Pennsylvania Intergovernmental Cooperation Authority

Staff Report on the City of Philadelphia's Five-Year Financial Plan for Fiscal Year 2015 - Fiscal Year 2019

PICA

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Pennