspections | 46.0 | 49.8 | 44.3 | 45.1 | 46.6 | 46.8 | 46.8 | 229.7 |
| Records | 15.4 | 16.1 | 17.4 | 18.4 | 18.6 | 18.6 | 18.6 | 91.5 |
| Finance | 21.9 | 17.9 | 13.8 | 13.8 | 13.9 | 13.9 | 13.9 | 69.3 |
| First Judicial District | 50.0 | 44.2 | 40.6 | 40.8 | 41.1 | 41.3 | 41.6 | 205.4 |
| Other | 70.0 | 55.3 | 54.4 | 54.5 | 56.0 | 57.1 | 58.3 | 280.4 |
| *Total* | 280.0 | 251.5 | 246.3 | 247.6 | 252.7 | 256.1 | 259.1 | 1,261.8 |
| **Revenues from Other Governments** | | | | | | | | |
| Public Health | 54.6 | 60.9 | 59.0 | 58.0 | 58.0 | 58.0 | 58.0 | 291.0 |
| Public Property | 18.0 | 18.0 | 18.0 | 18.0 | 18.0 | 18.0 | 18.0 | 90.0 |
| Human Services | 474.8 | 57.1 | 49.9 | -- | -- | -- | -- | 49.9 |
| Finance | 151.5 | 199.1 | 153.9 | 155.7 | 156.8 | 157.4 | 158.1 | 781.9 |
| Revenue | 41.6 | 43.4 | 35.2 | 35.2 | 36.2 | 36.2 | 36.2 | 179.1 |
| PICA City Account | 295.7 | 298.0 | 310.8 | 314.2 | 327.2 | 340.0 | 352.5 | 1,644.8 |
| First Judicial District | 15.3 | 15.1 | 15.1 | 15.1 | 15.1 | 15.1 | 15.1 | 75.4 |
| Other | 14.9 | 13.3 | 12.0 | 15.5 | 15.5 | 15.5 | 15.5 | 74.0 |
| *Total* | 1,066.5 | 704.9 | 653.8 | 611.8 | 626.8 | 640.3 | 653.4 | 3,186.0 |
| **Revenues from Other Funds** | 54.6 | 53.0 | 53.3 | 52.5 | 45.2 | 46.6 | 48.0 | 245.5 |
| **Total General Fund Revenues** | 3,860.3 | 3,546.6 | 3,567.7 | 3,610.4 | 3,559.3 | 3,619.7 | 3,682.3 | 18,039.4 |

Table 3.5 presents the annual percentage growth in revenues by major category for the FY13-FY17 period. These growth rates incorporate the impact of the tax base growth assumptions (shown in Table 2.2) as well as projected changes in tax rates, tax structure, and collection rates. Wage and earnings tax growth is projected at a relatively low 1.6 percent in FY16 and 1.1 percent in FY17, reflecting relatively large projected wage tax rate reductions in those years. Although the Plan projects modest rate reductions in FY14 and FY15, the reductions are much more significant in FY16 and FY17. Relatively low growth for the net profits tax is also projected in FY16 and FY17 due to rate reductions.

BIRT revenues are projected to decline in FY15 and FY16 due to the particularly large impact of tax restructuring in those years. However, in all years of the Plan, revenue growth is below the projected 2.5 percent base growth for this tax due to the impact of tax reforms. Sales tax revenue is projected to decline 47.2 percent in FY15 due to the expiration of one percent of the City sales tax on June 30, 2014.

**Table 3.5. Projected Annual Percentage Revenue Growth, FY13-FY17 Five-Year Financial Plan**

| | **FY12 Est.** | **FY13 Est.** | **FY14 Est.** | **FY15 Est.** | **FY16 Est.** | **FY17 Est.** |
|---|---|---|---|---|---|---|
| ***Taxes*** | | | | | | |
| Real Estate | 3.3 | 3.3 | 2.1 | 3.4 | 2.5 | 2.5 |
| Wage and Earnings | 3.0 | 3.4 | 3.2 | 3.2 | 1.6 | 1.1 |
| Business Income and Receipts | 3.8 | 0.9 | 2.0 | (2.2) | (3.7) | 1.0 |
| Net Profits | 36.5 | 2.0 | 1.9 | 1.9 | 1.0 | 0.8 |
| Sales | 2.3 | 3.7 | 4.7 | (47.2) | 5.0 | 3.5 |
| Real Property Transfer | 1.5 | 5.2 | 9.0 | 9.0 | 9.0 | 3.0 |
| Parking | 2.4 | 2.5 | 2.5 | 2.5 | 2.5 | 2.5 |
| Amusement | 4.2 | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 |
| Other | | | | | | |
| *Total Taxes* | 3.2 | 3.0 | 3.2 | (2.4) | 1.6 | 1.7 |
| ***Locally-Generated Non-Tax*** | (10.2) | (2.1) | 0.6 | 2.1 | 1.3 | 1.2 |
| ***Revenues from Other Governments*** | (33.9) | (7.2) | (6.4) | 2.5 | 2.2 | 2.0 |
| ***Revenues from Other Funds*** | (2.9) | 0.4 | (1.5) | (13.8) | 2.9 | 3.1 |
| **Total General Fund Revenues** | (8.1) | 0.6 | 1.2 | (1.4) | 1.7 | 1.7 |

Table 3.6 presents the Plan projected obligations for all major agencies and cost centers. The most significant changes are the $20 million annual increase in the City appropriation for SDP. (The increased contribution to SDP is shown in the City Council budget in FY13, and in the SDP Finance – Contribution to SDP line item in FY14-FY17.) The Plan assumes no additional increases in City contributions to SDP through FY17. The Plan shows pension costs increasing significantly through FY14, declining in FY15, and increasing in FY16 and FY17. These trends reflect the City's obligation under State law to repay to the Pension Fund the portion of the FY10 and FY11 minimum municipal obligation that was deferred. The Plan projected pension contributions in FY13 and FY14 include $124.5 million and $134.8 million, respectively, in repayments of deferred amounts plus interest.

Other employee benefits are projected to increase $56 million from FY13 to FY17, reflecting the assumption of increased costs for Police health care. Human Services obligations are projected to decline to $110.1 million in FY12 and remain at approximately that level through FY17, due to the transfer of reimbursed costs to the Grants Revenue Fund. The City's ability to meet this projection will depend on its continued success at containing DHS costs, as well as no significant changes in State or Federal funding policies.

Debt services obligations are projected to increase from $222.5 million in FY13 to $257.1 million in FY17. The increases reflect new General Obligation debt issuances in 2014 and 2016, and increased interest cost for short-term borrowings.

**Table 3.6. Projected General Fund Obligations in FY13-FY17 Five-Year Financial Plan ($ in Millions)**

| Agency/Cost Center | FY11 Actual | FY12 Est. | FY13 Est. | FY14 Est. | FY15 Est. | FY16 Est. | FY17 Est. | FY13-FY17 Total |
|---|---|---|---|---|---|---|---|---|
| Community College Subsidy | 25.4 | 25.4 | 25.4 | 25.4 | 25.4 | 25.4 | 25.4 | 127.0 |
| School District Contribution | 38.6 | 48.9 | 49.0 | 69.1 | 69.1 | 69.2 | 69.2 | 325.6 |
| City Council | 13.8 | 15.0 | 35.5 | 15.5 | 15.5 | 15.5 | 15.5 | 97.7 |
| Fire | 198.0 | 195.2 | 189.3 | 189.8 | 190.3 | 190.8 | 191.3 | 951.5 |
| First Judicial District | 115.4 | 117.0 | 101.4 | 102.1 | 102.1 | 102.1 | 102.1 | 510.0 |
| Fleet Management | 52.2 | 56.2 | 55.4 | 53.9 | 54.9 | 54.9 | 54.9 | 273.9 |
| Free Library | 32.5 | 33.4 | 33.7 | 33.7 | 33.7 | 33.7 | 33.7 | 168.4 |
| Pension Payments | 490.2 | 554.3 | 629.1 | 660.4 | 567.6 | 589.0 | 606.2 | 3,052.3 |
| Other Employee Benefits | 351.3 | 347.2 | 360.4 | 373.4 | 385.3 | 400.0 | 416.6 | 1,935.7 |
| Disability/Workers Compensation | 55.1 | 55.9 | 58.3 | 60.8 | 63.5 | 66.2 | 69.2 | 318.0 |
| Social Security Payments | 64.6 | 64.9 | 64.9 | 66.3 | 66.3 | 66.4 | 66.4 | 330.2 |
| Unemployment Compensation | 5.9 | 5.6 | 5.6 | 5.6 | 5.6 | 5.6 | 5.6 | 27.9 |
| Human Services | 543.6 | 110.1 | 111.0 | 109.1 | 109.1 | 109.1 | 109.1 | 547.6 |
| Indemnities | -- | 34.0 | 33.5 | 33.5 | 33.5 | 33.5 | 33.5 | 167.3 |
| Legal Services | 36.6 | 37.1 | 37.1 | 37.1 | 37.1 | 37.1 | 37.1 | 185.3 |
| Licenses and Inspections | 18.4 | 21.7 | 21.7 | 21.7 | 21.7 | 21.7 | 21.7 | 108.3 |
| Managing Director | 16.0 | 23.1 | 32.4 | 33.2 | 33.2 | 33.2 | 33.2 | 165.3 |
| Innovation and Technology | 61.3 | 70.4 | 70.0 | 68.1 | 59.7 | 59.7 | 59.7 | 317.4 |
| Supportive Housing | 36.4 | 38.5 | 39.6 | 39.6 | 39.6 | 39.6 | 39.6 | 198.2 |
| Director of Finance | 16.3 | 12.8 | 13.0 | 12.4 | 12.4 | 12.9 | 12.4 | 62.9 |
| Property Assessment | 5.7 | 8.1 | 11.7 | 10.7 | 10.7 | 10.7 | 10.7 | 54.3 |
| Parks and Recreation | 47.1 | 45.7 | 47.8 | 47.8 | 47.8 | 47.8 | 47.8 | 238.9 |
| Police | 551.4 | 553.2 | 556.8 | 560.6 | 557.9 | 558.1 | 558.5 | 2,791.9 |
| Prisons | 232.2 | 231.3 | 227.9 | 230.3 | 230.3 | 230.3 | 230.3 | 1,149.1 |
| Public Health | 108.9 | 110.4 | 111.6 | 110.7 | 110.7 | 110.7 | 110.7 | 554.4 |
| Public Property | 171.1 | 167.9 | 180.7 | 175.3 | 178.3 | 182.7 | 187.1 | 904.0 |
| Sheriff | 14.2 | 15.6 | 14.1 | 14.1 | 14.1 | 14.1 | 14.1 | 70.4 |
| Debt Service | 197.9 | 201.1 | 222.5 | 226.6 | 247.6 | 237.5 | 257.1 | 1,191.2 |
| Streets | 131.0 | 115.3 | 111.8 | 116.0 | 116.8 | 117.6 | 118.4 | 580.6 |
| Other | 139.8 | 136.2 | 134.4 | 134.4 | 134.4 | 134.4 | 134.4 | 671.9 |
| **Total General Fund Obligations** | 3,785.3 | 3,470.4 | 3,603.9 | 3,655.4 | 3,592.4 | 3,627.5 | 3,689.7 | 18,168.9 |

**Potential Budget Reductions**

After submittal of the July 27 Plan, PICA expressed concerns about the reasonableness of the Plan's assumption of no additional cost for outstanding labor contracts, including the IAFF arbitration. On August 9, the City provided PICA an addendum to the Plan listing potential budget actions that could result in annual savings of as much as $52.1 million. The addendum was a response to the concern that the Plan failed to include any details on how the City would respond to unanticipated costs and provide a contingency in the face of large financial risks. The City expressed the likelihood of having to choose from the scenario of cuts in the addendum to construct a balanced budget.

PICA does not hold any authority over how the City spends money. PICA does not control City decision making when it comes to expenditures and does not intend to imply such power. The decision on how and what to spend tax dollars upon, rests in the sole management prerogative of the Administration and within the authority of the City Council adopted budget appropriation. It is the Administration's prerogative to close a district health center or the Philadelphia Nursing Home (PNH) should it choose to do so. This is a subtle but important distinction for purposes of the discussion of the addendum. In this section of the staff report, PICA staff is solely commenting on the likelihood or reality of some of the cuts, given the use of the addendum as a contingency to balance the Plan. PICA staff does not endorse the list of cuts or in any way deny the City's management right to enact every cut if so desired.

The scenarios presented in the Plan addendum are based on information submitted by City agencies to the Office of Budget and Program Evaluation in spring of 2012. Each agency submitted proposed budget reductions under three scenarios, which required overall reductions of 2 percent, 4 percent and 5 percent in agency obligations. The level of cuts in the 5 percent reduction scenarios are summarized in the Table 3.7.

In review of the addendum, PICA staff notes some problems. First, there is little indication of the feasibility of some reductions. The largest projected cost reduction is in Prisons System, but since prison costs are closely related to the inmate population, it is unclear how these reductions can be achieved, particularly in light of the currently increasing prison population.

An additional problem relates to the lack of clear information about the actual impacts of the proposed reductions. In the case of the Department of Public Health, it is stated that a reduction of $7.2 million would result in the closure of one district health center and the Philadelphia Nursing Home (PNH). Given that a substantial portion of the costs of both of the health centers and PNH are reimbursed through Medicaid and Medicare, it appears unlikely that such a scenario would occur. The Department may have other options for reducing City-funded costs at these facilities that would not likely result in closure.

Additionally, there is no information submitted for two major departments, the Police Department and the Department of Human Services. While both of these departments deliver important services, it is questionable that if it were necessary to reduce overall General Fund obligations by $50 million annually, that the Administration would not consider any reductions in spending within these agencies. Finally, because this information was generated by City departments, there is some question as to how likely the City would be to implement the exact reductions listed in the addendum, were it necessary to reduce spending. Department heads may have shown worse case scenarios to stave off further budget reductions. A more likely scenario, were significant cuts to become necessary, is that the Administration would make reductions based on its own assessment of needs and priorities in conjunction with Department heads.

The addendum is useful because it presents scenarios to provide Plan balance. It is also responsive to a concern that the Plan did not communicate any contingencies in the face of unaccounted costs. The likelihood of the City making some of the reductions appears remote and the City has acknowledged some but not all reductions might serve as a means to readjust a plan imbalance. To underscore, PICA staff does not endorse the list of cuts and it is clearly the Administration's prerogative to make all of the reductions if it so chooses.

**Table 3.7 Summary of Potential Budget Reductions, by Agency ($ in Millions)**

| Agency | Amount | Type of Expenditure Reduction or Program Impact |
|---|---|---|
| Prisons | $11.4 | Various categories. |
| Fire | 8.4 | 108 positions reduced, and deactivation or brownout of certain medical or fire suppression units. |
| Public Health | 7.2 | Closure of one district health center and Philadelphia Nursing Home |
| Streets | 3.7 | Salt purchases, code enforcement, street cleaning, and administrative support. |
| Fleet Management | 2.4 | Overtime, maintenance contracts, and parts. |
| Parks and Recreation | 2.3 | Reduced program offerings, facility hours, and facility maintenance. |
| Innovation and Technology | 2.3 | Various categories |
| Debt Service | 2.0 | Possible need for transfer ordinance to meet debt service requirements. |
| Supportive Housing | 1.9 | Emergency and transitional housing, job training, and disability benefit eligibility services. |
| Free Library | 1.7 | 39 positions and reduced library hours. |
| Managing Director | 1.6 | Various categories. |
| Legal Services | 1.3 | 21 public defender positions. |
| Licenses and Inspections | 1.1 | Reduced demolitions |
| Revenue | 1.0 | 35 positions. |
| Behavioral Health | 0.7 | Tobacco education, case management, and prevention programs. |
| Director of Finance | 0.6 | Various categories. |
| Property Assessment | 0.5 | 15 positions. |
| Law | 0.5 | 7 positions, reductions in outside counsel expenses. |
| Commerce | 0.2 | 3 positions |
| Other | | |
| Total | 52.1 | |

Source: Addendum to FY13-17 Five-Year Financial Plan, City of Philadelphia.

# IV. Spending and Performance

This section presents an overview of General Fund obligations trends by major functional category, along with trends in related performance indicators. The goal is to describe some of the policy priorities and operational realities that have driven the General Fund financial results in recent years.

## Obligations by Program

Table 4.1 presents trends from FY08 through FY13 in obligations by major program category for the General Fund.

**Table 4.1. General Fund Obligations by Program, FY08-FY13 ($ in Millions)**

| | FY08 Actual | FY09 Actual | FY10 Actual | FY11 Actual | FY12 Est. | FY13 Est. | FY08-FY13 Percent Growth |
|---|---|---|---|---|---|---|---|
| *General Fund* | | | | | | | |
| Public Safety | 935.2 | 964.7 | 951.6 | 961.1 | 979.7 | 974.0 | 4.2% |
| Court System | 213.2 | 208.9 | 196.9 | 199.9 | 204.2 | 187.1 | (12.3%) |
| Social Services[1] | 176.1 | 174.0 | 166.6 | 161.8 | 165.8 | 168.2 | (4.5%) |
| Economic Devt./Education | 204.3 | 191.8 | 184.7 | 171.1 | 185.5 | 205.7 | 0.7% |
| Recreation, Arts and Culture | 97.0 | 91.6 | 85.7 | 84.2 | 85.3 | 87.6 | (9.6%) |
| Other Public Services | 165.7 | 168.1 | 166.7 | 140.8 | 130.2 | 126.7 | (23.5%) |
| Internal Services[2] | 209.1 | 200.8 | 186.5 | 218.8 | 228.2 | 239.7 | 14.7% |
| Governance/Administration | 127.9 | 129.0 | 109.8 | 109.7 | 118.5 | 130.7 | 2.2% |
| Debt Service | 172.2 | 187.0 | 185.5 | 197.9 | 201.1 | 222.5 | 29.2% |
| Indemnities | 21.4 | 26.4 | 28.7 | 30.3 | 34.0 | 33.5 | 56.2% |
| Employee Benefits | 983.0 | 973.2 | 831.4 | 967.1 | 1,027.9 | 1,118.3 | 13.8% |
| ***Total*** | 3,305.1 | 3,315.5 | 3,094.2 | 3,242.4 | 3,360.3 | 3,493.8 | 5.7% |

Note:
[1] For comparative purposes, amounts exclude Department of Human Services obligations.
[2] Increases are primarily due to the consolidation of information technology functions.

From FY08 through FY13, the most significant cost increases are projected to occur in employee benefits, debt service and indemnities. To some degree, spending in these areas is outside the City's control in the short term. Because of the City's severe financial constraints, maintaining fiscal balance has required reductions in spending in most major functional areas. Spending for the court system, social services, recreation, arts and culture, and other public services have declined since FY08. Public safety, and economic development and education have increased, a reflection of the priority the Administration has placed on public safety and increasing financial support of the School District of Philadelphia (SDP). Costs for governance and administration have increased modestly. Internal services has increased 14.7 percent from FY08 to FY13, but this increase primarily reflects consolidation of information technology functions in the Office of Innovation and Technology budget.

**Public Safety**

Public safety obligations are projected to increase 4.2 percent from FY08 to FY13, with the primary growth in Police and Prisons. Police Department obligations are projected to increase 6.3 percent from FY08 to FY13, while Fire Department obligations are projected to remain essentially flat over the period. The difference in growth between Police and Fire partly reflects wage increases of 3 percent in FY11 and FY12 for uniformed Police officers awarded by an arbitration panel in December 2009. Although a 2010 arbitration award would have provided the same increases to Firefighters, this award was appealed by the City to the Court of Common Pleas. The City's appeal was upheld by the Court and remanded to the arbitration panel. The panel issued a similar award in July 2012, and the City has appealed this award as well.

**Table 4.2. Public Safety: General Fund Obligations and Performance Indicators, FY08-FY13 ($ in Millions)**

| | FY08 Actual | FY09 Actual | FY10 Actual | FY11 Actual | FY12 Est. | FY13 Est. | FY08-FY13 Percent Growth |
|---|---|---|---|---|---|---|---|
| *General Fund Obligations*[1] | | | | | | | |
| Police | $524.0 | $534.3 | $528.9 | $536.2 | $553.2 | $556.8 | 6.3% |
| Fire | 189.2 | 189.1 | 188.9 | 193.8 | 195.2 | 189.3 | 0.1% |
| Prisons | 222.0 | 241.3 | 233.8 | 231.2 | 231.3 | 227.9 | 2.6% |
| Total | 935.2 | 964.7 | 951.6 | 961.1 | 979.7 | 974.0 | 4.2% |
| *Performance Indicators* | | | | | | | |
| Part 1 Offenses | | | | | | | |
| Violent Offenses | 20,596 | 20,279 | 18,602 | 18,521 | | | |
| Property Offenses | 62,073 | 58,712 | 56,493 | 58,809 | | | |
| Homicides | 350 | 314 | 305 | 318 | | | |
| Arrests | 75,805 | 68,922 | 64,465 | 73,310 | | | |
| Fires Handled[2] | 7,444 | 6,850 | 4,927 | 7,945 | | | |
| Fire Related Deaths | 35 | 36 | 32 | 41 | | | |
| EMS Medic Unit Runs | 215,305 | 217,505 | 222,882 | 227,147 | | | |
| Average Inmate Population | 9,133 | 9,554 | 8,806 | 7,935 | | | |

Note:
[1] Indemnities costs are excluded for major departments. Source: Comprehensive Annual Financial Report
[2] The classification of fires changed from FY10 to FY11.

Prison System obligations declined from FY09 through FY11, due to a declining average inmate population. The decline was made possible due to initiatives to speed the processing of cases through the court system, as well as the transfer of some sentenced inmates to State correctional institutions. However, the inmate population has increased in recent months, raising some concerns about whether the Plan projection for a further decline in FY13 can be met.

In March, an Act 195 interest arbitration panel awarded a five-year contract to correctional officers represented by District Council 33 of AFSCME. The contract covers the period from FY09 through FY14, and included a one-time bonus of $1,100 payable in FY12, and 2.5 percent wage increases in FY13 and FY14. The costs of this award are included in the revised Five-Year Financial Plan, and are projected to result in an additional $2.4 million in Prison costs in FY13 and $2.5 million in FY14. Under the award, step and longevity increases that had been frozen effective in July 2009 were reinstated effective with the date of issuance of the award.

**Court System**

Court system obligations are projected to decline 12.3 percent from FY08 to FY13. Each component of the court system is projected to decline over this period, with the most substantial reduction (18.8 percent) in the First Judicial District. However, $8.8 million of the decline from FY12 to FY13 is due to transferring costs for court-appointed counsel from the FJD budget to the Managing Director's Office budget. The decline also reflects the fact that the projected FY13 obligation figure does not incorporate likely increases due to revenue sharing agreements between the City and FJD. Under these agreements, the FJD is allowed to spend portions of the General Fund revenue it generates.

**Table 4.3. Court System: General Fund Obligations, FY08-FY13 ($ in Millions)**

| | FY08 Actual | FY09 Actual | FY10 Actual | FY11 Actual | FY12 Est. | FY13 Est. | FY08-FY13 Percent Growth |
|---|---|---|---|---|---|---|---|
| General Fund | | | | | | | |
| First Judicial District[1] | 124.9 | 121.3 | 111.7 | 115.2 | 117.0 | 101.4 | (18.8%) |
| Sheriff's Office | 15.4 | 15.7 | 15.8 | 14.2 | 15.6 | 14.1 | (8.7%) |
| Register of Wills | 3.5 | 3.6 | 3.2 | 3.2 | 3.3 | 3.3 | (5.4%) |
| District Attorney's Office | 32.0 | 30.9 | 30.2 | 30.5 | 31.1 | 31.1 | (3.0%) |
| Legal Services[2] | 37.3 | 37.3 | 35.9 | 36.6 | 37.1 | 37.1 | (0.5%) |
| Witness Fees | 0.1 | 0.1 | 0.1 | 0.1 | 0.2 | 0.2 | (30.2%) |
| Total | 213.2 | 208.9 | 196.9 | 199.9 | 204.2 | 187.1 | (12.3%) |

Note: Indemnities costs are excluded for major departments.
[1] Includes Clerk of Quarter Sessions, which was merged with the First Judicial District beginning in FY11.
[2] Includes subsidies to the Defender Association of Philadelphia, Community Legal Services, and Support Center for Child Advocates for legal representation.

The court system has implemented a variety of reforms in recent years, in part as a result of working collaboratively across agencies through the Criminal Justice Advisory Board. FJD has implemented reforms to process cases more efficiently. FJD has also increased the efficiency of its financial operations through the absorption of the Clerk of Quarter Sessions beginning in

FY11. The functions of this office, which has key administrative and record-keeping functions related to criminal cases, are now performed by the FJD's Clerk of Courts. The City received a substantial increase in revenue in FY11 and FY12 due to FJD's absorption of this office, and the implementation of more efficient technologies. Lastly, the Plan includes $.8 million in additional funding in the FJD beginning in FY14 to cover the cost of an arbitration award for Local 810.

**Social Services**

There have been modest declines in social service obligations over the FY08-FY13 period. Total social service obligations excluding Human Services are projected to decline 4.5 percent over the period. The reductions in funding have been offset to a large degree by increases in grant funding under the federal American Recovery and Reinvestment Act (ARRA). ARRA has provided additional funding for housing, homeless, and public health programs in FY10 through FY12. However, the expiration of this temporary funding, as well as other reductions in State and Federal social services funding, is projected to result in reductions in overall social services spending in FY13 (including all operating funds). The City's Five-Year Financial Plan does not anticipate that the City will compensate for these reductions with increased City tax-funded support.

From FY08 through FY11, the Department of Human Services (DHS) has been successful in reducing costs through various reforms. These initiatives have resulted in significant reductions in the number of children and youth in out-of-home placement, reductions in the length of stay in placement, and reductions in high-cost out-of-state placements. The FY12 and FY13 DHS obligations in the General Fund are projected to decline dramatically due to a shift in recognition of all grant-funded expenditures to the Grants Revenue Fund beginning in FY12. This change in accounting should improve the transparency of reported results for the General Fund. In the past, the timing of State and Federal grant receipts had a significant impact on reported General Fund balance. With only the City supported share of DHS expenditures shown in the General Fund, it is expected that General Fund results will no longer be impacted by changes in the timing of intergovernmental funding.

**Table 4.4. Social Services: General Fund Obligations and Performance Indicators, FY08-FY13($ in Millions)**

| | FY08 Actual | FY09 Actual | FY10 Actual | FY11 Actual | FY12 Est. | FY13 Est. | FY08-FY13 Percent Growth |
|---|---|---|---|---|---|---|---|
| *General Fund Obligations*[1] | | | | | | | |
| Human Services | $614.8 | $599.8 | $561.1 | $542.9 | $110.1 | $111.0 | (81.9%) |
| Public Health | 112.7 | 116.2 | 111.1 | 108.8 | 110.4 | 111.6 | (0.9%) |
| Behavioral Health | 14.1 | 14.3 | 14.2 | 14.3 | 14.3 | 14.3 | (1.0%) |
| Housing/Community Development | 5.2 | 4.0 | 2.8 | 2.3 | 2.5 | 2.5 | (51.5%) |
| Supportive Housing | 40.5 | 39.4 | 38.4 | 36.4 | 38.5 | 39.6 | (2.2%) |
| Other[2] | 3.5 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | |
| ***Total*** | | | | | | | |
| Including Human Services | 790.9 | 773.8 | 727.7 | 704.7 | 275.9 | 279.2 | (64.7%) |
| Excluding Human Services | 176.1 | 174.0 | 166.6 | 161.8 | 165.8 | 168.2 | (4.5%) |
| *Performance Indicators* | | | | | | | |
| Child Abuse and Neglect Reports | 14,200 | 11,500 | 12,400 | 12,400 | | | |
| Children in Placement | 7,739 | 7,993 | 8,792 | 7,122 | | | |
| Adoptions Finalized | 351 | 432 | 561 | 630 | | | |
| Health Center Patient Visits | 334,139 | 349,078 | 350,695 | 339,032 | | | |
| Emergency Shelter Beds (Average) | 2,747 | 2,689 | 2,617 | 2,520 | | | |
| Persons in Emergency Housing | 13,691 | 13,335 | 13,326 | 12,926 | | | |

Notes:
[1] Indemnities costs are excluded for major departments.
[2] Includes Mayor's Office of Community Services and Youth Commission.

The Department of Public Health (DPH) provides primary health care services through its District Health Centers, long-term care through the Philadelphia Nursing Home and Riverview Home, and administers other health programs including maternal and child health, lead poisoning prevention, environmental health, and disease control. DPH's district health centers enhance the level of primary health care services available to the low-income and uninsured population in Philadelphia. There were 339,000 visits to the health centers in FY11, of which 49.6 percent were by uninsured patients. The City may be able to reduce its level of tax support of the health centers if the level of insurance coverage in the City increases as a result of the federal Affordable Care Act.

## Economic Development and Education

Most categories of economic development-related spending are projected to decline from FY08 through FY13, including Commerce, Licenses and Inspections, and Planning and Zoning. The City's subsidy to the Pennsylvania Convention Center Authority (PCCA) is also projected to decline due to the City's reduced obligations to support PCCA as a result of the new financial arrangement implemented after the expansion of the Center. The City's subsidy to the Southeastern Pennsylvania Transportation Authority (SEPTA) is projected to increase 8.0 percent over the period. The level of funding for education is projected to increase 53.4 percent, due to significant increases in funding for SDP in FY12 and FY13.

**Table 4.5. Economic Development and Education: General Fund Obligations and Performance Indicators, FY08-FY13 ($ in Millions)**

| | FY08 Actual | FY09 Actual | FY10 Actual | FY11 Actual | FY12 Est. | FY13 Est. | FY08-FY13 Percent Growth |
|---|---|---|---|---|---|---|---|
| *General Fund Obligations*[1] | | | | | | | |
| Commerce[2] | 13.6 | 9.8 | 4.1 | 4.2 | 4.5 | 4.9 | (64.3%) |
| Convention Center Subsidy[3] | 32.3 | 22.7 | 24.2 | 15.0 | 15.0 | 15.0 | (53.6%) |
| SEPTA Subsidy | 61.5 | 62.9 | 64.2 | 65.9 | 66.4 | 66.4 | 8.0% |
| Licenses and Inspections[4] | 31.2 | 27.4 | 23.6 | 18.9 | 22.2 | 22.2 | (28.7%) |
| Planning and Zoning[5] | 4.0 | 3.8 | 3.8 | 3.1 | 2.8 | 2.6 | (35.7%) |
| Education [6] | 61.7 | 65.2 | 65.0 | 64.0 | 74.5 | 94.6 | 53.4% |
| ***Total*** | 204.3 | 191.8 | 184.7 | 171.1 | 185.5 | 205.7 | 0.7% |
| *Performance Indicators* | | | | | | | |
| Payroll Employment (Thousands) | 662.9 | 659.5 | 652.5 | 660.8 | | | |
| Unemployment Rate | 6.4 | 8.3 | 10.6 | 10.7 | | | |
| SEPTA Passenger Trips (Millions) | 236.3 | 241.5 | 234.9 | 247.0 | | | |
| Four Year High School Graduation | | 60.0 | 63.0 | 61.0 | | | |

Notes:
[1] Indemnities costs are excluded for major departments.
[2] Includes City Representative.
[3] FY08 cost is offset by convention center subsidy or revenue of approximately $20 million.
[4] Includes Board of Building Standards, Board of Licenses and Inspections Review, and Zoning Board of Adjustment
[5] Includes Planning Commission, Zoning Code Commission, and Historical Commission
[6] Includes subsidy to School District of Philadelphia, Community College of Philadelphia, and Mayor's Scholarships. In FY13, includes $20 million appropriated under the City Council budget that will be transferred to the School District of Philadelphia.

## Recreation, Arts and Culture

Funding for the Department of Parks and Recreation and the Free Library of Philadelphia has declined substantially from FY08 through FY13. Despite these declines, activity levels at the parks and libraries have remained high. Funding has stabilized in recent years, with a modest increase projected for Parks and Recreation in FY13. The Free Library received a small increase in its General Fund support in FY12.

Of the $2.1 million increase in Parks and Recreation in FY13, $1.0 million represents a transfer of the cost of tree maintenance from the Managing Director's Office budget.

**Table 4.6. Recreation, Arts and Culture: General Fund Obligations and Performance Indicators, FY08-FY13 ($ in Millions)**

| | FY08 Actual | FY09 Actual | FY10 Actual | FY11 Actual | FY12 Est. | FY13 Est. | FY08-FY13 Percent Growth |
|---|---|---|---|---|---|---|---|
| *General Fund Obligations*[1] | | | | | | | |
| Parks and Recreation[2] | 52.3 | 50.1 | 45.4 | 45.5 | 45.7 | 47.8 | (8.7%) |
| Free Library | 40.6 | 37.5 | 32.8 | 32.5 | 33.4 | 33.7 | (17.1%) |
| Arts and Culture/Creative Economy[3] | -- | -- | 3.9 | 2.5 | 2.7 | 2.7 | NA |
| Mural Arts Program | 1.1 | 0.8 | 1.0 | 1.0 | 1.0 | 0.9 | (16.7%) |
| Subsidies to Museums[4] | 2.9 | 3.3 | 2.6 | 2.6 | 2.6 | 2.6 | (12.4%) |
| ***Total*** | 97.0 | 91.6 | 85.7 | 84.2 | 85.3 | 87.6 | (9.6%) |
| *Performance Indicators* | | | | | | | |
| Parks Site Visits (Thousands) | 2,258 | 2,390 | 2,914 | 2,823 | | | |
| Persons Registered for Park Programs | 218.6 | 250.0 | 283.0 | 271.9 | | | |
| Athletic Field Permits Issued | 1,389 | 1,420 | 1,388 | 2,714 | | | |
| Library Items Borrowed (Thousands) | 7,038 | 7,419 | 6,531 | 7,210 | | | |
| Library Visitors (Millions) | 6.65 | 6.40 | 5.62 | 6.07 | | | |
| Library Hours of Service (Thousands) | 110.2 | 112.4 | 93.4 | 100.0 | | | |

Notes:
[1] Indemnities costs are excluded for major departments.
[2] Includes Department of Parks and Recreation and Camp William Penn.
[3] Costs were taken from other parts of the budget to fund.
[4] Includes subsidies to the Philadelphia Museum of Art and the Philadelphia History Museum.

## Other Public Services

Obligations for other public service agencies are projected to decline 23.5 percent from FY08 to FY13. This decline primarily reflects reduced costs in the Streets Department due to projected reductions in the cost of snow removal and a new lower cost waste disposal contract and the PGW reduction. This new contract is projected to result in savings of $7.7 million in FY13, with greater savings in future years. Increased rates of recycling have also improved financial results at the Streets Department, by lowering the costs of waste disposal, and increasing revenues. Revenues from the sale of recyclable materials are projected at $6.5 million in FY12 and at $5 million annually during the Plan period.

Improved financial operations at the Philadelphia Gas Works have also allowed PGW to reinstate its annual $18 million payment to the City. This is reflected as a decline in obligations, which had offset the payment from PGW during years when the City was releasing PGW from its obligation to make annual payments to the General Fund.

**Table 4.7. Other Public Services: General Fund Obligations and Performance Indicators, FY08-FY13 ($ in Millions)**

| | FY08 Actual | FY09 Actual | FY10 Actual | FY11 Actual | FY12 Est. | FY13 Est. | FY08-FY13 Percent Growth |
|---|---|---|---|---|---|---|---|
| *General Fund Obligations*[1] | | | | | | | |
| Streets | 128.6 | 131.4 | 130.4 | 124.1 | 115.3 | 111.8 | (13.0) |
| Philadelphia Gas Works | 18.0 | 18.0 | 20.0 | 1.8 | -- | -- | (100.0) |
| City Commissioners | 9.3 | 9.7 | 9.2 | 9.0 | 8.9 | 8.8 | (4.7%) |
| Records | 7.6 | 6.9 | 5.2 | 4.0 | 4.0 | 4.0 | (47.5%) |
| Commission on Human Relations | 2.1 | 2.1 | 2.0 | 1.9 | 2.0 | 2.0 | (5.8%) |
| Hero Awards | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | (21.9%) |
| ***Total*** | 165.7 | 168.1 | 166.7 | 140.8 | 130.2 | 126.7 | (23.5%) |
| *Performance Indicators* | | | | | | | |
| Refuse Collected[2] | 2,798 | 2,532 | 2,412 | 2,254 | | | |
| Recyclables Collected[2] | 197 | 288 | 381 | 441 | | | |
| Streets Resurfaced (Miles) | 74 | 119 | 69 | 36 | | | |

Notes:
[1] Indemnities costs are excluded for major departments.
[2] Tons per day.

## Internal Services

Obligations for the Office of Innovation and Technology (OIT) are projected to increase 105.8 percent from FY08 to FY13, a reflection of the centralization of responsibility and budget for information technology functions within that office. The Capital Program includes $136.5 million in funding from FY13 to FY18 for information technology projects, including network stabilization and enhancement, and citywide and departmental applications. These projections have the potential to increase the efficiency of City operations, although the Plan makes no assumptions about specific cost savings that will be enabled by technology.

The Office of Fleet Management obligations are projected to decline 17.4 percent from FY08 through FY13. Fuel costs were $5.0 million higher than budgeted in FY12, which contributed to a $4 million increase in total agency obligations in that year. The Plan projects a reduction in fuel costs in FY13, and a $4.5 million increase in vehicle purchase costs.

Obligations in the Department of Public Property (DPP) declined from FY08 through FY12. However, a $13 million increase is projected in FY13 due to $9 million for initial design work for a new Police Department headquarters in West Philadelphia, and a $3.6 million increase in the General Fund payment to the Philadelphia Water Department.

**Table 4.8. Internal Services: General Fund Obligations, FY08-FY13 ($ in Millions)**

| | FY08 Actual | FY09 Actual | FY10 Actual | FY11 Actual | FY12 Est. | FY13 Est. | FY08-FY13 Percent Growth |
|---|---|---|---|---|---|---|---|
| Public Property[1] | 105.6 | 106.8 | 100.6 | 105.3 | 101.5 | 114.3 | 8.2% |
| Fleet Management | 67.0 | 54.6 | 47.3 | 52.2 | 56.2 | 55.4 | (17.4%) |
| Innovation and Technology | 34.0 | 36.4 | 38.5 | 61.3 | 70.4 | 70.0 | 105.8% |
| Capital Program Office | 2.4 | 3.0 | -- | -- | -- | -- | (100.0%) |
| ***Total*** | 209.1 | 200.8 | 186.5 | 218.8 | 228.2 | 239.7 | 14.7% |

Notes: Indemnities costs are excluded for major departments.
[1]Excludes subsidy to SEPTA.

## Governance and Administration

Governance and administration costs are projected to increase 2.2 percent from FY08 through FY13, reflecting growth in the Managing Director's Office, City Council, and other financial administration agencies. The growth in the Managing Director's Office reflects transfer of costs for court-appointed counsel fees from the First Judicial District in FY13, the transfer of animal control programs in FY12, and increased personnel and professional services costs. The growth in other financial administration primarily reflects the transfer of tax enforcement functions from the Law Department to the Revenue Department in FY12, and increased funding for the Office of Property Assessments in FY12 and FY13.

**Table 4.9. Governance and Administration: General Fund Obligations, FY08-FY13 ($ in Millions)**

| | FY08 Actual | FY09 Actual | FY10 Actual | FY11 Actual | FY12 Est. | FY13 Est. | FY08-FY13 Percent Growth |
|---|---|---|---|---|---|---|---|
| Mayor | 5.7 | 9.4 | 4.5 | 3.8 | 3.7 | 3.7 | (34.4%) |
| City Council[1] | 14.6 | 14.7 | 13.5 | 13.8 | 15.0 | 15.5 | 6.6% |
| City Controller | 8.2 | 7.9 | 7.4 | 7.8 | 7.4 | 7.4 | (9.4%) |
| Managing Director | 15.9 | 20.1 | 16.6 | 16.0 | 23.1 | 32.4 | 104.0% |
| Director of Finance | 25.8 | 19.8 | 14.0 | 16.3 | 12.8 | 13.0 | (49.6%) |
| Other Financial[2] | 30.5 | 31.3 | 28.9 | 27.4 | 32.9 | 36.8 | 20.6% |
| Law | 21.1 | 19.3 | 18.0 | 17.1 | 14.9 | 12.8 | (39.6%) |
| Personnel Administration[3] | 4.8 | 4.7 | 4.2 | 4.8 | 5.3 | 5.5 | 14.0% |
| Other[4] | 1.3 | 1.7 | 2.9 | 2.7 | 3.4 | 3.5 | 168.3% |
| ***Total*** | 127.9 | 129.0 | 109.8 | 109.7 | 118.5 | 130.7 | 2.2% |

Notes: Indemnities costs are excluded for major departments.
[1] Excludes $20 million shown in the FY13 City Council budget that will be allocated to the School District of Philadelphia.
[2] Includes City Treasurer, Board of Revision of Taxes, Office of Property Assessment, Procurement Department, and Revenue Department
[3] Includes Office of Human Resources and Civil Service Commission
[4] Includes Board of Ethics, Office of Labor Relations, Office of Transportation, Office of Inspector General, and Refunds.

## Employee Benefits

Overall employee benefits costs are projected to increase13.8 percent from FY08 to FY13. The most significant increase is projected to occur in pension spending. This category, which includes both the City's state-mandated "minimum municipal obligation" payment to the Pension Fund, and debt service on Pension Obligation Bonds, is projected to increase from $430.8 million in FY08 to $629.1 million in FY13, a 46.0 percent increase. The increase partly reflects the cost of repaying contributions that were deferred in FY10 and FY11.

Health benefits costs are projected to decline 16.8 percent from FY08 to FY13. These declines have been made possible in part through reforms to the structure of City administered benefit programs. Health plans administered for non-union employees and for FOP employees have moved to self-insurance, under which the City pays directly the cost of claims and administration to a third-party administrator. Previously, the City had negotiated monthly payments to its insurers based on the number of covered employees. In addition, the City changed the co-pay of employee contributions and implemented an extensive wellness program.  These changes have resulted in significant savings on the City administered end. It is unclear whether the City will be able to achieve similar savings for the other three major employee health insurance plans and continue savings on City administered and FOP.

**Table 4.10. Employee Benefits: General Fund Obligations, FY08-FY13 ($ in Millions)**

| | FY08 Actual | FY09 Actual | FY10 Actual | FY11 Actual | FY12 Est. | FY13 Est. | FY08-FY13 Percent Growth |
|---|---|---|---|---|---|---|---|
| Pension Payments | 430.8 | 459.0 | 346.7 | 485.2 | 554.3 | 629.1 | 46.0% |
| Employee Health Benefits | 433.1 | 392.7 | 362.4 | 351.3 | 347.2 | 360.4 | (16.8%) |
| Disability Benefits | 46.7 | 49.0 | 50.3 | 55.1 | 55.9 | 58.3 | 24.8% |
| Social Security | 69.7 | 68.8 | 65.2 | 64.6 | 64.9 | 64.9 | (6.8%) |
| Unemployment | 2.8 | 3.7 | 5.3 | 5.9 | 5.6 | 5.6 | 99.7% |
| Total | 983.0 | 973.2 | 831.4 | 967.1 | 1,027.9 | 1,118.3 | 13.8% |

# V. Indicators of Financial Health

## Economic Indicators

Major indicators of the city's economic health include payroll employment, the unemployment rate, and personal income. Table 5.1 presents average monthly payroll employment for the city of Philadelphia, the Philadelphia region, and the nation. Average monthly payroll employment in the city increased by 2,000 in 2011. As a share of the region, Philadelphia's 2011 employment remained at 24.36 percent, higher than the level of 2007. Philadelphia's share of national payroll employment declined slightly from 0.51 percent to 0.50 percent. This share is slightly larger than the level of 2007. Because the city's economy is relatively highly concentrated in health services and higher education, two sectors that are relatively stable over the business cycle, the city's economy overall has not been as dramatically affected as that of the region or the nation as a result of the economic slowdown since 2007.

Table 5.2 presents average annual unemployment rates in the city, the region, and the nation as a whole from 2002 through 2011. While the city's unemployment rates over the past decade have been consistently above that of the region and nation, in relative terms the City's unemployment rate has not increased as rapidly as that of the nation or region since 2007. Philadelphia's average unemployment rate of 10.8 percent in 2011 is 26 percent above that of the region, compared to a rate of 6.0 percent in 2007 that was 40 percent higher than the regional average. Similarly, Philadelphia's 2011 unemployment rate was 21 percent above the national average in 2011, and 30 percent above the nation in 2007. However, Philadelphia's average unemployment rate was at 10.8 percent in 2011, the same level as 2010, while the regional and national rates declined between 2010 and 2011.

**Table 5.1. Payroll Employment in Thousands, Philadelphia City, Region and Nation, 2002-2011**

| | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 |
|---|---|---|---|---|---|---|---|---|---|---|
| City | 683.7 | 671.5 | 657.8 | 660.2 | 662.5 | 662.6 | 663.4 | 652.5 | 657.0 | 659.0 |
| Region | 2,740.0 | 2,728.8 | 2,745.4 | 2,773.6 | 2,798.5 | 2,811.2 | 2,807.4 | 2,711.0 | 2,696.6 | 2,705.4 |
| Nation | 130.3 | 130.0 | 131.4 | 133.7 | 136.1 | 137.6 | 136.8 | 130.8 | 129.9 | 131.4 |
| City as a Percent of the Region | 24.95 | 24.61 | 23.96 | 23.80 | 23.67 | 23.57 | 23.63 | 24.07 | 24.36 | 24.36 |
| City as a Percent of the Nation | 0.52 | 0.52 | 0.50 | 0.49 | 0.49 | 0.48 | 0.48 | 0.50 | 0.51 | 0.50 |

Source: Bureau of Labor Statistics, Current Employment Statistics, Philadelphia region is the Philadelphia-Wilmington-Camden PA-NJ-DE-MD region. Figures are annual averages.

**Table 5.2. Unemployment Rate, Philadelphia City, Region, and Nation, 2002-2011**

| | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 |
|---|---|---|---|---|---|---|---|---|---|---|
| City | 7.3 | 7.5 | 7.3 | 6.7 | 6.2 | 6.0 | 7.1 | 9.6 | 10.8 | 10.8 |
| Region | 5.4 | 5.4 | 5.1 | 4.7 | 4.5 | 4.3 | 5.4 | 8.2 | 8.9 | 8.6 |
| Nation | 5.8 | 6.0 | 5.5 | 5.1 | 4.6 | 4.6 | 5.8 | 9.3 | 9.6 | 8.9 |
| City Percent of Region | 135 | 139 | 143 | 143 | 138 | 140 | 131 | 117 | 121 | 126 |
| City Percent of Nation | 126 | 125 | 133 | 131 | 135 | 130 | 122 | 103 | 113 | 121 |

Source: Bureau of Labor Statistics, Current Population Survey and Local Area Unemployment Statistics. Philadelphia region is the Philadelphia-Wilmington-Camden PA-NJ-DE-MD region. Figures are annual averages.

Table 5.3 presents trends in median household income for the city, region, and nation from 2002 through 2010. The city's median household income has declined 6.5 percent from 2008 to 2010, compared to a national decline of 3.8 percent. Over the past decade, Philadelphia's median household income has been approximately 70 percent of the national level.

**Table 5.3. Median Household Income, Philadelphia and Nation, 2002-2010**

| | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|---|---|---|---|
| City | 29,540 | 30,517 | 30,892 | 32,671 | 33,368 | 35,431 | 37,090 | 36,959 | 34,667 |
| Nation | 42,409 | 43,318 | 44,334 | 46,242 | 48,451 | 50,740 | 52,029 | 50,221 | 50,046 |
| City as a Percent of the Nation | 69.7 | 70.4 | 69.7 | 70.7 | 68.9 | 69.8 | 71.3 | 73.6 | 69.3 |

Source: Small Area Income and Poverty Estimates, U. S. Bureau of the Census

## Financial Indicators

The end of year General Fund balance in FY11 was $92,000, less than one-tenth of a percent of General Fund obligations, but nonetheless positive. This is an improved result compared to the prior two fiscal years, which ended in deficits. The General Fund's financial position deteriorated from FY07, when it ended the year with a $297.9 million surplus, through FY09, when it ended the year with a deficit of $137.2 million. Over the past two years, the General Fund has posted operating surpluses, which improved the end of year fund balance in FY10 and FY11.

**Table 5.4. General Fund End of Year Fund Balance and Obligations, FY02-FY11 ($ in Millions)**

| | FY02 | FY03 | FY04 | FY05 | FY06 | FY07 | FY08 | FY09 | FY10 | FY11 |
|---|---|---|---|---|---|---|---|---|---|---|
| Fund Balance | 139.0 | 91.3 | (46.8) | 96.2 | 254.5 | 297.9 | 119.5 | (137.2) | (114.0) | 0.1 |
| Obligations | 2,981.1 | 3,153.2 | 3,248.2 | 3,386.3 | 3,426.0 | 3,736.7 | 3,919.8 | 3,915.3 | 3,653.7 | 3,785.3 |
| Fund Balance as Percent of Obligations | 4.7% | 2.9% | (1.4%) | 2.8% | 7.4% | 8.0% | 3.0% | (3.5%) | (3.1%) | 0.0% |

Source: *Comprehensive Annual Financial Report*, Office of the Director of Finance, City of Philadelphia, various years.

**Debt Burden**

At the end of FY11, total City debt outstanding was $4,282.9 million, of which $1,407.3 million was the City's pension obligation bonds. This included City general obligation debt and PICA special tax revenue bonds, and debt issued on behalf of the City by independent agencies, including the Philadelphia Municipal Authority (PMA), the Philadelphia Authority for Industrial Development (PAID), and the Philadelphia Redevelopment Authority (RDA). Debt issued by PMA, PAID, and RDA is secured by lease payments made by the City.

Including debt issued by the School District of Philadelphia (SDP), overall debt outstanding at the end of FY11 was $7,204.7 million, which represented $4,689 per capita. As of the end of 2010, the total value of outstanding City and School District-related debt was 12.7 percent of personal income of city residents. Since 2002, City debt per capita increased modestly, from $2,630 to $2,787, while SDP debt per capita increased significantly, from $942 to $1,902.

City debt service payments as a percent of General Fund obligations increased from 6.5 percent in FY02 to 7.8 percent in FY11, largely as a result of the increase in debt service for pension obligation bonds.

**Table 5.5. Debt Indicators, 2002-2011**

| | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 |
|---|---|---|---|---|---|---|---|---|---|---|
| *Debt Outstanding ($ in Millions)* | | | | | | | | | | |
| City Pension Bonds | 1,386.6 | 1,394.6 | 1,416.4 | 1,429.7 | 1,439.2 | 1,444.9 | 1,446.6 | 1,443.8 | 1,428.3 | 1,407.3 |
| City Other | 2,554.7 | 2,439.2 | 2.589.0 | 2,629.4 | 2,544.2 | 2,800.5 | 2,689.3 | 2,867.4 | 2,842.8 | 2,875.6 |
| School District | 1,410.9 | 1,371.8 | 2,294.4 | 2,365.6 | 2,346.9 | 2,591.6 | 2,564.6 | 2,776.1 | 2,946.5 | 2,921.8 |
| Total | 5,352.2 | 5,205.6 | 6,299.8 | 6,424.7 | 6,330.3 | 6,837.0 | 6,700.5 | 7,087.3 | 7,217.6 | 7,204.7 |
| *Debt Per Capita* | | | | | | | | | | |
| City | 2,630 | 2,566 | 2,683 | 2,723 | 2,676 | 2,843 | 2,758 | 2,846 | 2,795 | 2,787 |
| School District | 942 | 918 | 1,537 | 1,587 | 1,576 | 1,735 | 1,710 | 1,883 | 1,928 | 1,902 |
| Total | 3,572 | 3,485 | 4,220 | 4,309 | 4,252 | 4,578 | 4,468 | 4,679 | 4,723 | 4,689 |
| *Debt as Percent of Personal Income* | | | | | | | | | | |
| City | 9.7 | 9.1 | 9.2 | 9.0 | 8.4 | 8.4 | 7.6 | 8.0 | 7.5 | NA |
| School District | 3.5 | 3.3 | 5.3 | 5.3 | 4.9 | 5.1 | 4.7 | 5.1 | 5.2 | |
| Total | 13.1 | 12.3 | 14.5 | 14.3 | 13.3 | 13.5 | 12.3 | 13.1 | 12.7 | NA |
| *City Debt Service as Percent of General Fund Obligations* | | | | | | | | | | |
| Pension Bonds | 1.5 | 1.8 | 1.8 | 2.0 | 2.1 | 2.0 | 2.0 | 2.2 | 2.6 | 2.6 |
| Other | 5.0 | 5.4 | 5.1 | 4.7 | 4.7 | 4.6 | 4.4 | 4.8 | 5.1 | 5.2 |
| Total | 6.5 | 7.2 | 6.9 | 6.7 | 6.7 | 6.6 | 6.4 | 6.9 | 7.7 | 7.8 |

Source: Debt Outstanding, *Comprehensive Annual Financial Report*, Office of the Director of Finance, City of Philadelphia, FY11, and *Comprehensive Annual Financial Report*, School District of Philadelphia, FY11; Population, Intercensal Estimates and Annual Estimates of Resident Population, U. S. Census Bureau, Personal Income, U. S. Bureau of Economic Analysis.
Note: Debt outstanding does not include water, airport, and Philadelphia Gas Works revenue bonds.

**Pension Funding**

Annual actuarial valuation reports for the City pension fund indicate a deteriorating position of the fund from 2002 through 2009, with modest improvements over the past two years. The actuarial reports report an "actuarial" value of assets in the Pension Fund as of July 1 of each year. This actuarial value differs from market value because annual investment gains and losses are only recognized over a period of time. Currently, this "smoothing" period is ten years. The actuarial liability of the Pension Fund is the estimate of amount of funding that would be required to be in the fund to pay all benefits already earned by current employees, assuming a specific rate of return on investments in the future. As of July 1, 2011, the actuarial value of assets was $4,719.1 million, and the actuarial liability was $9,487.5 million. The ratio between assets and liabilities, the funded ratio of the Pension Fund, was 49.7 percent.

The funded ratio declined from 72.7 percent in 2002 to 45.0 percent in 2009, in part due to significant investment losses. The funded ratio increased slightly to 49.7 percent in 2011, but this level is well below what is considered appropriate, and well below the typical level of other major municipal pension funds across the country.

The difference between the actuarial value of assets and liabilities is known as the unfunded actuarial accrued liability (UAAL). Another benchmark is the amount of the UAAL as a percent of current worker salaries. This percentage was 347.7 percent in 2011. This percentage has increased dramatically over the past decade. Another benchmark is the relationship between the City's actual contributions to the Pension Fund and its Annual Required Contribution (ARC). The ARC is a standardized benchmark for assessing the adequacy of pension contributions as defined by the Government Accounting Standards Board (GASB). It represents the amount necessary to pay costs of pensions earned by employees in the current year and to amortize the unfunded pension liability over a 30 year period. In 2011, the City's actual contribution to the pension fund was 65.1 percent of the ARC.

**Table 5.6. Pension Funding Indicators, 2002-2011 ($ in Millions)**

| | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 |
|---|---|---|---|---|---|---|---|---|---|---|
| Actuarial Value of Assets | 4,891.3 | 4,548.1 | 4,333.1 | 4,159.5 | 4,168.5 | 4,421.7 | 4,623.6 | 4,042.1 | 4,380.9 | 4,719.1 |
| Actuarial Liability | 6,727.2 | 7,188.3 | 7,247.7 | 7,851.5 | 8,083.7 | 8,197.2 | 8,402.2 | 8,975.0 | 9,317.0 | 9,487.5 |
| Unfunded Actuarial Accrued Liability (UAAL) | 1,835.9 | 2,640.1 | 2,914.7 | 3,691.9 | 3,915.2 | 3,775.5 | 3,778.7 | 4,932.9 | 4,936.2 | 4,768.4 |
| Funded Ratio | 72.7% | 63.3% | 59.8% | 53.0% | 51.6% | 53.9% | 55.0% | 45.0% | 47.0% | 49.7% |
| Salaries | 1,207.3 | 1,269.3 | 1,266.0 | 1,270.7 | 1,319.4 | 1,351.8 | 1,456.5 | 1,463.3 | 1,421.2 | 1,371.3 |
| UAAL as Percent of Salaries | 152.1% | 208.0% | 230.2% | 290.6% | 296.7% | 279.3% | 259.4% | 337.1% | 347.3% | 347.7% |
| Annual Required Contribution (ARC) | 218.7 | 234.6 | 291.1 | 392.3 | 426.0 | 556.3 | 561.0 | 559.0 | 597.0 | 721.7 |
| Percent of ARC Paid | 81.5% | 76.6% | 69.7% | 76.3% | 77.9% | 75.4% | 76.1% | 81.5% | 52.4% | 65.1% |

Source: City of Philadelphia Municipal Retirement System Actuarial Valuation Reports, various years; *Comprehensive Annual Financial Report*, Office of the Director of Finance, City of Philadelphia, various years.

## Other Post-Employment Benefits

Similar to the method of reporting the funding status of the City's Pension Fund, the City also reports on the extent to which other future obligations related to employee benefits are funded. These obligations reflect primarily the City's obligation to pay for health benefits for future retirees in the first five years after retirement. The City finances these costs on a pay-as-you-go basis, but nonetheless has been required by GASB since 2008 to report the liability associated with these other post-employment benefits (OPEB). As of July 1, 2010, the most recent year available, the City's OPEB liability was $1,169.5 million. This liability represented 82.4 percent of FY10 employee salaries.

The City also reports its annual required contribution (ARC) associated with OPEB. Under GASB rules, this is the amount the City would be required to pay the cost of benefit earned by current employees, as well as the amount necessary to amortize the unfunded OPEB liability over a 30 year period. In FY11, the City's actual payments for retiree health care were $65.5 million, which represented 64 percent of the ARC.

**Table 5.7. Other Post-Employment Benefits Indicators, 2002-2011 ($ in Millions)**

| | 2008 | 2009 | 2010 | 2011 |
|---|---|---|---|---|
| Actuarial Value of Assets | -- | -- | -- | -- |
| Actuarial Liability | 1,156.0 | 1,119.6 | 1,169.5 | |
| Unfunded Actuarial Accrued Liability (UAAL) | 1,156.0 | 1,119.6 | 1,169.5 | |
| Funded Ratio | -- | -- | -- | |
| Salaries | 1,456.5 | 1461.7 | 1,419.5 | |
| UAAL as Percent of Salaries | 79.4% | 76.6% | 82.4% | |
| Annual Required Contribution (ARC) | 83.4 | 98.7 | 93.8 | 101.7 |
| Actual Payments Made | 79.7 | 81.3 | 71.7 | 65.5 |
| Percent of ARC Paid | 96% | 82% | 76% | 64% |

Source: *Comprehensive Annual Financial Report*, Office of the Director of Finance, City of Philadelphia, various years.

**<u>Tax Competitiveness</u>**

One benchmark study that compares tax burdens across major cities is published annual by the Government of the District of Columbia. This study estimates state and local taxes that would be paid by representative families at various income levels in the largest city in each of the fifty states, and in Washington, DC. The table below presents the estimate for a family with earned income of $50,000 per year in Philadelphia and in the median city among the 51 cities included in the study. Philadelphia's tax burden is generally between 50 and 65 percent higher than the median city. In 2010, the most recent year for which results are available, Philadelphia's tax burden was 54.5 percent above the median.

Table 5.8 also highlights a positive trend for the City. From 2007 to 2010, Philadelphia as a percent of the median City dropped from 96.2 percent to 54.5 percent. This may indicate that other municipalities took more drastic tax increase measures than Philadelphia to cope with the recession. The City's quick and forceful reaction to the economic recession and execution of significant expenditure reductions may prove in hindsight to be one of the strongest local models of recovery.

**Table 5.8. Taxes Paid by a Family Earning $50,000 Annually, Philadelphia and other Cities, 2002-2010**

| | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|---|---|---|---|
| Philadelphia | 6,581 | 6,591 | 6,237 | 6,838 | 6,839 | 8,629 | 6,864 | 6,859 | 6,928 |
| Median City | 4,152 | 4,070 | 4,073 | 4,235 | 4,214 | 4,398 | 3,849 | 4,182 | 4,484 |
| Philadelphia as a Percent of the Median City | 158.5 | 161.9 | 153.1 | 161.5 | 162.3 | 196.2 | 178.3 | 164.0 | 154.5 |

Note: Figures represent estimates of state and local taxes paid by a family earning $50,000 per year. The study estimates tax burdens in the largest city in each of the fifty states, and in Washington, DC. The median shown is the median estimate of family tax burden among the cities in this group.

Source: *Tax Rates and Tax Burdens in the District of Columbia – A Nationwide Comparison,* Government of the District of Columbia, various years.

# VI. Policy and Management Issues that Impact Financial Health

The intent of the General Assembly in enacting the PICA Act was to "foster sound financial planning and budgetary practices that will address the underlying problems which result in…deficits for cities of the first class" and that the City of Philadelphia "shall be charged with the responsibility to exercise efficient and accountable fiscal practices…" The Act gives eight examples of such "efficient and accountable" practices, including: "increased managerial accountability…consolidation or elimination of inefficient city programs…privatization of appropriate city services…sale of city assets as appropriate…[and] review of compensation and benefits of city employees…"[10]

This section of the PICA Act indicates that the legislature intended that the City's Five-Year Financial Plan process should promote both near-term fiscal balance and policy and management changes that would secure the City's long-term fiscal stability. Consistent with these objectives, this section reviews and assesses current issues that are related to Philadelphia's long-term fiscal health. They include: tax policy, tax enforcement, and economic development.

## Tax Policy

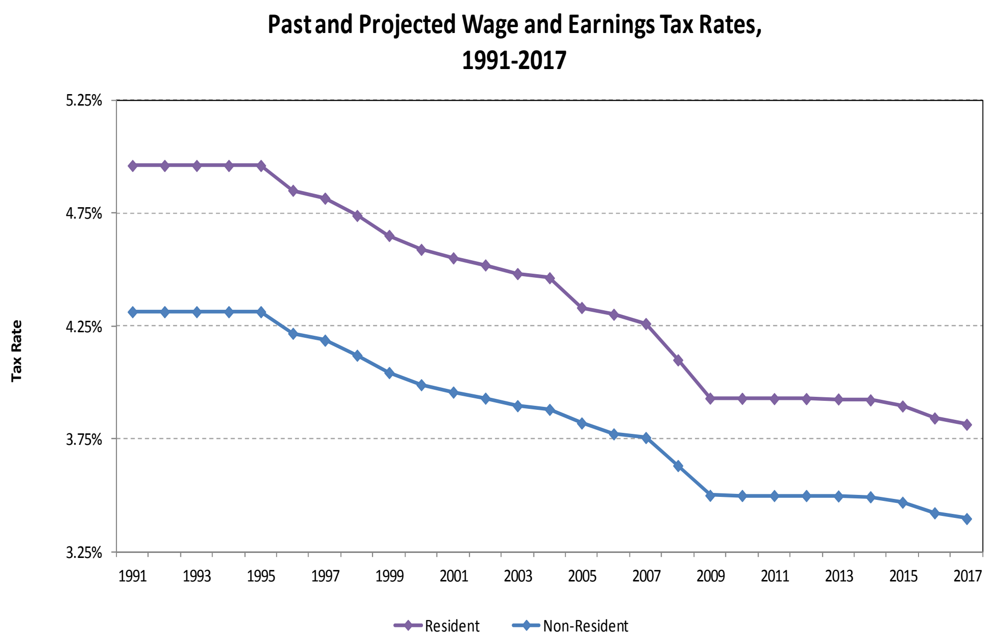
The Five-Year Financial Plan is the City's ultimate statement of priorities. A plan for raising revenue and allocating it across public programs reflects the City's values, as well as its capacity to use available information to most effectively promote those values. The revenue side of the Plan should be a reflection of a desire of elected officials to promote equity and efficiency – a fair distribution of the tax burden, and a tax policy that minimizes the negative impact of taxes on local economic growth. While the City continues to make progress, having enacted important business tax reforms over the past year, much remains to be done to enact a tax policy that is both equitable and efficient.

*Tax Competitiveness.* From 1970 to 1990, the City enacted a series of significant tax increases. Over this period, the real estate tax increased from 4.475 to 8.264 percent, the resident wage tax increased from 3.0 to 4.96 percent, and the real estate transfer tax increased from 1.0 to 4.07 percent. At the same time, the City replaced a mercantile license tax levied at 3 mills on gross receipts with a business privilege tax that included a gross receipts tax imposed at a rate of 3.25 mills and a net income tax imposed at a rate of 6.5 percent. A pattern of repeated tax increases continued throughout the two decades leading up to the City's fiscal crisis and the creation of PICA in 1991.

With the assistance of PICA deficit financing, changes in labor costs, DHA reimbursements and State authorization of a new 1 percent City sales tax, the City's fiscal situation rapidly improved during the first two years of the Rendell Administration. The City achieved a $3.0 million General Fund surplus by the end of FY93. The surplus increased to $15.4 million at the end of FY94 and $80.5 million at the end of FY95. In 1996, with its fiscal situation stabilized, the City began a series of annual reductions in the rates of the wage, earnings, and net profits taxes, and the gross receipts portion of the business privilege tax. As shown in the figure below, the City

[10] The Pennsylvania Intergovernmental Cooperation Authority Act for Cities of the First Class, Act of 1991, P. L. 9, No. 6 at § 102(b)(1)(iii).

continued to reduce the rates of the wage and earnings taxes for both residents and non-residents over the period from 1996 to 2010. Over this period, the resident rate declined from 4.96 to 3.928 percent, and the non-resident rate from 4.3125 to 3.4985 percent. The rate of the gross receipts portion of the business privilege tax also declined significantly from 3.25 mills in 1995 to 1.415 mills in 2008. Since 2010, reductions in these taxes have been suspended due to the severe financial constraints the City has faced as result of the recession of 2008-2009 and the slow economic recovery that has occurred to date.




Source: *Summary Schedule of Tax Rates Since 1952*, Department of Revenue, City of Philadelphia; *FY13-17 Five-Year Financial Plan*, City of Philadelphia.
Note: Figures represent calendar year average. Tax rates are actual from 1991 through 2012 and projected from 2013 through 2017.

While the current Plan projects further annual reductions in the wage, earnings, and net profits tax rates beginning in FY14 and continuing through FY17, in percentage terms these reductions are projected to occur at an average pace of approximately one-half of the 1996 to 2010 period. Moreover, the City has increased the real estate tax in each of the past three years, with the combined 2013 City and School District tax rate 18.2 percent higher than 2010. Moreover, given the tenuous nature of the City's current financial state, the various risks to the FY13-17 Plan, and the School District's financial problems, it is possible that the string of recent tax increases will continue. The significant progress toward tax competitiveness that occurred during the first two decades of PICA's existence is at risk unless the City takes significant steps to reverse the current course.

In the opinion of PICA staff, the City should place a high priority on returning to the virtuous cycle that was in place during the period 1995 to 2010, when the City made annual reductions in the two taxes that research suggests are most damaging to economic growth in the city. These reductions were modest in any one year, but over a 15 year period, they resulted in significant change. By continually reducing these taxes, the City will again send a signal to businesses and residents that Philadelphia is on a path toward greater competitiveness as a residential and business location. And by making reductions in a fiscally responsible manner in the context of a balanced Five-Year Financial Plan, the City can also maintain fiscal integrity as it seeks to improve its economy.

*Business Tax Reform.* In November 2011, the City took an important step to reducing the economic burden its tax system imposes on business by enacting reforms to the business income and receipts tax (BIRT). Key changes include single sales factor apportionment for the net income portion of BIRT, and the exemption of the first $100,000 in receipts from the gross receipts portion of the tax.[11] The changes will be fully implemented by 2016. To partially offset revenue losses, the previously scheduled phase out of the gross receipts tax was repealed. Current law now projects no change in the gross receipts tax rate through 2023. In addition, the scheduled reduction in the net income tax rate to 6.0 percent was delayed slightly, with the reduction now expected by 2023, instead of 2022.

The BIRT reforms are estimated to result in a net revenue loss of $115.8 million over the Plan period. This estimate, however, does not assume any impact of the reforms on business formation or growth, a conservative assumption.

In fact, the reforms, particularly if combined with further reductions in BIRT tax rates over the long term, should enhance the City's attractiveness as a business location. The exemption of the first $100,000 in gross receipts will reduce the tax burden for small businesses. Businesses will no longer be taxed on personnel or property which should reduce the disincentive to locate facilities and workers in Philadelphia.

*Actual Value Initiative and Changing Philadelphia's Tax Mix.* The Plan projects that the City will implement the Actual Value Initiative (AVI) beginning in 2014. Under this initiative, real estate and use and occupancy taxes levied by the City and SDP will be based on property assessments that more accurate reflect actual market values. AVI is a critical component of any long-term tax reform strategy for the City, because in the long run it should enable Philadelphia's overall local tax system to rely more heavily on property taxes as a source of revenue. Research suggests that property taxation is a more efficient source of revenue than taxes on business or personal income.

An efficient local tax policy raises a given amount of revenue while minimizing the extent to which taxes distort location decisions of residents and firms.[12] Philadelphia's overall local tax structure, because of its high dependence on business and personal income taxation, is inefficient by this standard, and has been for decades.

[11] The reform package also eliminates business privilege license fees, and provides a two-year exemption from BIRT and certain license fees for new companies.

[12] Efficiency in the context of local tax policy is a separate issue from the level of taxation and whether taxes are competitive with other jurisdictions. The level of revenue required to meet the obligations of a city like Philadelphia reflects policy choices, State mandates, and other institutional factors separate from tax policy choices.

One study estimated that increases in the wage tax from 3.0 percent in 1971 to 4.56 percent for residents and 3.97 for non-residents in 2001 resulted in a loss of over 170,000 jobs. In other words, the City's total employment would have been higher by more than 170,000 in 2001 if wage tax rates had remained at 3.0 percent over the three decades. The study also estimated that the loss would have been more than 200,000 jobs by 2001 if not for the wage tax reductions that occurred after 1996.[13] Other studies have found that the City's high wage and business taxes have a significant, negative impact on the city's economic growth.[14] A recent review of Philadelphia's economic history finds that low human capital, high taxes, and high public sector costs are among the most important factors that contributed to the city's relative economic decline in the twentieth century.[15]

AVI, over the long run, will enable the City to adopt a more efficient mix of taxes. It should allow Philadelphia to increases its relative dependence on the real property tax, which is less damaging to economic growth, and reduce its dependence on the wage, earnings and net profits taxes, and the business income and receipts tax, which are more damaging to growth. The reason AVI is important is that it should increase public confidence in the fairness of the property tax system. This should create a political environment that will allow public officials to argue persuasively that the City should over time shift the burden of its tax system from wage and business taxes toward property taxes. This should allow the City, over time, to achieve wage and business tax rates that are not a serious impediment to economic growth. It should be noted however, that such a revenue shift will need to be accomplished along with other measures to control the growth of expenditures, and thus the overall level of tax revenue raised.

AVI appears to be that rare tax policy reform that can promote equity and efficiency simultaneously. It should promote equity by improving the fairness of the distribution of property tax burdens. And it has the potential to improve the efficiency of the overall tax system in the city by creating the opportunity for a shift toward greater dependency on the property tax.

*Property Tax Relief Programs.* In conjunction with the transition to AVI, the City plans to implement a homestead exemption would exempt the first $30,000 of property value from taxation for all residential properties. A program to assist homeowners in gentrified neighborhoods who are expected to face large assessment increases under AVI is also being considered. IN the opinion of PICA staff, programs to provide targeted property tax relief may be appropriate, but they should be carefully designed. Any program that provides relief to particular property taxpayers will have the effect of shifting the tax burden toward those who do not receive relief. Assuming a given level of revenue is required to finance City and SDP

[13] Andrew Haughwout, Robert Inman, Steven Craig, and Thomas Luce, "Local Revenue Hills: Evidence from Four U. S. Cities," *Review of Economics and Statistics*, May 2004, 86 (2): 570-85.
[14] See the studies cited in the *Final Report* of the Philadelphia Tax Reform Commission (TRC), November 15, 2003, Volume I, p. 33, and "Choosing the Best Mix of Taxes for Philadelphia: An Econometric Analysis of the Impacts of Tax Rates on Tax Bases, Tax Revenue, and the Private Economy," a 2003 study conducted for the TRC by Econsult Corporation and contained in Volume III of the *Final Report*. The TRC *Final Report* is available at www.philadelphiataxreform.org.
[15] Joseph Gyourko, "Looking Back to Look Forward: Learning from Philadelphia's 350 Years of Urban Development," in Gary Burtless and Janet Rothenberg Pack, eds., *Brookings-Wharton Papers on Urban Affairs* (Washington, DC: Brookings Institution Press, 2005).

operations, implementing any type of property tax relief or exemption program will reduce the property tax base and increase the rate required to generate the needed public revenue.

It is particularly important that any tax relief programs be justified on the basis of need. In the context of property taxation, this means tax burdens that are high in relation to income. At the state level, property tax relief programs, often referred to as “circuit breakers,” are generally targeted to low-income households. Targeted relief programs that relate the level of relief to income are generally seen as preferable to a homestead exemption because they target the relief to those most in need.[16]

Within the limits of the City’s legal authority, the City should attempt to target any City-funded program of tax relief to households whose tax burdens are high in relation to their incomes. Another option would be for the City to advocate for expansion of State property tax relief programs. The Commonwealth currently provides property tax rebates to low-income senior citizens. The City could advocate for an expansion of this program to include all age groups. In general, states, and not local governments, should finance property tax relief for low-income homeowners. Because these programs are redistributive, states are in a better financial position to pay for the cost of these programs without seriously impacting their economic competitiveness.

## Tax Enforcement

In the context of Philadelphia’s relatively high tax burden, and the City’s current financial stress, tax enforcement has recently risen to the top of the agenda. The increased attention was prompted by a series of 2011 articles in the *Philadelphia Inquirer* focusing on Philadelphia’s higher number of tax delinquent properties compared to other cities, and the institutional and political forces that may be contributing to its low collection rate.[17]

Legislative proposals to address this issue are currently pending. A bill in City Council would seek to improve the City’s collection of real estate taxes by providing full or partial forgiveness of interest and penalties to taxpayers who pay the full principal amount due. The bill would also require foreclosure within specific time periods for taxpayers who do not enter into and remain current with payment agreements.[18]

As of June 2012, the total amount of delinquent City and School District taxes was $1.01 billion, including principal, interest and penalties. Of this amount, 44.6 percent represented amounts

[16] John H. Bowman, Daphne A. Kenyon, Adam Langley, and Bethany A. Paquin, *Property Tax Circuit Breakers: Fair and Cost-Effective Relief for Taxpayers*, Policy Focus Report (Cambridge, MA: Lincoln Institute of Land Policy, 2009).
[17] Patrick Kerkstra, PlanPhilly, “Taxes Wither on the Vine: With No Clear System, Phila. Lags Behind Other Cities in Collection,” *Philadelphia Inquirer*, Saturday, August 30, 2011.
[18] Bill 120054, introduced February 2, 2012.

from active tax periods.[19] The portion of this delinquency associated with City taxes was $765.9 million, as detailed in Table 6.1 below.[20]

**Table 6.1. City Delinquent Taxes as of June 2012 ($ in Millions)**

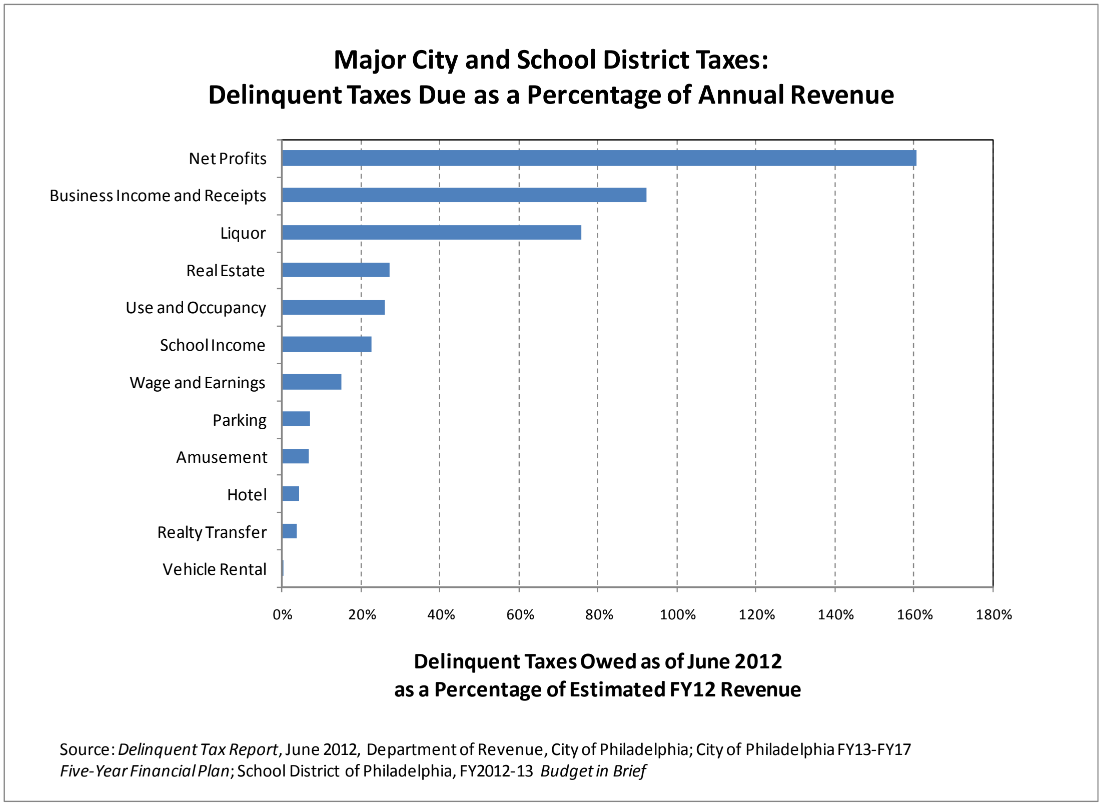
| | Active Periods | Written Off Periods | Total |
|---|---|---|---|
| Wage and Earnings | 62.8 | 164.7 | 227.5 |
| Net Profits | 9.9 | 21.7 | 31.6 |
| Business Income and Receipts | 158.1 | 203.1 | 361.2 |
| Real Estate | 104.9 | 27.7 | 132.7 |
| Real Estate Transfer | 1.7 | 2.5 | 4.2 |
| Parking | 2.9 | 2.4 | 5.3 |
| Hotel | 0.8 | 1.2 | 2.0 |
| Amusement | 0.6 | 0.8 | 1.4 |
| Other | 0.0 | 0.0 | 0.0 |
| Total | 341.7 | 424.2 | 765.9 |

Note: Excludes School District portion of real estate taxes.
Source: *Tax Delinquency Report*, Department of Revenue, City of Philadelphia, June 2012.

In relation to the level of revenue collected, delinquency appears to be a particularly serious problem for business taxes. The level of BIRT delinquent taxes owed (including active and inactive periods) as of June 2012 was 92 percent of the annual revenue from this tax, while the level of delinquent net profits tax was 161 percent of annual revenue. The SDP liquor tax also had a relatively high rate of taxes owed in relation to the annual revenue generated.

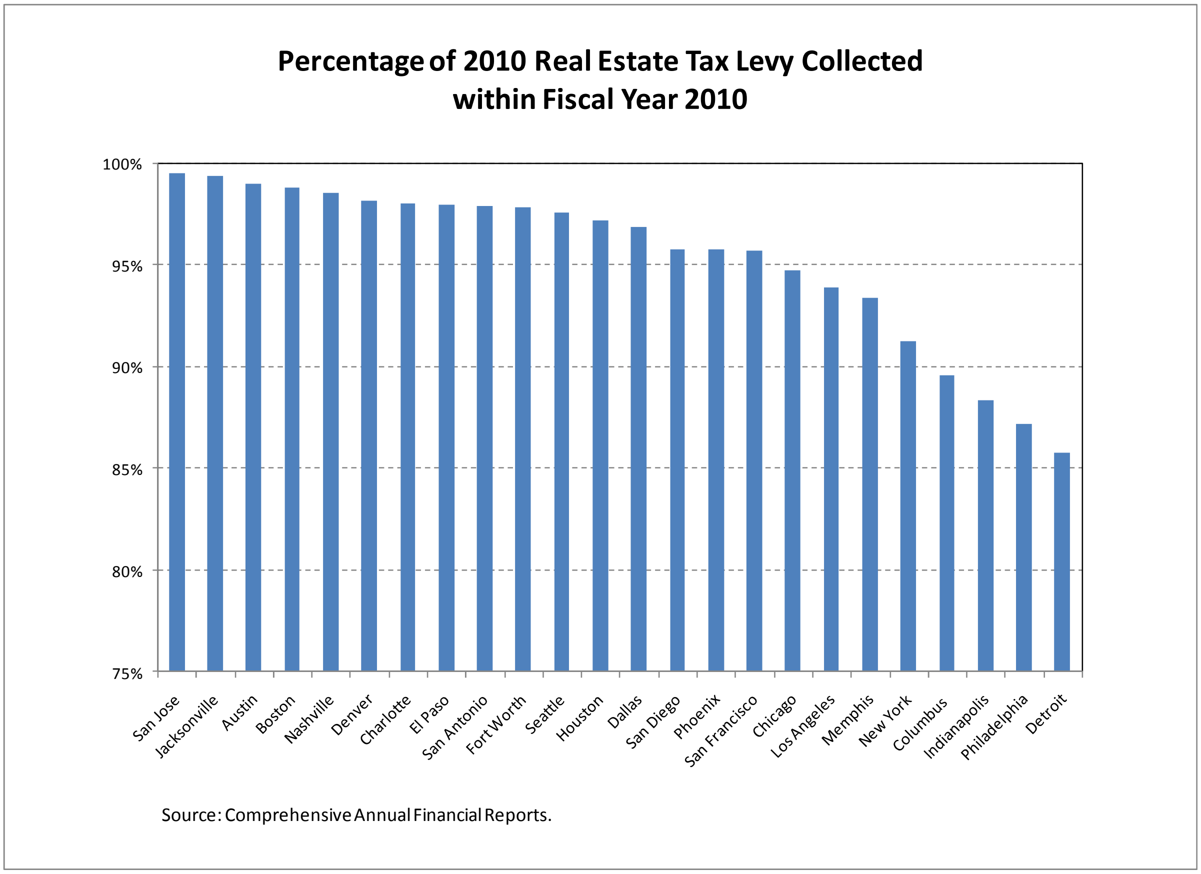
[19] In the case of the real estate tax, the most recent 10 years are considered active periods and amounts associated with these periods are counted as receivable for accounting purposes. For other taxes, the most recent six years are considered active periods.

[20] The figures shown represent only those amounts which are known to the Department of Revenue. The total level of tax evasion – the level of taxes legally owed, but unpaid – is not known. The City does not estimate this amount for each of its self-assessed taxes.




In the case of the real estate tax, the high rate of delinquency in Philadelphia may reflect, at least in part, relatively low household income. More than 83 percent of delinquent real estate tax accounts owe less than $5,000 (these accounts represent more than 41 percent of the total real estate tax due from all taxpayers). This high number of relatively low amounts due suggests that a substantial portion of the tax delinquency problem may reflect the inability of households to pay taxes owed.

The figure below presents real estate tax collection rates in major cities in fiscal year 2010. Philadelphia's collection rate was the second lowest out of 24 cities compared.




High interest and penalty rates may provide a disincentive for taxpayers to enter into payment agreements, particularly for properties with many years of delinquency. According to the Mayor's Task Force on Tax Policy and Economic Competitiveness, the rates of interest and penalty applied in Philadelphia are higher than in other major cities. The Task Force recommended reductions in these rates to encourage compliance. As of May 2012, 11,098 of the 101,600 delinquent real estate accounts were in payment agreements.[21] The City also appears to make limited use of hardship agreements, which can reduce payments for low-income homeowners. Tax delinquency experts suggest that for cities with substantial numbers of low-income property owners, it is important to encourage delinquent taxpayers to enter into payment agreements that take into account their limited ability to pay.[22]

Another key issue in the past has been the inability of the City to effectively use the Sheriff sale process as an incentive for compliance. If Sheriff sales were routinely and quickly conducted for tax delinquent properties, it would facilitate not only tax collection, but also economic development, by transferring properties to new owners, in cases where there is a potential for productive reuse. The City appears to be taking steps to increase the number of Sheriff sales, which is a positive sign. The number of properties newly listed for Sheriff sale increased from 50 per month in 2008 and 2009 to 150 as of June 2012.

[21] *Tax Delinquent Report*, May 2012, City of Philadelphia.
[22] Kerkstra, PlanPhilly, "Taxes Wither on the Vine."

With respect to other self-assessed taxes, delinquency appears to be partly due to the complexity of the local tax system. The City and School District collectively levy 16 taxes other than the real estate tax. Enforcement is an inherent challenge given the number of local taxes levied in the city, and the complexity of Philadelphia's business taxes in particular, certain taxes. As part of ongoing tax reform efforts, the City needs to consider ways to reduce the complexity of specific taxes, and the overall tax system, in order to improve its ability to enforce the tax laws.

The City has implemented a series of tax enforcement measures over the past year. In the fall of 2011, the Revenue Department sent letters to 20,000 delinquent taxpayers, communicating the consequences of not paying by July 31, 2012. The Department is working with the District Attorney's Office to prosecute delinquent taxpayers. It also plans to withhold taxes due from pension payments of delinquent taxpayers who are former City employees. In addition, the Department made outbound collection calls in May 2012 to collect an additional $3.5 million of SDP revenue. The City is also working with Community Legal Services and small advocacy groups to encourage eligible taxpayers to enter into hardship agreements. The Department plans to add another collection agency in September 2012 to pursue11,000 cases.

Still, it is unclear whether the City's various enforcement initiatives have resulted in increases in overall delinquent collections. The City's tax amnesty program in 2010 did generate an estimated $72.3 million in delinquent tax collections from May through August of 2010. The combined revenue generated by other initiatives – including audit, discovery, data matching, and other initiatives – was $53.3 million from FY09 to FY12. However, overall General Fund delinquent tax collections for the real estate, wage and earnings, net profits, and business income and receipts taxes in FY11 was $79.9 million, a level comparable to the past six years.

In summary, tax enforcement is a significant challenge for the City. The City needs to focus on policy and institutional reforms that will encourage taxpayers to comply with tax law, and ensure swift and certain sanctions for those who do not. While attention to this issue has increased in recent years due to the City's ongoing financial challenges, tax enforcement is a matter of equity, and it critical to the City's pursuit of greater tax competitiveness. It should remain a priority regardless of the degree of financial pressure in any given year.

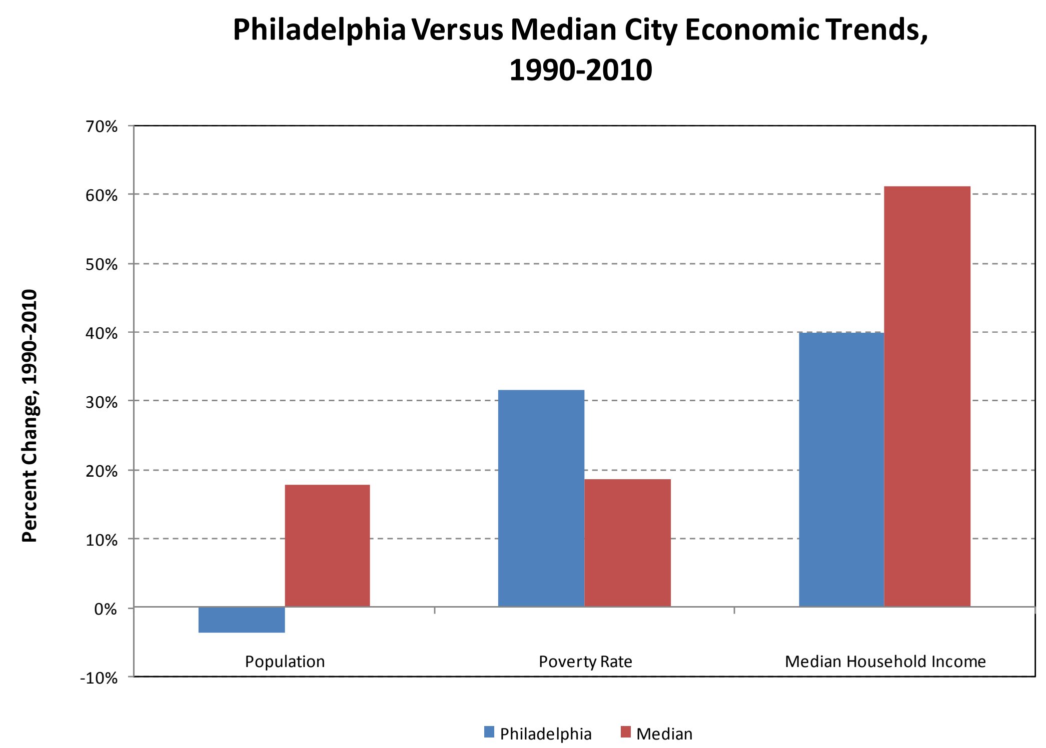
## Economic Development

For the City's long-term financial stability, a key challenge remains the level of economic growth. Robust economic growth more consistent with that in the region and the nation as a whole would greatly enhance the City's ability to achieve fiscal stability.

Philadelphia has been successful at stabilizing employment since the early 1990s. Further, the 2010 Census confirms that after decades of dramatic population declines, Philadelphia's population has stabilized. Nonetheless, on several important measures of economic health – population, median household income, and poverty rate – available data suggest that Philadelphia's economy has not performed particularly well compared to other large cities since 1990.

The chart below presents a comparison of growth rates from 1990 to 2010 for three key economic indicators in Philadelphia and the median city among a comparison group of 28 large cities.[23] Among this group, Philadelphia's population ranking was unchanged at fifth over the period, but Philadelphia's 3.8 percent decline did not favorably compare to the 17.7 population increase in the median city. Philadelphia's poverty rate was the 11th highest in 1990 and 5th highest in 2010. Philadelphia's median household income in 1990 ranked 20th out of the 28 cities, and its rank slipped to 25th in 2010. Median income increased 39.8 percent in Philadelphia over the period compared to 61.2 percent in the median city.

In short, aggregate statistics suggest that Philadelphia's economic performance relative to other major US cities over the past two decades has not been particularly strong. While the City has made progress in certain areas of revitalization, the economic well-being of the city as a whole does not appear to have improved at the pace of other cities.




Source: US Census Bureau. Median City is the median of a group of 28 cities that were the most populous in either 1990 or 2010.

[23] The comparison group includes those cities that were among the 25 most populous cities in the US in either 1990 or 2010. They include: New York City, Los Angeles, Chicago, Houston, Philadelphia, Phoenix, San Antonio, San Diego, Dallas, San Jose, Jacksonville, Indianapolis, San Francisco, Austin, Columbus, Fort Worth, Charlotte, Detroit, El Paso, Memphis, Baltimore, Boston, Seattle, Nashville, Denver, Milwaukee, Cleveland, and New Orleans.

Many U. S. cities have made substantial progress in turning around their economies by capitalizing on their competitive advantages in a post-industrial economy. These include the traditional urban advantage of density, the innate productivity of cities owing to the proximity of firms and workers. In recent decades, cities have also become more attractive as business and residential locations because of their quality of life. Urban amenities such as parks, waterfronts, specialized shopping, and arts and cultural institutions have become increasingly important for quality of life and urban competitiveness. Public safety and quality public schools are also essential aspects of quality of life, and many cities have made progress in these areas as well.[24]

In recent years, Philadelphia has taken strides toward greater competitiveness in several areas. With several specific initiatives and reforms, the City is beginning to create some of the ingredients of a successful twenty-first century city. They include a reorganized workforce development system, a new comprehensive plan, *Citywide Vision: Philadelphia 2035*, an updated zoning code, improvements to the development review process, and a strategic plan for environmental sustainability, *Greenworks Philadelphia*.

Nonetheless, challenges remain. Quality public schools and public safety remain major concerns. Without measurable progress in these areas, the City's potential for growth will be limited. The potential of the City's waterfronts and other public spaces as urban amenities is not fully realized, although progress is being made on waterfront development, with the adoption of a waterfront master plan and the formation of the Race Street Pier and Delaware River Bike Trail.)

Despite tangible developments, many promising active construction sites in the City, and the attraction and growth of new firms in viable industries, progress toward economic development goals could be facilitated by an overall strategic plan for economic development. Such a plan could help coordinate the City's various activities from an economic development perspective and improve the allocation of capital and operating resources related to economic development. The plan would describe goals and strategies and financial and operational metrics for the various agencies involved in economic development: the Department of Commerce, Philadelphia Industrial Development Corporation (PIDC), the Redevelopment Authority of Philadelphia (RDA), and the Delaware River Waterfront Corporation (DRWC). A key element of such a plan would be a discussion of the industrial sectors that could represent areas of potential growth in the future.

As part of a more strategic approach to economic development, the City also needs to clarify and evaluate the level of resources currently devoted to specific tax exemptions. Tax expenditures, such as real estate tax abatements and business tax credits and exemptions, involve an investment of public resources that is just as costly to taxpayers as direct appropriations to government agencies. But the City does not publish, as part of its annual budget document, a tax expenditure budget that lists the various local tax exemptions and abatements and their cost. This prevents a systematic process of evaluating whether the costs of these policies are justified in relation to their benefits.

[24] Edward Glaeser, *Triumph of the City: How Our Greatest Invention Makes Us Richer, Smarter, Greener, Healthier, and Happier* (New York: The Penguin Press, 2011), pp. 117-33.

Resource allocation is also hampered by a lack of information in City budget documents about the direct expenditures of agencies that are not formally part of City government. The City substantially controls and funds agencies such as PIDC and DRWC, and it should be more accountable for their activities and outcomes. This would be facilitated by improved disclosure about their activities and funding levels within the City budget document.

A substantial part of the City's investment in economic development is contained in the Capital Budget and six-year Capital Program. While the City's resources in these areas are constrained by the debt limit contained in the State constitution, and by fiscal constraints, over the long-term the City will need to continue to devote additional resources to economic development. The allocation of these resources could be facilitated if capital investments were considered as part of a City-wide strategic plan.

Philadelphia's economic potential is suggested by the gradual stabilization of employment and population in recent years. Nationwide, there are many thriving post-industrial cities that serve as examples to emulate. Philadelphia needs to more systematically address its strategic economic challenges, and use budgeting and strategic planning to coordinate the many initiatives that are underway and identify opportunities for needed new initiatives and investments.

# Appendix A: Statutory Background, Plan Review Methodology and Summary of Events

This section summarizes the principal provisions of the PICA Act and the Intergovernmental Cooperation Agreement between PICA and the City. It also contains a brief summary of events to date, a summary of PICA staff's Plan review methodology, and a compilation of required future City reporting to PICA.

## Statutory Basis -- The PICA Act

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 (the "PICA Act") (Act of June 5, 1991, P.L. 9, No. 6).

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 Intergovernmental 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 Intergovernmental 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 Intergovernmental 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 Intergovernmental 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 percent) 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 Intergovernmental 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 service on PICA bonds.

## Plan Review Methodology

*Staff Report.* The Plan was submitted to PICA by the Mayor on July 27, 2012, and later supplemented by an addendum which was submitted to PICA on August 9, 2012. For purposes of the PICA, the official submittal date of the Plan is considered to be August 9. The Act provides a 30 day period for the Authority to review the Plan prior to taking action. In the course of reviewing the Plan, PICA staff has consulted with City officials, both on the departmental level and otherwise, since the Plan was initially submitted to City Council by the Mayor on March 8, 2012. PICA Staff has also 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 from external sources. This report includes reference to materials received by the Authority through September 5, 2012.

Under Section 5.07 of the Intergovernmental 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.

*Relationship to Future Plan Revisions.* The City is obligated under the both the Intergovernmental 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 Intergovernmental 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, revisions mandated by conditions of Plan approval, 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 22, 2013 (100 days prior to the end of FY13). At that time, the City is required to add its Fiscal Year 2018 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 Intergovernmental 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….

## Summary of Events to Date

PICA was created by the Commonwealth of Pennsylvania in direct reaction to Philadelphia’s financial crisis. Accordingly, PICA’s primary focus during its initial years of existence was 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 Intergovernmental 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 in the early years of PICA's existence.

Since 1991, 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 ongoing City improvement as envisioned by the PICA Act.

PICA also provides continuing oversight of 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 bond issues from 1992 to 1994provided in excess of $1.1 billion in funding to assist the City, allocated to the following purposes:

| Purpose | Amount (thousands) |
|---|---|
| Deficit Elimination/Indemnities Funding | $ 269,000 |
| Productivity Bank | 20,000 |
| Capital Projects | 468,500 |
| Retirement of Certain High Interest City Debt | 384,300 |
| TOTAL | $1,141,800 |

PICA's authority to issue new money debt to fund City deficits or capital projects expired on December 31, 1994. Since 1994, PICA's activities have focused on oversight on the City's efforts to maintain financial balance, institutionalize management reforms and to implement ongoing operations changes.

It is anticipated that the PICA-City relationship will continue to be a catalyst for further City operational improvements.

## 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 2013. 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 Intergovernmental 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:

> <u>Quarterly Plan Reports</u> 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. Quarterly reporting deadlines for FY2013 are November 15, 2012, February 15, 2013, May 15, 2013 and August 15, 2013. The Intergovernmental 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.
>
> <u>Grants Revenue Fund Contingency Account Report</u>. The Intergovernmental 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. For FY2013, the reporting dates are October 20, 2012, January 20, 2013, April 20, 2013 and July 20, 2013. The report details the receipt 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.
>
> <u>Prospective Debt Service Requirements Reports</u> The Intergovernmental 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 FY2013 are August 1, 2012, October 31, 2012, January 31, 2013 and May 1, 2013.

# Appendix B: Office of City Controller Reports on the Plan

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 report on the Five-Year Financial Plan as submitted by the City to PICA on July 27, 2012. The Controller's Office also issued an additional report on the Five-Year Financial Plan as supplemented by an addendum submitted to PICA on August 9, 2012.

The City Controller's report on the Plan as submitted by the City to PICA on July 27 was formally submitted to PICA on August 8, 2012. The report on the Plan as supplemented by the Addendum submitted to PICA on August 9 was submitted to PICA on August 23, 2012. The Independent Auditor's Report submitted by the Controller's Office to PICA on both versions of the Plan is reproduced in this Appendix as well as the transmittal letters from the City Controller highlighting concerns and risks. Certain 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 City Controller's perspective on the Five-Year Financial Plan.

PICA Staff is grateful for the assistance provided by the City Controller's staff in evaluating this Plan.

# CITY OF PHILADELPHIA

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ALAN BUTKOVITZ
City Controller
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August 8, 2012

Ms. Fran Burns
Executive Director
Pennsylvania Intergovernmental Cooperation Authority
1500 Walnut Street, Suite 1600
Philadelphia, PA 19102

Dear Ms. Burns:

In accordance with Section 12720.209(f)(1) of the Pennsylvania Intergovernmental Cooperation Authority Act, my office conducted an examination of the Forecasted General Fund Statements of Operations for the fiscal years ending June 30, 2013 through June 30, 2017 (the forecasted statements). The forecasted statements were prepared by the Office of the Director of Finance and submitted to the Pennsylvania Intergovernmental Cooperation Authority (PICA) on July 27, 2012.

My staff conducted its examination of the forecasted statements in accordance with attestation standards established by the American Institute of Certified Public Accountants. Those standards require that we evaluate whether the assumptions used by the City of Philadelphia's management at the time the Plan was submitted provide a reasonable basis for management's forecasted statements. Attached is the independent auditor's report signed by my deputy who is a Certified Public Accountant.

The independent auditor's report indicates that certain management assumptions used in the Plan did not provide a reasonable basis for management's forecast. I urge PICA to reject the Plan for these reasons:

- The forecasted statements are based upon City of Philadelphia management's assumption of a favorable outcome of its latest appeal of the IAFF award, and do not include any potential changes in costs related to the appeal. The City's current appeal was filed in August 2012 after an arbitration panel rejected the City's initial appeal and reaffirmed the interest arbitration award granted to the IAFF in October 2010. The IAFF has filed a lawsuit seeking implementation of the arbitration award. City of Philadelphia management asserts that the arbitrator's award imposes more than $203 million in new wage and benefit costs over the life of the Plan, and has not included any provision for covering these costs in the event of an unfavorable outcome of the latest appeal. We do not believe the assumption that the City will prevail is reasonable.

- Based upon the City of Philadelphia management's assumption, the forecasted statements do not include any potential changes in costs resulting from ongoing negotiations with unions representing the city's non-uniformed workers. We do not believe this assumption provides a reasonable basis for management's forecast because recent awards between the city and other labor unions have resulted in employee salary increases.

In addition, the following questionable items, worthy of your attention, were noted during our review of the forecasted statements:

- The Plan overstates forecasted expenditures for debt service over the life of the Plan by approximately $90 million, primarily because it includes debt service on two anticipated, but unissued and unapproved bond offerings of $221 million and $177 million.

- Forecasted FY13 revenue includes $9 million requested from PICA for design work for a new Police Department headquarters, city morgue and health offices. Both the revenue and the corresponding expenditures for design work should be budgeted and recorded in the city's capital projects fund. Including this revenue in the city's general fund fails to restrict the use of these monies for capital purposes, and allows these funds to be spent for general governmental purposes.

Furthermore, several uncertainties exist which could dramatically impact the Plan's effectiveness. These uncertainties, which PICA should also weigh when reviewing the Plan, include:

- The probability of additional, large funding requests by the School District (District) in future years. The District's current year deficit is estimated to be approximately $282 million; a staggering amount which has it on the brink of insolvency. The District has no taxing authority and lacks the ability to borrow to finance its deficit. Adding to the District's fiscal woes, the Commonwealth has taken the position that it will not provide additional funding to the District. Although the city recently enacted increases in Real Estate and Use and Occupancy taxes to provide the District with $40 million in additional contributions from its general fund in fiscal year 2013 and beyond, the District in all probability, will seek further sizable increases in city contributions in later years of the Plan. As City Controller, I again state the need for the District to prepare a Five Year Plan of its own, which would require the approval of an independent authority. I believe this additional level of oversight is necessary to halt the District's pattern of recurring fiscal crises of escalating proportions which we have witnessed in recent years. Unless the District takes the necessary steps to operate within its budgetary constraints and eliminate the uncertainty regarding its future funding requirements, the possibility of further financial shortfalls will remain, placing additional strains on the city's finances.

- The impact of any new union contract settlements. If the arbitrator's award to the IAFF is upheld, the city is facing a retroactive wage and benefit payment of approximately $66 million in the current year. In addition, non-uniformed employees have been working under the terms of a labor agreement that expired more than four years ago. If the ongoing negotiations with the non-uniformed workers result in an agreement requiring additional retroactive wage and benefit payments, the city, under the Five Year Plan as presented, would lack the necessary funding to make that payment.

Finally, I would like to express our thanks to the management and staff of the city's Office of Budget and Program Evaluation for their courtesy and cooperation in the conduct of our examination.

Respectfully submitted,

ALAN BUTKOVITZ
City Controller

cc: Chair and Board Members of the
Pennsylvania Intergovernmental Cooperation Authority
Michael A. Nutter, Mayor
Rob Dubow, Director of Finance
Rebecca Rhynhart, Budget Director

# FORECASTED GENERAL FUND
# STATEMENTS OF OPERATIONS

# CITY OF PHILADELPHIA

# ACCOUNTANT'S REPORT

# FISCAL YEARS 2013 – 2017

**CONTENTS**

# CITY OF PHILADELPHIA

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ALAN BUTKOVITZ
City Controller

GERALD V. MICCIULLA
Deputy City Controller

## INDEPENDENT ACCOUNTANT'S REPORT

To the Chair and Board Members of the
Pennsylvania Intergovermental Cooperation Authority

We have examined the accompanying Forecasted General Fund Statements of Operations for the fiscal years ending June 30, 2013 through June 30, 2017 (the forecasted statements). The City of Philadelphia's management is responsible for the forecasted statements, which were prepared for the purpose of complying with the provisions of the Pennsylvania Intergovermental Cooperation Authority (PICA) Act. Our responsibility is to express an opinion on the forecasted statements based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included such procedures as we considered necessary to evaluate both the assumptions used by the City of Philadelphia's management and the preparation and presentation of the forecasted statements. We believe that our examination provides a reasonable basis for our opinion.

As described in the Summary of Significant Forecast Assumptions, Note C.6.a. the City of Philadelphia's management will appeal for a second time the interest arbitration award granted to the International Association of Fire Fighters (IAFF). The City of Philadelphia's current appeal was filed in August 2012 after an arbitration panel rejected the initial appeal and reaffirmed the interest arbitration award granted to the IAFF in October 2010. The IAFF has filed a lawsuit seeking implementation of the arbitration award. City of Philadelphia's management expects a favorable outcome of the current appeal and as such, the forecasted statements do not include any potential changes in costs related to the August 2012 appeal. In addition, the forecasted statements do not include any potential changes in costs related to the outcome of negotiations with its non-uniformed employee unions. Recent settlements between the City of Philadelphia and other labor unions have resulted in employee salary increases.

In our opinion, the accompanying forecasted statements are not presented in conformity with guidelines for presentation of forecasted information established by the American Institute of Certified Public Accountants because management's assumptions, as discussed in the preceding paragraph, do not provide a reasonable basis for management's forecast. We have no responsibility to update this report for events and circumstances occurring after the date of this report.

The accompanying forecasted statements and our report are intended solely for the information and use of the management of the City of Philadelphia and PICA and are not intended to be used and should not be used by anyone other than these specified parties.

Gerald V. Micciulla

August 8, 2012

GERALD V. MICCIULLA, CPA
Deputy City Controller

# City of Philadelphia - Office of the Director of Finance

## Forecasted General Fund Statements of Operations

## Fiscal Years Ending June 30, 2013 through June 30, 2017

(Amounts in Thousands)

| No. | Item | FY 2013 Estimate | FY 2014 Estimate | FY 2015 Estimate | FY 2016 Estimate | FY 2017 Estimate |
|---|---|---|---|---|---|---|
| (1) | (2) | (3) | (4) | (5) | (6) | (7) |
| | **OPERATIONS OF FISCAL YEAR** | | | | | |
| | **REVENUES** | | | | | |
| 1 | Taxes | 2,614,398 | 2,698,477 | 2,634,532 | 2,676,741 | 2,721,889 |
| 2 | Locally Generated Non-Tax Revenues | 246,253 | 247,641 | 252,745 | 256,083 | 259,079 |
| 3 | Revenue from Other Governments | 653,817 | 611,779 | 626,789 | 640,275 | 653,379 |
| 4 | Sub-Total (1)+(2)+(3) | **3,514,468** | **3,557,897** | **3,514,066** | **3,573,099** | **3,634,347** |
| 5 | Revenue from Other Funds of City | 53,253 | 52,463 | 45,247 | 46,557 | 47,982 |
| 6 | Total - Revenue (4)+(5) | **3,567,721** | **3,610,360** | **3,559,313** | **3,619,656** | **3,682,329** |
| 7 | Other | 0 | 0 | 0 | 0 | 0 |
| 8 | **Total Revenue and Other Sources (6)+(7)** | **3,567,721** | **3,610,360** | **3,559,313** | **3,619,656** | **3,682,329** |
| | **OBLIGATIONS/APPROPRIATIONS** | | | | | |
| 9 | Personal Services | 1,341,313 | 1,349,909 | 1,346,931 | 1,347,467 | 1,347,933 |
| 10 | Personal Services-Pensions | 629,106 | 660,364 | 567,640 | 588,970 | 606,242 |
| 11 | Personal Services-Other Employee Benefits | 489,151 | 506,159 | 520,678 | 538,132 | 557,722 |
| 12 | **Sub-Total Employee Compensation** | **2,459,570** | **2,516,432** | **2,435,249** | **2,474,569** | **2,511,897** |
| 13 | Purchase of Services | 768,574 | 764,504 | 759,323 | 756,600 | 762,838 |
| 14 | Materials, Supplies and Equipment | 79,290 | 76,159 | 77,511 | 77,113 | 77,113 |
| 15 | Contributions, Indemnities, and Taxes | 137,862 | 137,422 | 137,483 | 138,044 | 137,606 |
| 16 | Debt Service | 127,433 | 128,650 | 149,579 | 146,048 | 163,323 |
| 17 | Capital Budget Financing | 0 | 0 | 0 | 0 | 0 |
| 18 | Advances and Miscellaneous Payments | 0 | 0 | 0 | 0 | 0 |
| 19 | Sub-Total (12 thru 18) | 3,572,729 | 3,623,167 | 3,559,145 | 3,592,374 | 3,652,777 |
| 20 | Payments to Other Funds | 31,138 | 32,219 | 33,291 | 35,115 | 36,936 |
| 21 | **Total - Obligations (19+20)** | **3,603,867** | **3,655,386** | **3,592,436** | **3,627,489** | **3,689,713** |
| 22 | Oper.Surplus (Deficit) for Fiscal Year (8-21) | (36,146) | (45,026) | (33,123) | (7,833) | (7,384) |
| 23 | **Prior Year Adjustments:** | | | | | |
| 24 | Revenue Adjustments | 0 | 0 | 0 | 0 | 0 |
| 25 | Other Adjustments | 18,500 | 18,500 | 18,500 | 18,500 | 18,500 |
| 27 | Total Prior Year Adjustments | 18,500 | 18,500 | 18,500 | 18,500 | 18,500 |
| 28 | **Adjusted Oper. Surplus/ (Deficit) (22+27)** | **(17,646)** | **(26,526)** | **(14,623)** | **10,667** | **11,116** |
| | **OPERATIONS IN RESPECT TO** | | | | | |
| | **PRIOR FISCAL YEARS** | | | | | |
| | Fund Balance Available for Appropriation | | | | | |
| 29 | June 30 of Prior Fiscal Year | 98,970 | 81,324 | 54,798 | 40,175 | 50,842 |
| 30 | Residual Equity Transfer | 0 | 0 | 0 | 0 | 0 |
| 31 | Fund Balance Available for Appropriation June 30 (28)+(29)+(30) | **81,324** | **54,798** | **40,175** | **50,842** | **61,958** |

See accompanying summaries of significant accounting policies and assumptions and accountant's report.

## A. **Nature of the Forecast**

The City of Philadelphia Office of Budget and Program Evaluation (OBPE) is responsible for providing revenue and obligation estimates to the Director of Finance and the Mayor for discussion and inclusion in the FY2013 budget and the FY2013-2017 Five Year Financial Plan (FYP) submitted by the Mayor to the Pennsylvania Intergovernmental Cooperation Authority (PICA) on July 27, 2012. These financial forecasts present, to the best of management's knowledge and belief, the City's expected results of operations for the forecast periods. Accordingly, the forecasts reflect the City's judgment as of July 27, 2012, the date of these forecasts, of the expected conditions and its expected course of action. The assumptions disclosed herein are those that management believes are significant to the forecasts. There may be differences between the forecasted and actual results because events and circumstances frequently do not occur as forecasted or expected.

## B. Summary of Significant Accounting Policies

The Forecasted General Fund Statement of Operations is presented on the budgetary basis of accounting. The budgetary basis of accounting differs from the modified accrual (Generally Accepted Accounting Principles) basis used in the preparation of the city's governmental fund financial statements in that both expenditures and encumbrances are applied against the current budget, adjustments affecting activity budgeted in prior years are accounted for through fund balance or as a reduction of expenditures and certain interfund transfers and reimbursements are budgeted as revenues and expenditures.

## C. Summary of Significant Forecast Assumptions

### 1. Approach to Revenue Forecasting

The city's estimated general fund revenues for FY13 total $3.568 billion. Approximately 73% of the city's budget comes from local taxes, and 18% comes from other governments. Locally generated non-tax revenues, which include fees, fines and permits, account for 7% of revenues.

OBPE provides forecasts of the six major taxes, totaling over $2.5 billion in the adopted FY13 budget, as well as $246.3 million of Locally Generated Non-Tax revenues, and $653.8 million in Revenue from Other Governments. These three sources comprise 98% of the revenues anticipated for the FY13 budget.

OBPE employs a number of approaches to developing its forecasts of local revenues:

a. Forecasts of economic activity provided by several sources including the Congressional Budget Office and the Blue Chip Economic Indicators;

b. Continuous evaluation of national and local economic data on employment, inflation, interest rates, and economic growth;

c. Ongoing examination of the city's current tax receipts;

d. Economic forecasting of tax revenues provided by a revenue forecasting consultant;

e. Discussions with economists at the Federal Reserve Bank of Philadelphia; and

f. The extensive experience of its staff.

OPBE's tax projections for the FYP were developed in conjunction with a revenue forecasting consultant, IHS Global Insight, Inc (IHS). IHS created econometric models which included variables such as wage and salary disbursements in the metropolitan statistical area (MSA) and the county, personal income in the county, the unemployment rate, home prices in the county, real estate transaction growth, and national corporate profits. These models, together with their forecast of the Philadelphia economy, were used by IHS to project tax revenues for the City. IHS focused on four taxes – Wage and Earnings Tax, Business Privilege Tax, Real Estate Transfer Tax, and Sales Tax. These projections were refined by OBPE after discussions with leading economists at the Federal Reserve Bank of Philadelphia.

**2. The National and Local Economic Context**

As is the case with municipalities across the country, the City experienced significant tax revenue declines during the deep world-wide recession of 2007-2009. Since 2008, governments and businesses across the globe have had to grapple with a world economy beset by a profound financial crisis, large declines in residential housing markets, a global contraction in economic activity, and a weak job market characterized by high unemployment. The economic recovery has been slow and while tax revenues have rebounded somewhat, the level of growth witnessed in years prior to 2007 is not expected to return. In addition, revenues from some taxes have yet to hit the level they attained before the recession.

Growth in the United States' output since the middle of 2009 has been very weak compared to previous economic recoveries. Following weak growth in the first two quarters of 2011, the financial rating agency, Standard & Poor's, cut the U.S.'s AAA credit rating in August 2011, further exacerbating economic concerns. U.S. gross domestic product (GDP) increased only 1.7% in 2011. This was weaker than the growth of 3.0% seen in 2010, the first year of the economic recovery.[1] In contrast to this weak growth in 2011, real GDP grew 5.6% during the second year of recovery following the recession of 1981-1982. Economists believe that recoveries following a financial crisis are weaker and more prolonged as businesses and households reduce debt before increasing spending (compared to recoveries that do not follow a financial crisis).[2] Consensus forecasts of U.S. GDP growth are projected to be 2.1% in 2012 and 2.3% in 2013. National unemployment is projected to decline but still remain high. According to the Blue Chip consensus, unemployment is expected to be 8.2% in 2012, declining to 7.8% in 2013. [3] All of this taken together signifies that the economy is anticipated to improve, albeit at a slower pace than in most past recoveries from recession.

Philadelphia has been substantially impacted by the economic crises described above. The number of people employed dropped from 593,800 in April 2009 to a low of 572,100 in October 2010, rebounding slightly to 578,300 in April 2012, a decline of 2.6% since 2009. Unemployment has had a sizable increase, from 6.0% in August 2007 to a high of 11.2% in November 2010 and has improved somewhat to 10.3% in April 2012. [4] Employment levels are particularly important for Philadelphia's budget because it is heavily reliant on the Wage Tax.

### 3. The City's Major Taxes

The city receives revenue to fund its services and programs from six major taxes (contributing to 73% of the expected General Fund revenue in FY13). These include:

1. Wage and Earnings and Net Profit Tax (Wage),
2. Property Tax,
3. Business Income and Receipts Tax (BIRT),
4. Real Estate Transfer Tax (RTT),
5. Sales Tax, and

[1] Blue Chip Economic Indicators February 10, 2012
[2] Blue Chip Economic Indicators August 10, 2011
[3] Blue Chip Economic Indicators July 10, 2012
[4] Pennsylvania Department of Labor and Industry, Monthly Seasonally Adjusted Unemployment Rates

6. Parking Tax.

The remaining taxes, including the amusement tax, provide less than 1% of General Fund revenue. Philadelphia's reliance on the Wage Tax (34% of the General Fund) and the BIRT (11%) places the city at risk from economic trends and employment fluctuations of the local economy. Other cities and counties that rely more heavily on property tax revenues are more susceptible to dramatic shifts in the housing market.

**a. Wage Tax**

The largest tax revenue source (comprising 47% of tax revenues) is the Wage, Earnings, and Net Profits (Wage) tax. The Wage Tax is collected from all employees working within city limits, and all city residents regardless of work location. Currently, the Wage Tax rate is 3.9280% for residents and 3.4985% for non-residents. The resident rate includes 1.5% that is reserved for the Pennsylvania Intergovernmental Cooperation Authority (PICA). PICA has overseen the city's finances since 1992, when the State Oversight Board was first established. The PICA statute permits the Authority to a "first dollar" claim on its portion of Wage Tax proceeds, which is used to pay debt service on bonds issued by PICA for the benefit of the city. Excluding the PICA portion, the Wage Tax is projected to bring in $1.220 billion in FY13. This projection includes a 3.4% growth rate in the Wage and Earnings Tax and a 2.5% expected growth rate in the Net Profits Tax. [5] In FY14, assuming that the city's fund balances remains consistent with or higher than those in the FYP, the city plans to resume previously planned wage tax reductions that were suspended in FY10.

**b. Property Tax**

The Real Property Tax (Property) is the city's second largest source of tax revenue (20%), estimated to contribute $514.9 million of the FY13 tax revenues. This tax is levied on the assessed value of residential and commercial property in the city. The city's portion of the property tax rate was increased to $4.462 for FY13 to fund a $20 million additional contribution to the School District and to protect against increased appeal losses. FY12 property tax receipts are coming in stronger than anticipated due to better collections so projections have been revised upwards in the Plan to reflect the higher 5-year average collection rate.

[5] Growth rates referenced throughout these notes are applied to the current portion of the tax base.

**c. Business Income and Receipts Tax**

The Business Income and Receipts Tax (BIRT, formerly the Business Privilege Tax) is projected to produce $394.9 million in FY13, 15% of total tax revenue. The majority of the BPT is derived from corporate profits which had solid years in calendar years 2010 and 2011 but are volatile and dependent on economic conditions within the city. In FY12, BIRT tax reform legislation was signed by the Mayor which incorporated several changes intended to help small and medium size businesses grow in Philadelphia. Under Bill 110548, business taxes for the first two years of operations for all new businesses that employ at least three employees in their first year and six in the second would be eliminated beginning in FY13. This legislation also provides for across the board exclusions on the gross receipts portion for all businesses scaled in over a three year period beginning in FY15 and reductions in the net income portion of the BIRT. When the exclusions are fully phased in, the first $100,000 of receipts will be excluded. Lastly, the bill calls for implementation of single sales factor apportionment. This enables businesses to pay BIRT solely on sales, not on property or payroll. By taxing property and payroll, the BIRT previously had provided disincentives to firms to locate in the city.

**d. Sales Tax**

Sales Tax revenues are projected to generate $259.3 million in FY13, 10% of tax revenues. As part of its response to projected budget deficits in 2009, the city passed new legislation which was approved by the Commonwealth of Pennsylvania (the Commonwealth) to temporarily increase the Sales Tax rate from 1% to 2%. This raised the total Sales Tax rate to 8%, with 6% going to the Commonwealth and 2% to the city. The increased rate is scheduled to be in effect through FY14 and return to 7% in FY15.

**e. Real Estate Transfer Tax**

Economic conditions have negatively affected the Real Estate Transfer Tax (RTT) since the housing market decline began in 2007; however, RTT revenues grew slightly from FY11 to the FY12 estimate. The RTT is projected to provide $124.5 million in FY13; a growth rate of 5.2% over FY12 anticipated collections. A growth rate of 9.0% is projected for FY14-FY16 and a lower growth rate of 3.0% is projected for FY17. Even with projected strong growth for transfer tax revenues, the $166 million the Plan includes for FY17 is almost $70 million below the $234 million in transfer tax revenues collected in FY06. The city imposes a 3% tax on real property sales and an additional 1% is charged by the Commonwealth for a 4% total RTT.

### f. Parking Tax

The parking tax is levied on the gross receipts from all parking transactions. Parking tax revenue is projected to generate $75.1 million in FY13.

**Major Taxes ($ in Millions)**
**with Percentage Change from Previous Year**

| Tax | FY11 Actual | FY12 Estimate | FY13 Estimate | FY14 Estimate | FY15 Estimate | FY16 Estimate | FY17 Estimate |
|---|---|---|---|---|---|---|---|
| Wage & Net Profits - Current & Prior | 1,143.1 | 1,180.5 | 1,220.1 | 1,259.4 | 1,300.1 | 1,320.5 | 1,335.6 |
| % change from prior year | n.a. | 3.3% | 3.4% | 3.2% | 3.2% | 1.6% | 1.1% |
| Real Property - Current & Prior | 482.7 | 498.5 | 514.9 | 525.9 | 544.0 | 557.4 | 571.2 |
| % change from prior year | n.a. | 3.3% | 3.3% | 2.1% | 3.4% | 2.5% | 2.5% |
| Bus. Income & Receipts - Current & Prior | 376.9 | 391.4 | 394.9 | 402.9 | 393.9 | 379.4 | 383.0 |
| % change from prior year | n.a. | 3.8% | 0.9% | 2.0% | -2.2% | -3.7% | 1.0% |
| Sales | 244.6 | 250.2 | 259.3 | 271.5 | 143.2 | 150.4 | 155.6 |
| % change from prior year | n.a. | 2.3% | 3.7% | 4.7% | -47.2% | 5.0% | 3.5% |
| Real Property Transfer | 116.6 | 118.4 | 124.5 | 135.8 | 148.0 | 161.3 | 166.1 |
| % change from prior year | n.a. | 1.5% | 5.2% | 9.0% | 9.0% | 9.0% | 3.0% |
| Parking | 71.6 | 73.3 | 75.1 | 77.0 | 78.9 | 80.9 | 82.9 |
| % change from prior year | n.a. | 2.4% | 2.5% | 2.5% | 2.5% | 2.5% | 2.5% |
| Other Taxes | 23.5 | 25.0 | 25.5 | 25.9 | 26.4 | 26.9 | 27.4 |
| % change from prior year | n.a. | 6.3% | 1.9% | 1.8% | 1.9% | 1.9% | 1.9% |
| **Total Taxes** | **2,459.1** | **2,537.1** | **2,614.4** | **2,698.5** | **2,634.5** | **2,676.7** | **2,721.9** |
| **% Change from prior year** | **n.a.** | **3.2%** | **3.0%** | **3.2%** | **-2.4%** | **1.6%** | **1.7%** |

Note: Wage & Net Profits Taxes include rate reductions that will resume in FY14. Business Income & Receipts Tax incorporate rate reductions in recently passed legislation that will begin in FY13. The reduced estimate for the Sales Tax in FY15 is due to the sunsetting of the temporary 1% increase that began in FY10. Other Taxes include the Amusement Tax and miscellaneous taxes. Wage tax does not include the PICA tax.

## 4. Locally Generated Non-Tax Revenues

Locally Generated Non-Tax revenues are estimated based on historical trends, rate changes, and current collection patterns. Certain revenues such as interest earnings, licenses and permits and recording fees are subject to economic contractions and are estimated accordingly.

**5. Revenue from Other Governments**

Revenue from Other Governments is estimated based on historical trends and state and federal budget information. The PICA city account which represents 46% of Revenue from Other Governments is estimated using Wage Tax variables.

**6. Obligation Estimates**

The City of Philadelphia OBPE provided obligation estimates to the Director of Finance and the Mayor for discussion and inclusion in the revised annual FY2013 budget and FY2013-2017 Five-Year Financial Plan (FYP) submitted by the Mayor to the Pennsylvania Intergovernmental Cooperation Authority (PICA) on July 27, 2012. OBPE provides forecasts of all major expenditure categories. In the FY13 budget, total expenses increase $133 million from FY12 estimated obligations, $107 million of that increase is caused by rising pension, other employee benefits and debt service costs. The remaining $26 million represents a 0.8% increase.

**FY 13 Expenditure Increases**:
The largest single investment in the FY13 Adopted Budget is an additional $20 million contribution to the School District of Philadelphia funded by an increase in the City portion of the property tax. Due to the provisions of the Commonwealth of Pennsylvania's Act 46, these additional funds are now a permanent part of the City's contribution.

The Adopted Budget also includes investments in the following:

- $9.0 million for the Public Property Department for the initial design work for a new police headquarters, city morgue, and health offices co-located at 4601 Market Street. This is a consolidation which could provide needed facility upgrades while allowing the sale of existing City assets and revitalizing part of West Philadelphia in need of investment. The City has requested $9.0 million from PICA for this one-time cost.
- $4.1 million for the Police Department will fund the hiring of close to 400 officers by the end of FY13 to increase the uniform officer level to 6,525 and maintain it at that level with expected levels of employee retirement.
- $1.2 million for the Office of Supportive Housing for housing contracts to replace beds available at the Ridge Avenue Center which is closing.

- $1.1 million of additional funding for the Office of Property Assessment towards the complete overhaul of the property tax assessment system.
- $200,000 for the Managing Director's Office to fund anti-violence initiatives across the City.
- $734,000 to fund a maintenance team in the Public Property Department to prevent deferring maintenance in City buildings.

In addition to the additional investments listed above, the distribution of funding between departments also changed. These changes included transferring $8.8 million from the First Judicial District to the Managing Director's Office which will be managing this payment of conflict counsel fees starting in FY13. In order to consolidate court counsel costs under the Managing Director's Office, the $37 million Legal Services budget (supporting the Defender's Association, Community Legal Services, and the Support Center for Child Advocates) was moved from Finance to the Deputy Mayor for Public Safety's allocation within the Managing Director's Office starting in FY13.

**a. Labor Agreements**

The City's labor agreements with its four major bargaining units – FOP Lodge No. 5, IAFF Local 22, DC 33 and DC 47 – expired on June 30, 2009. An interest arbitration award to the FOP was made in FY 10. Contracts with DC 33 and DC 47 remain outstanding. Except for its pension provisions, the interest arbitration award granted to the IAFF on October 12, 2010 was appealed by the City. The Court of Common Pleas vacated the 2010 Award on November 16, 2010. On July 2, 2012, a new interest arbitration award was issued and the City will again appeal the award.

**AFSCME District Council 33, Local 159**

On March 16, 2012, a six year interest arbitration award with AFSCME District Council 33, Local 159 was issued to cover FY 2009 through FY 2014. Local 159 governs the wages of approximately 2,000 employees who work as Correctional Officers, Youth Detention Counselors and Security Guards throughout facilities in the City's Prison System as well as in the Department of Human Services and the Police Administration

Building. Important financial components of the award that affect FY 2013 through FY 2017 include:

- Two and one-half percent wage increases for covered employees on July 1, 2012 (FY 2013) and July 1, 2013 (FY 2014).
- Restoration of step and longevity increments that were frozen by the City in July 2009. Restoration was effective with the issuance of this award.
- No specific changes to the Health Plan. Any future changes to District Council 33 will automatically apply to employees covered by the award.
- Any employee hired or rehired to a position covered under the award must participate in the new hybrid Pension Municipal Plan 10. Current employees may elect to make an irrevocable move to Plan 10.
- Effective, July 1, 2012 the uniform maintenance allowance for employees covered by the award is increased to $250 per year (previously paid at $175 per year).
- Only vacation leave (excluding holiday pay, sick time or annual leave days) will be considered hours worked for purposes of determining when overtime is due.

The FYP includes estimates for all of the above costs as well as savings related to FY 2013 through FY 2017.

**AFSCME District Council 47, Local 810 Courts**

On July 12, 2012, a five year interest arbitration award with AFSCME District Council 47, Local 810 Courts was issued to cover FY 2010 through FY 2014. The Local 810 Courts bargaining unit titles include Probation Officers, Hearing Officers and Court Representatives. Important financial components of the award that affect FY 2013 through FY 2017 include:

- Two and one-half percent wage increases for covered employees on July 1, 2012 (FY 2013) and July 1, 2013 (FY 2014). Any wage increases negotiated with the larger District Council 47 bargaining unit for FY 2010 or FY 2011 will automatically apply to Local 810.

- No specific changes to the Health Plan. Any future changes to the larger District Council 47 will automatically apply to employees covered by the award.
- Any employee hired to a position covered under the award must participate in the new hybrid Pension Municipal Plan 10. Current employees may elect to make an irrevocable move to Plan 10.
- The award contains a reclassification of Probation Officer 2 from EP Range 21 to EP Range 22 effective July 1, 2012. The City is dissenting from this portion of the award, which it thinks went beyond the arbitration panel's authority. As a result, increased costs pertaining to this salary adjustment are not reflected in the FYP.

The FYP includes estimates for the above costs except as noted as well as savings related to FY 2014 through FY 2017.

**I.A.F.F.**

On July 2, 2012, a four year interest arbitration award with the IAFF was issued to cover FY 2010 through FY 2014. Though the terms of the award are similar to those in the FOP award and takes a crucial step toward reform by establishing a hybrid pension system, it imposes more than $203 million in new costs through Fiscal 2017 without giving the City the required tools to manage these costs. Unlike the award for FOP members this award does not give the City the right to furlough, which could have been used to help fund the added cost of a contract. As a result, the City plans to appeal this award.

The portion of the award not appealed from the 2010 Award and already implemented is the change to the IAFF members' pension plan. Similar to the pension changes made in the arbitration award with the FOP, new IAFF members as October 15, 2010, must choose between increasing their pension contribution from 5% to 6% of pay or enrolling in a new hybrid pension plan.

**F.O.P. Lodge 5**

On December 18, 2009, a five year interest arbitration award with the FOP, Lodge No. 5 was issued to cover FY10 through FY14. Important financial components of the award that affect FY13 through FY17 include:

- The award will be reopened for FY13 and FY14 for a determination by the arbitration panel as to what salary changes, if any, will be awarded for those two years.
- In FY11, the FOP's health plan moved to self insurance. Instead of paying a carrier for insurance, the FOP began paying the actual cost of services provided to members. This health insurance change followed a similar change made by the City in FY10 to the plan it administers for non-union employees. The FYP includes an estimate for these costs based on an average of six months of actual FY12 expenditures increased by 10% per year based on medical cost trends.
- Pension changes for new hires – FOP members will now choose between increasing their pension contribution from 5% to 6% of pay and enrolling in a new hybrid pension plan. The hybrid pension plan reduces the risk to the City of poor market returns and is unprecedented for uniformed employees in any major city in the country. Meanwhile, increased employee pension contributions provide General Fund savings for the City.
- Up to 30 furloughs (days off without pay) in a fiscal year.

**F.O.P. – Deputy Sheriffs and Register of Wills**

On June 21, 2011, a five year interest arbitration award with the FOP, Lodge No. 5 concerning Deputy Sheriffs and Register of Wills employees was issued to cover FY10 through FY14. Important financial components of the award that affect FY13 through

FY17 include:

- The award will be reopened for FY13 and FY14 for a determination by the arbitration panel as to what salary changes, if any, will be awarded for those two years. Register of Wills employee wage increases will be based on what is negotiated between DC 33 and the City.
- Restoration of step and longevity increments that were frozen by the City in July 2009. Increments were restored retroactively to July 1, 2009 for employees of the Sheriff's Office and restored as of the date of the award for Register of Wills' employees.
- The FOP's health plan, which includes Deputy Sheriffs, moved to self insurance in FY11. This award continues that arrangement. It also reduced the City's monthly contribution from $1,165 per member to $965 per member for the period January 1, 2010 through June 30, 2010. The City will get a credit for contributions already made. Register of Wills employees will continue to participate in the City Administered plan.
- Pension changes for new hires. Deputy Sheriffs will have to choose between going into the existing municipal Plan 87 and increasing their contribution from 30% of normal cost to 50% of normal cost, or going into the new hybrid plan. Register of Wills employees hired after the date of the award must enter the hybrid plan.

**AFSCME District Council 33 and District Council 47**

Negotiations continue with the City's other two major municipal unions, DC 33 and DC 47. The City seeks changes in the structure of health and welfare benefit funding, as well as changes in overtime rules and the right to furlough employees, similar to the police award, as part of an overall contract package that the City can afford.

The City also seeks to require all new employees to enter the new hybrid pension plan put in place by the award covering the employees of the Sheriff's Office, Register of Wills, Correctional Officers and Local 810 Courts and contains increased pension contributions from employees.

The Administration is committed to having reasonable collective bargaining agreements in place as early as possible. Those contracts must, however, be affordable in the short-term and provide long-term reform.

**Summary**

The Administration hopes to resolve all outstanding contract issues as soon as possible in an affordable manner. The plan assumes savings from employee costs of $10 million in FY 2013 and $9.6 million in FY 2014 through FY 2017 - $48.5 million over the life of the Plan. If any final labor agreements result in significant unbudgeted costs across the Plan, budget cuts to many departments are likely to be necessary.

**b. Health / Medical**

The Administration implemented a self-insured group health plan in 2010 for medical benefits for non-union employees. In FY11, coverage for members of the Fraternal Order of Police (FOP), Lodge No. 5 also switched to self-insurance. For non-union employees, an average of six months of experience was used to determine cost estimates in the FYP. No increases were built in for the life of the plan as the City can change the design of the health plan (increase co-pays and employee contributions for example) to keep costs level. For the FOP six months of actual experience was used to estimate the annual cost. However, because the City has no control over the design of the FOP health plan, an increase of 10% per year based on medical cost trends has been included.

Cost estimates for DC 33 and DC 47 are based on an average of six months of actual expenditures in FY12 which is used to estimate the annual cost. Because there are no new contracts for these groups and therefore no change in the per member, per month City contribution, it is assumed costs for FY 2013 – 2017 will approximate the FY12 average expenditure.

As the 2012 arbitration award to the IAFF is under review, the move to self-insurance included in the award has not been implemented. For that reason, the cost estimate for the IAFF is based on an average of six months of actual expenditures under the provisions of the expired contract ($1,270 per employee, per month) with no increase assumed for the life of the plan.

**c. Pensions**

As part of the effort to control major cost drivers and to improve the health of the pension fund, several changes have been made over the past few years and the Administration continues to seek additional changes.

The City of Philadelphia's Act 111 interest arbitration award with the Fraternal Order of Police (FOP), Lodge No. 5 issued on December 18, 2009 requires all FOP employees hired on or after January 1, 2010 to make a one-time irrevocable election between:

1) Participating in the City's current defined benefit pension plan and increasing their contribution by 20%, from 5% to 6%; or

2) Participating in a hybrid plan, containing both a defined benefit and a voluntary defined contribution component.

Similar pension changes were awarded in the October 12, 2010 interest arbitration award with IAFF, Local 22. The award's pension provisions were not part of the 2010 Award appeal and, therefore, have been implemented. New IAFF members hired as of October 15, 2010, must make the same one-time irrevocable election between increasing their pension contribution from 5% to 6% of pay and enrolling in a new hybrid pension plan.

The new Municipal Plan 10 hybrid plan for Uniform employees includes the following elements:

1) Employee Contribution: A 5.5 % employee contribution for the first 20 years of service, and no employee contribution thereafter.
2) Normal Retirement Benefit: A defined benefit equal to 1.75% multiplied by the average final compensation for the employee, multiplied by up to a maximum of 20 years of service.
3) Average Final Compensation: The average of the employee's 5 highest annual compensations calculated for either five calendar years or 5 anniversary years.
4) After 20 years of credited service, employees will no longer earned credited service, will no longer make contributions to the pension fund and their average final compensation shall not increase.
5) Voluntary Defined Contribution Plan: Employees may make voluntary contributions to their

accounts under the City's 457 Plan. For each fiscal year, the City will make a contribution to a defined contribution plan individual account of 50 cents on the dollar for each dollar contributed by the employee to their 457(b) plan account, up to a maximum City contribution of 1.5% of compensation.

Municipal Plan 10 for Civilians is a hybrid plan with a mandatory defined benefit and a voluntary defined contribution component. This plan is mandatory for new hires in both the DC 33 Local 159 and the DC 47 Local 810 Courts arbitration awards. Key elements of Plan 10 include:

6) Years of Credited Service: Only the first 20 years will be calculated.
7) Average Final Compensation: City will take the 5-year period in which the employee's compensation is greatest.
8) Multiplier: 1.25% x Years of Credited Service up to 20 x Average Final Compensation.
9) Employees will contribute 50% of normal cost of the Plan toward the defined benefit.
10) Voluntary Defined Contribution Plan: the city will contribute $1 for every $2 the employee contributes up to 3% of the employee's compensation contributed to the Defined Contribution Plan. The City will contribute no more than 1.5% of eligible compensation.

Increasing employee pension contributions and introducing a hybrid pension plan are expected to reduce the costs to the City in the short and long term and help minimize the risk that the City faces from dramatic decreases in the stock market, like the ones suffered in FY09. Similar pension benefit changes are being sought as part of the City's ongoing negotiations with DC 33 and DC 47.

In addition to the changes in pension benefits over the past few years as outlined above, the City's pension fund has undergone the following changes:

- Re-amortized the pension fund's unfunded actuarial accrued liability over a 30-year period using level-dollar amortization payments.
- Deferred payment of a portion of its Minimum Municipal Obligation (MMO) to be repaid by end of the fiscal year ending June 30, 2014 with 8.25% interest, which was the fund's earnings assumption rate when the state law enabling the deferrals was enacted. The City deferred about 20% of its pension costs, $150 million and $80 million for the fiscal years ending June 30, 2010, and June 30, 2011, respectively.
- Eliminated the eligibility of newly elected city officials to participate in Philadelphia's

DROP.

- Reduced the pension fund's earnings assumption from 8.75% to 8.10% for Fiscal Years' 2013 through 2017. Lower earnings assumptions allow funds to moderate the risk of their investments, which can also reduce the likelihood of losses.
- Increased the smoothing period for actuarial losses and gain from five to ten years. Increasing the smoothing period reduces the impact that any particular year will have on the fund's funded status and on the City's required payments. This, in turn, reduces the volatility of pension payments.

The net impact of all of these changes to the City's pension benefits and fund is to moderate what would have been devastating increases in pension costs over the five year plan and to increase the City's ability to fund existing liabilities in the long term. The specific changes to the pension fund assumptions have been tested by the City's actuary and have been determined to be actuarially sound. Yet despite these proactive changes, pension costs will continue to rise. Costs will be substantially higher each year from FY12 through FY17 than they were in FY11. That increase is caused in part by the deferral of FY10's and FY11's payments to FY13 and FY14. The pension amounts included in the FYP are provided by the City's actuary and are based on the amounts required to be paid under state law.

# CITY OF PHILADELPHIA

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ALAN BUTKOVITZ
City Controller
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August 23, 2012

Ms. Fran Burns
Executive Director
Pennsylvania Intergovernmental Cooperation Authority
1500 Walnut Street, Suite 1600
Philadelphia, PA 19102

Dear Ms. Burns:

This correspondence is a follow-up to my August 8, 2012 letter issued in conjunction with the examination of the city's Five Year Plan conducted by the City Controller's Office. In that letter I stated that management's assumptions used in the Plan did not provide a reasonable basis for the forecast, and I urged the Pennsylvania Intergovernmental Cooperation Authority (PICA) to reject the Plan. As submitted, the Plan did not include funding for the $203 million interest arbitration award to the International Association of Fire Fighters (IAFF) or provide for any potential changes in costs resulting from ongoing negotiations with unions representing the city's non-uniformed workers.

I personally believe it is unrealistic for management to assume it will prevail in its current appeal of the arbitrated IAFF award after the same arbitration panel denied the city's previous appeal. Moreover, because it may take several years before a decision on the current appeal will be rendered, management is needlessly assuming the risk that it will be required to make a very substantial retroactive payment if the city loses on appeal. It is short-sighted of management to not anticipate the long-term damaging effect a sizable retroactive payment would have on the city's budget because it would not be surprising if the amount of the retroactive payment in future years eventually dwarfs the $66 million retroactive payment that would be due currently if the city dropped its appeal and implemented the terms of the IAFF award.

Likewise, I believe management's inability to reach a settlement in its ongoing negotiations with its non-uniformed workers may have a similar, devastating effect on the city's budget. The Five Year Plan with its supplemental projected expenditure reductions addresses only the $203 million in additional costs for the IAFF award, and makes no provision for increases for the city's non-uniformed workers. Because these employees have been working under the terms of an agreement that expired more than four years ago, the terms of any future settlement may include additional retroactive wage and benefit payments which the city has not planned for and may not be able to afford without large tax increases or further expenditure reductions.

With respect to your request of August 10, 2012, my office conducted an examination of the Forecasted and Supplemental Projected General Fund Statements of Operations for the fiscal years ending June 30, 2013 through June 30, 2017 (the forecasted and supplemental projected statements). The forecasted and supplemental projected statements within the Five Year Plan were prepared by the Office of the Director of Finance to reflect the financial impact of the addendum submitted to PICA on August 9, 2012. The supplemental projected statements assume hypothetical levels of expenditure reductions that would be necessary to fund the IAFF award if an outcome unfavorable to the city should occur.

My staff conducted its examination of the forecasted and supplemental projected statements in accordance with attestation standards established by the American Institute of Certified Public Accountants. Those standards require that we evaluate whether the assumptions used by the City of Philadelphia's management at the time the Plan was submitted provide a reasonable basis for management's forecasted and supplemental projected statements. Attached is the independent accountant's report signed by my deputy who is a Certified Public Accountant.

The independent accountant's report indicates that the assumptions used in the plan provide reasonable bases for City of Philadelphia management's forecast and for the City of Philadelphia management's supplemental projections assuming the implementation of the IAFF award and the reduction of expenditures. However, the forecasted statements include particularly sensitive assumptions which PICA should consider when assessing the plan. These particularly sensitive assumptions include:

- The forecasted statements do not include any of the potential new costs of more than $203 million associated with the IAFF interest arbitration award since the city expects a favorable outcome on appeal. Accordingly, this assumption is considered particularly sensitive.

- The forecasted statements do not include any potential changes in costs or achieved savings resulting from ongoing negotiations with unions representing the city's non-uniformed workers. Accordingly, this assumption is considered particularly sensitive.

Additionally, our review of the supplemental projected statements with hypothetical levels of expenditure reductions that would be necessary to fund the IAFF award disclosed the following areas of concern which, I believe, warrant PICA's attention:

- The possible deactivation or brownout of full- and/or part-time Fire Department Medic Units as well as Engine and Ladder companies to reduce forecasted expenditures by $3.4 million to $8.4 million. I have repeatedly commented in prior audit reports that the city's Emergency Medical Services are strained at the current staffing level and paramedics are frequently unable to respond in a timely manner. To propose a further reduction in the number of paramedics is unreasonable, and will only serve to increase the response time and unnecessarily jeopardize the health and safety of the citizens.

- The reduction of certain classes of expenditures for the Philadelphia Prisons System to reduce costs by $1.9 million to $3.6 million. These proposed expenditure reductions are based upon a decrease in the city's prison population; a factor which is clearly beyond the city's ability to control. Therefore, it is unlikely that the projected reduction of expenditures related to providing food and incarcerating fewer inmates will be possible.

- The elimination of nine to seventeen Public Defender positions to reduce forecasted expenditures by $0.5 million to $1.3 million. It is impractical to assume the elimination of these positions while the District Attorney's Office, which will prosecute theses cases, continues to receive sufficient funding to maintain its current staffing levels. Eliminating these positions may result in the need to provide defense attorneys by contracting with outside agencies which could increase the overall cost of providing this service.

Additionally, as I wrote to you in my August 8, 2012 letter, I believe there are several questionable items in the forecasted statements that could dramatically impact its effectiveness. These include:

- The Plan assumes $90 million in forecasted expenditures for debt service over the life of the Plan that may never materialize.

- Forecasted FY13 revenue includes an assumption that the city will receive $9 million requested from PICA for construction-related purposes which should be budgeted and recorded in the city's capital projects fund to prevent its use for general purposes.

- The Plan does not provide for increases in funding for the School District whose estimated $282 million current year deficit has it bordering on insolvency. It remains my belief that the School District will seek further sizable increases in city contributions in the later years of the Plan.

To date, the above uncertainties remain unresolved. I again urge PICA to strongly consider the potential effect of these uncertainties when evaluating the Plan.

I would like to express our thanks to the management and staff of the city's Office of Budget and Program Evaluation for their courtesy and cooperation in the conduct of our examination.

Respectfully submitted,

ALAN BUTKOVITZ
City Controller

cc: Chair and Board Members of the
Pennsylvania Intergovernmental Cooperation Authority
Michael A. Nutter, Mayor
Rob Dubow, Director of Finance
Rebecca Rhynhart, Budget Director

# CITY OF PHILADELPHIA PENNSYLVANIA

## OFFICE OF THE CONTROLLER

*Promoting honest, efficient, and fully accountable government*

**FORECASTED AND SUPPLEMENTAL PROJECTED GENERAL FUND STATEMENTS OF OPERATIONS**

**CITY OF PHILADELPHIA**

**ACCOUNTANT'S REPORT**

**FISCAL YEARS 2013 – 2017**


City Controller
**ALAN BUTKOVITZ**

# CONTENTS

# CITY OF PHILADELPHIA

OFFICE OF THE CONTROLLER
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ALAN BUTKOVITZ
City Controller

GERALD V. MICCIULLA
Deputy City Controller

## INDEPENDENT ACCOUNTANT'S REPORT

To the Chair and Board Members of the
Pennsylvania Intergovermental Cooperation Authority

We have examined the accompanying Forecasted and Supplemental Projected General Fund Statements of Operations for the fiscal years ending June 30, 2013 through June 30, 2017 (the forecasted and supplemental projected statements). The City of Philadelphia's management is responsible for the forecast and accompanying supplemental projections, which were prepared for the purpose of complying with the provisions of the Pennsylvania Intergovermental Cooperation Authority (PICA) Act and to provide additional information on the hypothetical effects of the International Association of Fire Fighters (IAFF) award. Our responsibility is to express an opinion on the forecasted and supplemental projected statements based on our examinations.

Our examinations were conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included such procedures as we considered necessary to evaluate both the assumptions used by the City of Philadelphia's management and the preparation and presentation of the statements. We believe that our examinations provide a reasonable basis for our opinion.

In our opinion, the accompanying statements are presented in conformity with guidelines for presentation of prospective financial statements established by the American Institute of Certified Public Accountants, and the underlying assumptions provide reasonable bases for City of Philadelphia management's forecast and for City of Philadelphia management's supplemental projections assuming the implementation of the IAFF award and the reduction of expenditures. However, because events and circumstances frequently do not occur as expected, there will usually be differences between the forecasted and actual results, and even if the IAFF award is implemented and expenditures are reduced, there will usually be differences between the projected and actual results, and those differences may be material. We have no responsibility to update this report for events and circumstances occurring after the date of this report.

The forecasted and supplemental projected statements referred to in the preceding paragraph include assumptions that are particularly sensitive as described in Note C.6. The assumptions relating to wage and benefit savings totaling $203 million are considered particularly sensitive due to the uncertainty in the timing and outcome of the City's appeal of the IAFF interest arbitration award. The assumptions relating to non-uniformed employee costs are dependent on successful labor negotiations and, accordingly, are considered particularly sensitive.

The accompanying forecasted and supplemental projected statements and our report are intended solely for the information and use of the management of the City of Philadelphia and PICA and are not intended to be used and should not be used by anyone other than these specified parties.

Gerald V. Micciulla

August 16, 2012

GERALD V. MICCIULLA, CPA
Deputy City Controller

# City of Philadelphia - Office of the Director of Finance

## Forecasted General Fund Statements of Operations

## Fiscal Years Ending June 30, 2013 through June 30, 2017

(Amounts in Thousands)

| NO. | ITEM | FY 2013 Estimate | FY 2014 Estimate | FY 2015 Estimate | FY 2016 Estimate | FY 2017 Estimate |
|---|---|---|---|---|---|---|
| (1) | (2) | (3) | (4) | (5) | (6) | (7) |
| | **OPERATIONS OF FISCAL YEAR** | | | | | |
| | **REVENUES** | | | | | |
| 1 | Taxes | 2,614,398 | 2,698,477 | 2,634,532 | 2,676,741 | 2,721,889 |
| 2 | Locally Generated Non-Tax Revenues | 246,253 | 247,641 | 252,745 | 256,083 | 259,079 |
| 3 | Revenue from Other Governments | 653,817 | 611,779 | 626,789 | 640,275 | 653,379 |
| 4 | Sub-Total (1)+(2)+(3) | **3,514,468** | **3,557,897** | **3,514,066** | **3,573,099** | **3,634,347** |
| 5 | Revenue from Other Funds of City | 53,253 | 52,463 | 45,247 | 46,557 | 47,982 |
| 6 | Total - Revenue (4)+(5) | **3,567,721** | **3,610,360** | **3,559,313** | **3,619,656** | **3,682,329** |
| 7 | Other | 0 | 0 | 0 | 0 | 0 |
| 8 | **Total Revenue and Other Sources (6)+(7)** | **3,567,721** | **3,610,360** | **3,559,313** | **3,619,656** | **3,682,329** |
| | **OBLIGATIONS/APPROPRIATIONS** | | | | | |
| 9 | Personal Services | 1,341,313 | 1,349,909 | 1,346,931 | 1,347,467 | 1,347,933 |
| 10 | Personal Services-Pensions | 629,106 | 660,364 | 567,640 | 588,970 | 606,242 |
| 11 | Personal Services-Other Employee Benefits | 489,151 | 506,159 | 520,678 | 538,132 | 557,722 |
| 12 | **Sub-Total Employee Compensation** | **2,459,570** | **2,516,432** | **2,435,249** | **2,474,569** | **2,511,897** |
| 13 | Purchase of Services | 768,574 | 764,504 | 759,323 | 756,600 | 762,838 |
| 14 | Materials, Supplies and Equipment | 79,290 | 76,159 | 77,511 | 77,113 | 77,113 |
| 15 | Contributions, Indemnities, and Taxes | 137,862 | 137,422 | 137,483 | 138,044 | 137,606 |
| 16 | Debt Service | 127,433 | 128,650 | 149,579 | 146,048 | 163,323 |
| 17 | Capital Budget Financing | 0 | 0 | 0 | 0 | 0 |
| 18 | Advances and Miscellaneous Payments | 0 | 0 | 0 | 0 | 0 |
| 19 | Sub-Total (12 thru 18) | 3,572,729 | 3,623,167 | 3,559,145 | 3,592,374 | 3,652,777 |
| 20 | Payments to Other Funds | 31,138 | 32,219 | 33,291 | 35,115 | 36,936 |
| 21 | **Total - Obligations (19+20)** | **3,603,867** | **3,655,386** | **3,592,436** | **3,627,489** | **3,689,713** |
| 22 | Oper.Surplus (Deficit) for Fiscal Year (8-21) | (36,146) | (45,026) | (33,123) | (7,833) | (7,384) |
| 23 | **Prior Year Adjustments:** | | | | | |
| 24 | Revenue Adjustments | 0 | 0 | 0 | 0 | 0 |
| 25 | Other Adjustments | 18,500 | 18,500 | 18,500 | 18,500 | 18,500 |
| 27 | Total Prior Year Adjustments | 18,500 | 18,500 | 18,500 | 18,500 | 18,500 |
| 28 | **Adjusted Oper. Surplus/ (Deficit) (22+27)** | **(17,646)** | **(26,526)** | **(14,623)** | **10,667** | **11,116** |
| | **OPERATIONS IN RESPECT TO** | | | | | |
| | **PRIOR FISCAL YEARS** | | | | | |
| | Fund Balance Available for Appropriation | | | | | |
| 29 | June 30 of Prior Fiscal Year | 98,970 | 81,324 | 54,798 | 40,175 | 50,842 |
| 30 | Residual Equity Transfer | 0 | 0 | 0 | 0 | 0 |
| 31 | Fund Balance Available for Appropriation June 30 (28)+(29)+(30) | **81,324** | **54,798** | **40,175** | **50,842** | **61,958** |

See accompanying summaries of significant accounting policies and assumptions and accountant's report.

A. **Nature of the Presentations**

The City of Philadelphia (City) Office of Budget and Program Evaluation (OBPE) is responsible for providing revenue and obligation estimates to the Director of Finance and the Mayor for discussion and inclusion in the FY2013 budget and the FY2013-2017 Five Year Financial Plan (FYP) submitted by the Mayor to the Pennsylvania Intergovernmental Cooperation Authority (PICA) on August 9, 2012.

**1. Forecasted Statements**

The forecasts present, to the best of the management of the City's Office of the Director of Finance (Management) knowledge and belief, the City's expected results of operations for the forecast periods. Accordingly, the forecasts reflect the City's judgment as of July 27, 2012, the date of these forecasts, of the expected conditions and its expected course of action. The assumptions disclosed herein are those that Management believes are significant to the forecasts at the time the forecasts were prepared. Certain assumptions involving costs and savings pertaining to unresolved matters involving the City's labor agreements as discussed in note C6 are particularly sensitive. There may be differences between the forecasted and actual results because events and circumstances frequently do not occur as expected and those differences may be material.

**2. Supplemental Projections**

The supplemental projections present, to the best of Management's knowledge and belief, the effect on the City's general fund assuming a two, four, or five percent expenditure reduction becomes necessary to fund an unfavorable IAFF interest arbitration award, as discussed in Note D. Accordingly, the projections reflect its judgments as of August 9, 2012, the date of these supplemental projections, of the expected conditions and its expected course of action, if the expenditure reductions were to occur at each of the hypothetical assumptions. The supplemental projections are designed to provide PICA with additional information to analyze the effects of hypothetical reductions in expenditures should an unfavorable outcome to the City with respect to the IAFF interest arbitration award occur and should not be considered a presentation of expected future results. Accordingly, these projections may not be useful for other purposes. The assumptions disclosed herein are those that Management believes are significant to the projections. Management considers it highly unlikely that any of the three hypothetical levels of reductions in expenditures will be necessary. Furthermore, even if one of the three hypothetical levels of expenditure reductions were to occur, there will usually be differences between projected and actual results, because events and circumstances frequently do not occur as expected, and those differences may be material.

**B. Summary of Significant Accounting Policies**

The prospective presentations of the General Fund Statements of Operations are presented on the budgetary basis of accounting. The budgetary basis of accounting differs from the modified accrual (Generally Accepted Accounting Principles) basis used in the preparation of the City's governmental fund financial statements in that both expenditures and encumbrances are applied against the current budget, adjustments affecting activity budgeted in prior years are accounted for through fund balance or as a reduction of expenditures and certain interfund transfers and reimbursements are budgeted as revenues and expenditures.

**C. Summary of Significant Forecast Assumptions**

**1. Approach to Revenue Forecasting**

The City's estimated general fund revenues for FY13 total $3.568 billion. Approximately 73% of the City's budget comes from local taxes, and 18% comes from other governments. Locally generated non-tax revenues, which include fees, fines and permits, account for 7% of revenues.

OBPE provides forecasts of the six major taxes, totaling over $2.5 billion in the adopted FY13 budget, as well as $246.3 million of Locally Generated Non-Tax revenues, and $653.8 million in Revenue from Other Governments. These three sources comprise 98% of the revenues anticipated for the FY13 budget.

OBPE employs a number of approaches to developing its forecasts of local revenues:

a. Forecasts of economic activity provided by several sources including the Congressional Budget Office and the Blue Chip Economic Indicators;

b. Continuous evaluation of national and local economic data on employment, inflation, interest rates, and economic growth;

c. Ongoing examination of the City's current tax receipts;

d. Economic forecasting of tax revenues provided by a revenue forecasting consultant;

e. Discussions with economists at the Federal Reserve Bank of Philadelphia; and

f. The extensive experience of its staff.

OPBE's tax projections for the FYP were developed in conjunction with a revenue forecasting consultant, IHS Global Insight, Inc (IHS). IHS created econometric models which included variables such as wage and salary disbursements in the metropolitan statistical area (MSA) and the county, personal income in the county, the unemployment rate, home prices in the county, real estate transaction growth, and national corporate profits. These models, together with their forecast of the Philadelphia economy, were used by IHS to project tax revenues for the City. IHS focused on four taxes – Wage and Earnings Tax, Business Privilege Tax, Real Estate Transfer Tax, and Sales Tax. These projections were refined by OBPE after discussions with leading economists at the Federal Reserve Bank of Philadelphia.

## 2. The National and Local Economic Context

As is the case with municipalities across the country, the City experienced significant tax revenue declines during the deep world-wide recession of 2007-2009. Since 2008, governments and businesses across the globe have had to grapple with a world economy beset by a profound financial crisis, large declines in residential housing markets, a global contraction in economic activity, and a weak job market characterized by high unemployment. The economic recovery has been slow and while tax revenues have rebounded somewhat, the level of growth witnessed in years prior to 2007 is not expected to return. In addition, revenues from some taxes have yet to hit the level they attained before the recession.

Growth in the United States' output since the middle of 2009 has been very weak compared to previous economic recoveries. Following weak growth in the first two quarters of 2011, the financial rating agency, Standard & Poor's, cut the U.S.'s AAA credit rating in August 2011, further exacerbating economic concerns. U.S. gross domestic product (GDP) increased only 1.7% in 2011. This was weaker than the growth of 3.0% seen in 2010, the first year of the economic recovery.[1] In contrast to this weak growth in 2011, real GDP grew 5.6% during the second year of recovery following the recession of 1981-1982. Economists believe that recoveries following a financial crisis are weaker and more prolonged as businesses and households reduce debt before increasing spending (compared to recoveries that do not follow a financial crisis).[2] Consensus forecasts of U.S. GDP growth are projected to be 2.1% in 2012 and 2.3% in 2013. National unemployment is projected to

[1] Blue Chip Economic Indicators February 10, 2012
[2] Blue Chip Economic Indicators August 10, 2011

decline but still remain high. According to the Blue Chip consensus, unemployment is expected to be 8.2% in 2012, declining to 7.8% in 2013. [3] All of this taken together signifies that the economy is anticipated to improve, albeit at a slower pace than in most past recoveries from recession.

Philadelphia has been substantially impacted by the economic crises described above. The number of people employed dropped from 593,800 in April 2009 to a low of 572,100 in October 2010, rebounding slightly to 578,300 in April 2012, a decline of 2.6% since 2009. Unemployment has had a sizable increase, from 6.0% in August 2007 to a high of 11.2% in November 2010 and has improved somewhat to 10.3% in April 2012. [4] Employment levels are particularly important for Philadelphia's budget because it is heavily reliant on the Wage Tax.

### 3. The City's Major Taxes

The City receives revenue to fund its services and programs from six major taxes (contributing to 73% of the expected General Fund revenue in FY13). These include:

1. Wage and Earnings and Net Profit Tax (Wage),
2. Property Tax,
3. Business Income and Receipts Tax (BIRT),
4. Real Estate Transfer Tax (RTT),
5. Sales Tax, and
6. Parking Tax.

The remaining taxes, including the amusement tax, provide less than 1% of General Fund revenue. Philadelphia's reliance on the Wage Tax (34% of the General Fund) and the BIRT (11%) places the City at risk from economic trends and employment fluctuations of the local economy. Other cities and counties that rely more heavily on property tax revenues are more susceptible to dramatic shifts in the housing market.

[3] Blue Chip Economic Indicators July 10, 2012
[4] Pennsylvania Department of Labor and Industry, Monthly Seasonally Adjusted Unemployment Rates

**a. Wage Tax**

The largest tax revenue source (comprising 47% of tax revenues) is the Wage, Earnings, and Net Profits (Wage) tax. The Wage Tax is collected from all employees working within city limits, and all City residents regardless of work location. Currently, the Wage Tax rate is 3.9280% for residents and 3.4985% for non-residents. The resident rate includes 1.5% that is reserved for the PICA. PICA has overseen the City's finances since 1992, when the State Oversight Board was first established. The PICA statute permits the Authority to a "first dollar" claim on its portion of Wage Tax proceeds, which is used to pay debt service on bonds issued by PICA for the benefit of the City. Excluding the PICA portion, the Wage Tax is projected to bring in $1.220 billion in FY13. This projection includes a 3.4% growth rate in the Wage and Earnings Tax and a 2.5% expected growth rate in the Net Profits Tax. [5] In FY14, assuming that the City's fund balances remain consistent with or higher than those in the FYP, the City plans to resume previously planned wage tax reductions that were suspended in FY10.

**b. Property Tax**

The Real Property Tax (Property) is the City's second largest source of tax revenue (20%), estimated to contribute $514.9 million of the FY13 tax revenues. This tax is levied on the assessed value of residential and commercial property in the City. The City's portion of the property tax rate was increased to $4.462 for FY13 to fund a $20 million additional contribution to the School District and to protect against increased appeal losses. FY12 property tax receipts are coming in stronger than anticipated due to better collections so projections have been revised upwards in the Plan to reflect the higher 5-year average collection rate.

**c. Business Income and Receipts Tax**

The Business Income and Receipts Tax (BIRT, formerly the Business Privilege Tax) is projected to produce $394.9 million in FY13, 15% of total tax revenue. The majority of the BIRT is derived from corporate profits which had solid years in calendar years 2010 and 2011 but are volatile and dependent on economic conditions within the City. In FY12, BIRT tax reform legislation was signed by the Mayor which incorporated several changes intended to help small and medium size businesses grow in Philadelphia. Under Bill 110548, business taxes for the first two years of operations for all new businesses that employ at least three employees in their first year and six in the second would be eliminated beginning in FY13. This legislation also provides for across the board exclusions on the gross

[5] Growth rates referenced throughout these notes are applied to the current portion of the tax base.

receipts portion for all businesses scaled in over a three year period beginning in FY15 and reductions in the net income portion of the BIRT. When the exclusions are fully phased in, the first $100,000 of receipts will be excluded. Lastly, the bill calls for implementation of single sales factor apportionment. This enables businesses to pay BIRT solely on sales, not on property or payroll. By taxing property and payroll, the BIRT previously had provided disincentives to firms to locate in the City.

**d. Sales Tax**

Sales Tax revenues are projected to generate $259.3 million in FY13, 10% of tax revenues. As part of its response to projected budget deficits in 2009, the City passed new legislation which was approved by the Commonwealth of Pennsylvania (the Commonwealth) to temporarily increase the Sales Tax rate from 1% to 2%. This raised the total Sales Tax rate to 8%, with 6% going to the Commonwealth and 2% to the City. The increased rate is scheduled to be in effect through FY14 and return to 7% in FY15.

**e. Real Estate Transfer Tax**

Economic conditions have negatively affected the Real Estate Transfer Tax (RTT) since the housing market decline began in 2007; however, RTT revenues grew slightly from FY11 to the FY12 estimate. The RTT is projected to provide $124.5 million in FY13; a growth rate of 5.2% over FY12 anticipated collections. A growth rate of 9.0% is projected for FY14-FY16 and a lower growth rate of 3.0% is projected for FY17. Even with projected strong growth for transfer tax revenues, the $166 million the Plan includes for FY17 is almost $70 million below the $234 million in transfer tax revenues collected in FY06. The City imposes a 3% tax on real property sales and an additional 1% is charged by the Commonwealth for a 4% total RTT.

**f. Parking Tax**

The parking tax is levied on the gross receipts from all parking transactions. Parking tax revenue is projected to generate $75.1 million in FY13.

| Major Taxes ($ in Millions) with Percentage Change from Previous Year | | | | | | | |
|---|---|---|---|---|---|---|---|
| **Tax** | **FY11 Actual** | **FY12 Estimate** | **FY13 Estimate** | **FY14 Estimate** | **FY15 Estimate** | **FY16 Estimate** | **FY17 Estimate** |
| Wage & Net Profits - Current & Prior | 1,143.1 | 1,180.5 | 1,220.1 | 1,259.4 | 1,300.1 | 1,320.5 | 1,335.6 |
| % change from prior year | n.a. | 3.3% | 3.4% | 3.2% | 3.2% | 1.6% | 1.1% |
| Real Property - Current & Prior | 482.7 | 498.5 | 514.9 | 525.9 | 544.0 | 557.4 | 571.2 |
| % change from prior year | n.a. | 3.3% | 3.3% | 2.1% | 3.4% | 2.5% | 2.5% |
| Bus. Income & Receipts - Current & Prior | 376.9 | 391.4 | 394.9 | 402.9 | 393.9 | 379.4 | 383.0 |
| % change from prior year | n.a. | 3.8% | 0.9% | 2.0% | -2.2% | -3.7% | 1.0% |
| Sales | 244.6 | 250.2 | 259.3 | 271.5 | 143.2 | 150.4 | 155.6 |
| % change from prior year | n.a. | 2.3% | 3.7% | 4.7% | -47.2% | 5.0% | 3.5% |
| Real Property Transfer | 116.6 | 118.4 | 124.5 | 135.8 | 148.0 | 161.3 | 166.1 |
| % change from prior year | n.a. | 1.5% | 5.2% | 9.0% | 9.0% | 9.0% | 3.0% |
| Parking | 71.6 | 73.3 | 75.1 | 77.0 | 78.9 | 80.9 | 82.9 |
| % change from prior year | n.a. | 2.4% | 2.5% | 2.5% | 2.5% | 2.5% | 2.5% |
| Other Taxes | 23.5 | 25.0 | 25.5 | 25.9 | 26.4 | 26.9 | 27.4 |
| % change from prior year | n.a. | 6.3% | 1.9% | 1.8% | 1.9% | 1.9% | 1.9% |
| **Total Taxes** | **2,459.1** | **2,537.1** | **2,614.4** | **2,698.5** | **2,634.5** | **2,676.7** | **2,721.9** |
| **% Change from prior year** | **n.a.** | **3.2%** | **3.0%** | **3.2%** | **-2.4%** | **1.6%** | **1.7%** |
| Note: Wage & Net Profits Taxes include rate reductions that will resume in FY14. Business Income & Receipts Tax incorporate rate reductions in recently passed legislation that will begin in FY13. The reduced estimate for the Sales Tax in FY15 is due to the sunsetting of the temporary 1% increase that began in FY10. Other Taxes include the Amusement Tax and miscellaneous taxes. Wage tax does not include the PICA tax. | | | | | | | |

### 4. Locally Generated Non-Tax Revenues

Locally Generated Non-Tax revenues are estimated based on historical trends, rate changes, and current collection patterns. Certain revenues such as interest earnings, licenses and permits and recording fees are subject to economic contractions and are estimated accordingly.

### 5. Revenue from Other Governments

Revenue from Other Governments is estimated based on historical trends and state and federal budget information. The PICA City account which represents 46% of Revenue from Other Governments is estimated using Wage Tax variables.

## 6. Obligation Estimates

The City OBPE provided obligation estimates to the Director of Finance and the Mayor for discussion and inclusion in the revised annual FY2013 budget and FY2013-2017 Five-Year Financial Plan (FYP) submitted by the Mayor to the PICA on August 9, 2012. OBPE provides forecasts of all major expenditure categories. In the FY13 budget, total expenses increase $133 million from FY12 estimated obligations, $107 million of that increase is caused by rising pension, other employee benefits and debt service costs. The remaining $26 million represents a 0.8% increase.

**FY 13 Expenditure Increases**:

The largest single investment in the FY13 Adopted Budget is an additional $20 million contribution to the School District of Philadelphia funded by an increase in the City portion of the property tax. Due to the provisions of the Commonwealth of Pennsylvania's Act 46, these additional funds are now a permanent part of the City's contribution.

The Adopted Budget also includes investments in the following:

- $9.0 million for the Public Property Department for the initial design work for a new police headquarters, City morgue, and health offices co-located at 4601 Market Street. This is a consolidation which could provide needed facility upgrades while allowing the sale of existing City assets and revitalizing part of West Philadelphia in need of investment. The City has requested $9.0 million from PICA for this one-time cost.
- $4.1 million for the Police Department will fund the hiring of close to 400 officers by the end of FY13 to increase the uniform officer level to 6,525 and maintain it at that level with expected levels of employee retirement.
- $1.2 million for the Office of Supportive Housing for housing contracts to replace beds available at the Ridge Avenue Center which is closing.
- $1.1 million of additional funding for the Office of Property Assessment towards the complete overhaul of the property tax assessment system.
- $200,000 for the Managing Director's Office to fund anti-violence initiatives across the City.
- $734,000 to fund a maintenance team in the Public Property Department to prevent deferring maintenance in City buildings.

In addition to the additional investments listed above, the distribution of funding between departments also changed. These changes included transferring $8.8 million from the First Judicial District to the Managing Director's Office which will be managing this payment of conflict counsel fees starting in FY13. In order to consolidate court counsel costs under the Managing Director's Office, the $37 million Legal Services budget (supporting the Defender's Association, Community Legal Services, and the Support Center for Child Advocates) was moved from Finance to the Deputy Mayor for Public Safety's allocation within the Managing Director's Office starting in FY13.

**a. Labor Agreements**

The City's labor agreements with its four major bargaining units – FOP Lodge No. 5, IAFF Local 22, DC 33 and DC 47 – expired on June 30, 2009. An interest arbitration award to the FOP was made in FY 10. Contracts with DC 33 and DC 47 remain outstanding. Except for its pension provisions, the interest arbitration award granted to the IAFF on October 12, 2010 was appealed by the City. The Court of Common Pleas vacated the 2010 Award on November 16, 2010. On July 2, 2012, a new interest arbitration award was issued and the City will again appeal the award.

**<u>AFSCME District Council 33, Local 159</u>**

On March 16, 2012, a six year interest arbitration award with AFSCME District Council 33, Local 159 was issued to cover FY09 through FY14. Local 159 governs the wages of approximately 2,000 employees who work as Correctional Officers, Youth Detention Counselors and Security Guards throughout facilities in the City's Prison System as well as in the Department of Human Services and the Police Administration Building. Important financial components of the award that affect FY13 through FY17 include:

- Two and one-half percent wage increases for covered employees on July 1, 2012 (FY13) and July 1, 2013 (FY14).
- Restoration of step and longevity increments that were frozen by the City in July 2009. Restoration was effective with the issuance of this award.
- No specific changes to the Health Plan. Any future changes to District Council 33 will automatically apply to employees covered by the award.
- Any employee hired or rehired to a position covered under the award must participate in

the new hybrid Pension Municipal Plan 10. Current employees may elect to make an irrevocable move to Plan 10.

- Effective, July 1, 2012 the uniform maintenance allowance for employees covered by the award is increased to $250 per year (previously paid at $175 per year).
- Only vacation leave (excluding holiday pay, sick time or annual leave days) will be considered hours worked for purposes of determining when overtime is due.

The FYP includes estimates for all of the above costs as well as savings related to FY13 through FY17.

**AFSCME District Council 47, Local 810 Courts**

On July 12, 2012, a five year interest arbitration award with AFSCME District Council 47, Local 810 Courts was issued to cover FY10 through FY14. The Local 810 Courts bargaining unit titles include Probation Officers, Hearing Officers and Court Representatives. Important financial components of the award that affect FY13 through FY17 include:

- Two and one-half percent wage increases for covered employees on July 1, 2012 (FY13) and July 1, 2013 (FY14). Any wage increases negotiated with the larger District Council 47 bargaining unit for FY10 or FY11 will automatically apply to Local 810.
- No specific changes to the Health Plan. Any future changes to the larger District Council 47 will automatically apply to employees covered by the award.
- Any employee hired to a position covered under the award must participate in the new hybrid Pension Municipal Plan 10. Current employees may elect to make an irrevocable move to Plan 10.
- The award contains a reclassification of Probation Officer 2 from EP Range 21 to EP Range 22 effective July 1, 2012. The City is dissenting from this portion of the award, which it thinks went beyond the arbitration panel's authority. As a result, increased costs pertaining to this salary adjustment are not reflected in the FYP.

The FYP includes estimates for the above costs except as noted as well as savings related to FY14 through FY17.

**I.A.F.F.**

On July 2, 2012, a four year interest arbitration award with the IAFF was issued to cover FY10 through FY13. Though the terms of the award are similar to those in the FOP award and takes a crucial step toward reform by establishing a hybrid pension system, it imposes more than $203 million in new costs through FY17 without giving the City the required tools to manage these costs. Unlike the award for FOP members this award does not give the City the right to furlough, which could have been used to help fund the added cost of a contract. As a result, the City plans to appeal this award.

The portion of the award not appealed from the 2010 Award and already implemented is the change to the IAFF members' pension plan. Similar to the pension changes made in the arbitration award with the FOP, new IAFF members as of October 15, 2010, must choose between increasing their pension contribution from 5% to 6% of pay or enrolling in a new hybrid pension plan.

Pending the outcome of the City's appeal of the IAFF interest arbitration award, the forecasted statements do not include any of the potential new costs of more than $203 million associated with the award since the City expects a favorable outcome on appeal. Accordingly, this assumption is considered particularly sensitive.

**F.O.P. Lodge 5**

On December 18, 2009, a five year interest arbitration award with the FOP, Lodge No. 5 was issued to cover FY10 through FY14. Important financial components of the award that affect FY13 through FY17 include:

- The award will be reopened for FY13 and FY14 for a determination by the arbitration panel as to what salary changes, if any, will be awarded for those two years.
- In FY11, the FOP's health plan moved to self insurance. Instead of paying a carrier for insurance, the FOP began paying the actual cost of services provided to members. This health insurance change followed a similar change made by the City in FY10 to the plan it administers for non-union employees. The FYP includes an estimate for these costs

based on an average of six months of actual FY12 expenditures increased by 10% per year based on medical cost trends.

- Pension changes for new hires – FOP members will now choose between increasing their pension contribution from 5% to 6% of pay and enrolling in a new hybrid pension plan. The hybrid pension plan reduces the risk to the City of poor market returns and is unprecedented for uniformed employees in any major city in the country. Meanwhile, increased employee pension contributions provide General Fund savings for the City.
- Up to 30 furlough days (off without pay) in a fiscal year.

**F.O.P. – Deputy Sheriffs and Register of Wills**

On June 21, 2011, a five year interest arbitration award with the FOP, Lodge No. 5 concerning Deputy Sheriffs and Register of Wills employees was issued to cover FY10 through FY14. Important financial components of the award that affect FY13 through FY17 include:

- The award will be reopened for FY13 and FY14 for a determination by the arbitration panel as to what salary changes, if any, will be awarded for those two years. Register of Wills employee wage increases will be based on what is negotiated between DC 33 and the City.
- Restoration of step and longevity increments that were frozen by the City in July 2009. Increments were restored retroactively to July 1, 2009 for employees of the Sheriff's Office and restored as of the date of the award for Register of Wills' employees.
- The FOP's health plan, which includes Deputy Sheriffs, moved to self insurance in FY11. This award continues that arrangement. It also reduced the City's monthly contribution from $1,165 per member to $965 per member for the period January 1, 2010 through June 30, 2010. The City will get a credit for contributions already made. Register of Wills employees will continue to participate in the City Administered plan.
- Pension changes for new hires. Deputy Sheriffs will have to choose between going into the existing municipal Plan 87 and increasing their contribution from 30% of normal cost to 50% of normal cost, or going into the new hybrid plan. Register of Wills employees hired after the date of the award must enter the hybrid plan.

**AFSCME District Council 33 and District Council 47**

Negotiations continue with the City's other two major municipal unions, DC 33 and DC 47. The City seeks changes in the structure of health and welfare benefit funding, as well as changes in overtime rules and the right to furlough employees, similar to the FOP award, as part of an overall contract package that the City can afford.

The City also seeks to require all new employees to enter the new hybrid pension plan put in place by the award covering the employees of the Sheriff's Office, Register of Wills, Correctional Officers and Local 810 Courts and contains increased pension contributions from employees.

The Administration is committed to having reasonable collective bargaining agreements in place as early as possible. Those contracts must, however, be affordable in the short-term and provide long-term reform.

The forecasted statements do not include any potential changes in costs or achieved savings related to the outcome of the ongoing negotiations with DC 33 and DC 47 since the City expects the effects of any new contract to be expense neutral. Accordingly, this assumption is considered particularly sensitive.

**b. Health / Medical**

The Administration implemented a self-insured group health plan in 2010 for medical benefits for non-union employees. In FY11, coverage for members of the Fraternal Order of Police (FOP), Lodge No. 5 also switched to self-insurance. For non-union employees, an average of six months of experience was used to determine cost estimates in the FYP. No increases were built in for the life of the plan as the City can change the design of the health plan (increase co-pays and employee contributions for example) to keep costs level. For the FOP six months of actual experience was used to estimate the annual cost. However, because the City has no control over the design of the FOP health plan, an increase of 10% per year based on medical cost trends has been included.

Cost estimates for DC 33 and DC 47 are based on an average of six months of actual expenditures in FY12 which is used to estimate the annual cost. Because there are no new contracts for these groups and therefore no change in the per member, per month City contribution, it is assumed costs for FY13 – 17 will approximate the FY12 average expenditure of $117.6 million per year and $587.8 million over the life of the forecast.

As the 2012 arbitration award to the IAFF has been appealed the move to self-insurance included in the award has not been implemented. For that reason, the cost estimate of $39.2 million per year and $196 million over the life of the plan for the IAFF is based on an average of six months of actual expenditures under the provisions of the expired contract ($1,270 per employee, per month) with no increase assumed for the life of the plan.

**c. Pensions**

As part of the effort to control major cost drivers and to improve the health of the pension fund, several changes have been made over the past few years and the Administration continues to seek additional changes.

The City of Philadelphia's Act 111 interest arbitration award with the Fraternal Order of Police (FOP), Lodge No. 5 issued on December 18, 2009 requires all FOP employees hired on or after January 1, 2010 to make a one-time irrevocable election between:

1) Participating in the City's current defined benefit pension plan and increasing their contribution by 20%, from 5% to 6%; or
2) Participating in a hybrid plan, containing both a defined benefit and a voluntary defined contribution component.

Similar pension changes were awarded in the October 12, 2010 interest arbitration award with IAFF, Local 22. The award's pension provisions were not part of the 2010 Award appeal and, therefore, have been implemented. New IAFF members hired as of October 15, 2010, must make the same one-time irrevocable election between increasing their pension contribution from 5% to 6% of pay or enrolling in a new hybrid pension plan.

The new Municipal Plan 10 hybrid plan for Uniform employees includes the following elements:

1) Employee Contribution: A 5.5 % employee contribution for the first 20 years of service, and no employee contribution thereafter.
2) Normal Retirement Benefit: A defined benefit equal to 1.75% multiplied by the average final

compensation for the employee, multiplied by up to a maximum of 20 years of service.

3) Average Final Compensation: The average of the employee's 5 highest annual compensations calculated for either five calendar years or 5 anniversary years.
4) After 20 years of credited service, employees will no longer earn credited service, will no longer make contributions to the pension fund and their average final compensation shall not increase.
5) Voluntary Defined Contribution Plan: Employees may make voluntary contributions to their accounts under the City's 457 Plan. For each fiscal year, the City will make a contribution to a defined contribution plan individual account of 50 cents on the dollar for each dollar contributed by the employee to their 457(b) plan account, up to a maximum City contribution of 1.5% of compensation.

Municipal Plan 10 for Civilians is a hybrid plan with a mandatory defined benefit and a voluntary defined contribution component. This plan is mandatory for new hires in both the DC 33 Local 159 and the DC 47 Local 810 Courts arbitration awards. Key elements of Plan 10 include:

1) Years of Credited Service: Only the first 20 years will be calculated.
2) Average Final Compensation: City will take the 5-year period in which the employee's compensation is greatest.
3) Multiplier: 1.25% x Years of Credited Service up to 20 x Average Final Compensation.
4) Employees will contribute 50% of normal cost of the Plan toward the defined benefit.
5) Voluntary Defined Contribution Plan: the City will contribute $1 for every $2 the employee contributes up to 3% of the employee's compensation contributed to the Defined Contribution Plan. The City will contribute no more than 1.5% of eligible compensation.

Increasing employee pension contributions and introducing a hybrid pension plan are expected to reduce the costs to the City in the short and long term and help minimize the risk that the City faces from dramatic decreases in the stock market, like the ones suffered in FY09. Similar pension benefit changes are being sought as part of the City's ongoing negotiations with DC 33 and DC 47.

In addition to the changes in pension benefits over the past few years as outlined above, the City's pension fund has undergone the following changes:

- Re-amortized the pension fund's unfunded actuarial accrued liability over a 30-year period using level-dollar amortization payments.

- Deferred payment of a portion of its Minimum Municipal Obligation (MMO) to be repaid by end of the fiscal year ending June 30, 2014 with 8.25% interest, which was the fund's earnings assumption rate when the state law enabling the deferrals was enacted. The City deferred about 20% of its pension costs, $150 million and $80 million for the fiscal years ending June 30, 2010, and June 30, 2011, respectively.
- Eliminated the eligibility of newly elected City officials to participate in Philadelphia's DROP.
- Reduced the pension fund's earnings assumption from 8.75% to 8.10% for Fiscal Years' 2013 through 2017. Lower earnings assumptions allow funds to moderate the risk of their investments, which can also reduce the likelihood of losses.
- Increased the smoothing period for actuarial losses and gain from five to ten years. Increasing the smoothing period reduces the impact that any particular year will have on the fund's funded status and on the City's required payments. This, in turn, reduces the volatility of pension payments.

The net impact of all of these changes to the City's pension benefits and fund is to moderate what would have been devastating increases in pension costs over the five year plan and to increase the City's ability to fund existing liabilities in the long term. The specific changes to the pension fund assumptions have been tested by the City's actuary and have been determined to be actuarially sound. Yet despite these proactive changes, pension costs will continue to rise. Costs will be substantially higher each year from FY13 through FY17 than they were in FY12. That increase is caused in part by the deferral of FY10's and FY11's payments to FY13 and FY14. The pension amounts included in the FYP are provided by the City's actuary and are based on the amounts required to be paid under state law.

**D. Projected Effect of Unfavorable Outcome to the City of the IAFF Interest Arbitration Award**

As discussed in Note A, the accompanying Supplemental Projected General Fund Statements of Operations illustrate the effect of an unfavorable outcome to the City pertaining to the IAFF interest arbitration award at one of three hypothetical levels of the reduction of forecasted expenditures. Those statements are presented for analysis purposes only because it is not expected that the expenditure reductions will occur. The three hypothetical cases are based on the following:

**Case 1** — the City will reduce expenditures by 2%. A 2% reduction would be taken across multiple City departments and result in lowering expenditure levels by more than $24.8 million in each year of the FY13 to FY17 financial forecast. Reductions would be taken across major expenditure classes including: Personal Services, Fringe Benefits, Purchase of Services, Materials, Supplies and Equipment, Contributions and Debt Service. Although Case 1 assumes a 2% reduction in expenditures, it is unlikely the City will implement this scenario because it would fail to provide for balanced budgets in the final four years of the plan.

**Case 2** — the City will reduce expenditures by 4%. A 4% reduction would be taken across multiple City departments and result in lowering expenditure levels by more than $44.0 million in each year of the FY13 to FY17 financial forecast. Reductions would be taken across major expenditure classes including: Personal Services, Fringe Benefits, Purchase of Services, Materials, Supplies and Equipment, Contributions and Debt Service.

**Case 3** — the City will reduce expenditures by 5%. A 5% reduction would be taken across multiple City departments and result in lowering expenditure levels by more than $59.4 million in each year of the FY13 to FY17 financial forecast. Reductions would be taken across major expenditure classes including: Personal Services, Fringe Benefits, Purchase of Services, Materials, Supplies and Equipment, Contributions and Debt Service.

Under each of the above hypothetical cases, it is assumed that the City has the authority to make the expenditure reductions.

## City of Philadelphia - Office of the Director of Finance

### Supplemental Projected General Fund Statements of Operations if City Exhausts All Appeals on Award Unsuccessfully and City Implements 2% Reductions

### Fiscal Years Ending June 30, 2013 through June 30, 2017

(Amounts in Thousands)

| NO. | ITEM | FY 2013 Estimate | FY 2014 Estimate | FY 2015 Estimate | FY 2016 Estimate | FY 2017 Estimate |
|---|---|---|---|---|---|---|
| (1) | (2) | (3) | (4) | (5) | (6) | (7) |
| | **OPERATIONS OF FISCAL YEAR** | | | | | |
| | **REVENUES** | | | | | |
| 1 | Taxes | 2,614,398 | 2,698,477 | 2,634,532 | 2,676,741 | 2,721,889 |
| 2 | Locally Generated Non-Tax Revenues | 243,923 | 245,311 | 250,415 | 253,753 | 257,079 |
| 3 | Revenue from Other Governments | 653,817 | 611,779 | 626,789 | 640,275 | 653,379 |
| 4 | Sub-Total (1)+(2)+(3) | **3,512,138** | **3,555,567** | **3,511,736** | **3,570,769** | **3,632,347** |
| 5 | Revenue from Other Funds of City | 53,253 | 52,463 | 45,247 | 46,557 | 47,982 |
| 6 | Total - Revenue (4)+(5) | **3,565,391** | **3,608,030** | **3,556,983** | **3,617,326** | **3,680,329** |
| 7 | Other | 0 | 0 | 0 | 0 | 0 |
| 8 | **Total Revenue and Other Sources (6)+(7)** | **3,565,391** | **3,608,030** | **3,556,983** | **3,617,326** | **3,680,329** |
| | **OBLIGATIONS/APPROPRIATIONS** | | | | | |
| 9 | Personal Services | 1,365,123 | 1,357,470 | 1,354,492 | 1,355,028 | 1,355,494 |
| 10 | Personal Services-Pensions | 629,106 | 660,364 | 567,640 | 588,970 | 606,242 |
| 11 | Personal Services-Other Employee Benefits | 536,809 | 515,927 | 530,446 | 547,900 | 567,490 |
| 12 | **Sub-Total Employee Compensation** | **2,531,038** | **2,533,761** | **2,452,578** | **2,491,898** | **2,529,226** |
| 13 | Purchase of Services | 759,778 | 755,708 | 750,527 | 747,804 | 754,042 |
| 14 | Materials, Supplies and Equipment | 78,242 | 75,111 | 76,463 | 76,065 | 76,065 |
| 15 | Contributions, Indemnities, and Taxes | 137,438 | 136,998 | 137,059 | 137,620 | 137,182 |
| 16 | Debt Service | 125,433 | 126,650 | 147,579 | 144,048 | 161,323 |
| 17 | Capital Budget Financing | 0 | 0 | 0 | 0 | 0 |
| 18 | Advances and Miscellaneous Payments | 0 | 0 | 0 | 0 | 0 |
| 19 | Sub-Total (12 thru 18) | 3,631,929 | 3,628,228 | 3,564,206 | 3,597,435 | 3,657,838 |
| 20 | Payments to Other Funds | 31,138 | 32,219 | 33,291 | 35,115 | 36,936 |
| 21 | **Total - Obligations (19+20)** | **3,663,067** | **3,660,447** | **3,597,497** | **3,632,550** | **3,694,774** |
| 22 | Oper.Surplus (Deficit) for Fiscal Year (8-21) | (97,676) | (52,417) | (40,514) | (15,224) | (14,445) |
| 23 | **Prior Year Adjustments:** | | | | | |
| 24 | Revenue Adjustments | 0 | 0 | 0 | 0 | 0 |
| 25 | Other Adjustments | 18,500 | 18,500 | 18,500 | 18,500 | 18,500 |
| 27 | Total Prior Year Adjustments | 18,500 | 18,500 | 18,500 | 18,500 | 18,500 |
| 28 | **Adjusted Oper. Surplus/ (Deficit) (22+27)** | **(79,176)** | **(33,917)** | **(22,014)** | **3,276** | **4,055** |
| | **OPERATIONS IN RESPECT TO** | | | | | |
| | **PRIOR FISCAL YEARS** | | | | | |
| | Fund Balance Available for Appropriation | | | | | |
| 29 | June 30 of Prior Fiscal Year | 98,970 | 19,794 | (14,123) | (36,137) | (32,861) |
| 30 | Residual Equity Transfer | 0 | 0 | 0 | 0 | 0 |
| 31 | Fund Balance Available for Appropriation | | | | | |
| | June 30 (28)+(29)+(30) | **19,794** | **(14,123)** | **(36,137)** | **(32,861)** | **(28,806)** |

See accompanying summaries of significant accounting policies and assumptions and accountant's report.

# City of Philadelphia - Office of the Director of Finance

## Supplemental Projected General Fund Statements of Operations if City Exhausts All Appeals on Award Unsuccessfully and City Implements 4% Reductions

## Fiscal Years Ending June 30, 2013 through June 30, 2017

(Amounts in Thousands)

| NO. | ITEM | FY 2013 Estimate | FY 2014 Estimate | FY 2015 Estimate | FY 2016 Estimate | FY 2017 Estimate |
|---|---|---|---|---|---|---|
| (1) | (2) | (3) | (4) | (5) | (6) | (7) |
| | **OPERATIONS OF FISCAL YEAR** | | | | | |
| | **REVENUES** | | | | | |
| 1 | Taxes | 2,614,398 | 2,698,477 | 2,634,532 | 2,676,741 | 2,721,889 |
| 2 | Locally Generated Non-Tax Revenues | 243,153 | 244,541 | 249,645 | 252,983 | 257,079 |
| 3 | Revenue from Other Governments | 653,817 | 611,779 | 626,789 | 640,275 | 653,379 |
| 4 | Sub-Total (1)+(2)+(3) | **3,511,368** | **3,554,797** | **3,510,966** | **3,569,999** | **3,632,347** |
| 5 | Revenue from Other Funds of City | 53,253 | 52,463 | 45,247 | 46,557 | 47,982 |
| 6 | Total - Revenue (4)+(5) | **3,564,621** | **3,607,260** | **3,556,213** | **3,616,556** | **3,680,329** |
| 7 | Other | 0 | 0 | 0 | 0 | 0 |
| 8 | **Total Revenue and Other Sources (6)+(7)** | **3,564,621** | **3,607,260** | **3,556,213** | **3,616,556** | **3,680,329** |
| | **OBLIGATIONS/APPROPRIATIONS** | | | | | |
| 9 | Personal Services | 1,357,201 | 1,349,548 | 1,346,570 | 1,347,106 | 1,347,572 |
| 10 | Personal Services-Pensions | 629,106 | 660,364 | 567,640 | 588,970 | 606,242 |
| 11 | Personal Services-Other Employee Benefits | 533,640 | 512,758 | 527,277 | 544,731 | 564,321 |
| 12 | **Sub-Total Employee Compensation** | **2,519,947** | **2,522,670** | **2,441,487** | **2,480,807** | **2,518,135** |
| 13 | Purchase of Services | 752,799 | 748,729 | 743,548 | 740,825 | 747,063 |
| 14 | Materials, Supplies and Equipment | 77,616 | 74,485 | 75,837 | 75,439 | 75,439 |
| 15 | Contributions, Indemnities, and Taxes | 137,008 | 136,568 | 136,629 | 137,190 | 136,752 |
| 16 | Debt Service | 125,433 | 126,650 | 147,579 | 144,048 | 161,323 |
| 17 | Capital Budget Financing | 0 | 0 | 0 | 0 | 0 |
| 18 | Advances and Miscellaneous Payments | 0 | 0 | 0 | 0 | 0 |
| 19 | Sub-Total (12 thru 18) | 3,612,803 | 3,609,102 | 3,545,080 | 3,578,309 | 3,638,712 |
| 20 | Payments to Other Funds | 31,138 | 32,219 | 33,291 | 35,115 | 36,936 |
| 21 | **Total - Obligations (19+20)** | **3,643,941** | **3,641,321** | **3,578,371** | **3,613,424** | **3,675,648** |
| 22 | Oper.Surplus (Deficit) for Fiscal Year (8-21) | (79,320) | (34,061) | (22,158) | 3,132 | 4,681 |
| 23 | **Prior Year Adjustments:** | | | | | |
| 24 | Revenue Adjustments | 0 | 0 | 0 | 0 | 0 |
| 25 | Other Adjustments | 18,500 | 18,500 | 18,500 | 18,500 | 18,500 |
| 27 | Total Prior Year Adjustments | 18,500 | 18,500 | 18,500 | 18,500 | 18,500 |
| 28 | **Adjusted Oper. Surplus/ (Deficit) (22+27)** | **(60,820)** | **(15,561)** | **(3,658)** | **21,632** | **23,181** |
| | **OPERATIONS IN RESPECT TO** | | | | | |
| | **PRIOR FISCAL YEARS** | | | | | |
| | Fund Balance Available for Appropriation | | | | | |
| 29 | June 30 of Prior Fiscal Year | 98,970 | 38,150 | 22,589 | 18,931 | 40,563 |
| 30 | Residual Equity Transfer | 0 | 0 | 0 | 0 | 0 |
| 31 | Fund Balance Available for Appropriation June 30 (28)+(29)+(30) | **38,150** | **22,589** | **18,931** | **40,563** | **63,744** |

See accompanying summaries of significant accounting policies and assumptions and accountant's report.

# City of Philadelphia - Office of the Director of Finance

## Supplemental Projected General Fund Statements of Operations if City Exhausts All Appeals on Award Unsuccessfully and City Implements 5% Reductions

## Fiscal Years Ending June 30, 2013 through June 30, 2017

(Amounts in Thousands)

| NO. | ITEM | FY 2013 Estimate | FY 2014 Estimate | FY 2015 Estimate | FY 2016 Estimate | FY 2017 Estimate |
|---|---|---|---|---|---|---|
| (1) | (2) | (3) | (4) | (5) | (6) | (7) |
| | **OPERATIONS OF FISCAL YEAR** | | | | | |
| | **REVENUES** | | | | | |
| 1 | Taxes | 2,614,398 | 2,698,477 | 2,634,532 | 2,676,741 | 2,721,889 |
| 2 | Locally Generated Non-Tax Revenues | 242,933 | 244,321 | 249,425 | 252,763 | 257,079 |
| 3 | Revenue from Other Governments | 653,817 | 611,779 | 626,789 | 640,275 | 653,379 |
| 4 | Sub-Total (1)+(2)+(3) | **3,511,148** | **3,554,577** | **3,510,746** | **3,569,779** | **3,632,347** |
| 5 | Revenue from Other Funds of City | 53,253 | 52,463 | 45,247 | 46,557 | 47,982 |
| 6 | Total - Revenue (4)+(5) | **3,564,401** | **3,607,040** | **3,555,993** | **3,616,336** | **3,680,329** |
| 7 | Other | 0 | 0 | 0 | 0 | 0 |
| 8 | **Total Revenue and Other Sources (6)+(7)** | **3,564,401** | **3,607,040** | **3,555,993** | **3,616,336** | **3,680,329** |
| | **OBLIGATIONS/APPROPRIATIONS** | | | | | |
| 9 | Personal Services | 1,351,418 | 1,343,765 | 1,340,787 | 1,341,323 | 1,341,789 |
| 10 | Personal Services-Pensions | 629,106 | 660,364 | 567,640 | 588,970 | 606,242 |
| 11 | Personal Services-Other Employee Benefits | 531,326 | 510,444 | 524,963 | 542,417 | 562,007 |
| 12 | **Sub-Total Employee Compensation** | **2,511,850** | **2,514,573** | **2,433,390** | **2,472,710** | **2,510,038** |
| 13 | Purchase of Services | 746,176 | 742,106 | 736,925 | 734,202 | 740,440 |
| 14 | Materials, Supplies and Equipment | 77,074 | 73,943 | 75,295 | 74,897 | 74,897 |
| 15 | Contributions, Indemnities, and Taxes | 136,851 | 136,411 | 136,472 | 137,033 | 136,595 |
| 16 | Debt Service | 125,433 | 126,650 | 147,579 | 144,048 | 161,323 |
| 17 | Capital Budget Financing | 0 | 0 | 0 | 0 | 0 |
| 18 | Advances and Miscellaneous Payments | 0 | 0 | 0 | 0 | 0 |
| 19 | Sub-Total (12 thru 18) | 3,597,384 | 3,593,683 | 3,529,661 | 3,562,890 | 3,623,293 |
| 20 | Payments to Other Funds | 31,138 | 32,219 | 33,291 | 35,115 | 36,936 |
| 21 | **Total - Obligations (19+20)** | **3,628,522** | **3,625,902** | **3,562,952** | **3,598,005** | **3,660,229** |
| 22 | Oper.Surplus (Deficit) for Fiscal Year (8-21) | (64,121) | (18,862) | (6,959) | 18,331 | 20,100 |
| 23 | **Prior Year Adjustments:** | | | | | |
| 24 | Revenue Adjustments | 0 | 0 | 0 | 0 | 0 |
| 25 | Other Adjustments | 18,500 | 18,500 | 18,500 | 18,500 | 18,500 |
| 27 | Total Prior Year Adjustments | 18,500 | 18,500 | 18,500 | 18,500 | 18,500 |
| 28 | **Adjusted Oper. Surplus/ (Deficit) (22+27)** | **(45,621)** | **(362)** | **11,541** | **36,831** | **38,600** |
| | **OPERATIONS IN RESPECT TO** | | | | | |
| | **PRIOR FISCAL YEARS** | | | | | |
| | Fund Balance Available for Appropriation | | | | | |
| 29 | June 30 of Prior Fiscal Year | 98,970 | 53,349 | 52,987 | 64,528 | 101,359 |
| 30 | Residual Equity Transfer | 0 | 0 | 0 | 0 | 0 |
| 31 | Fund Balance Available for Appropriation June 30 (28)+(29)+(30) | **53,349** | **52,987** | **64,528** | **101,359** | **139,959** |

See accompanying summaries of significant accounting policies and assumptions and accountant's report.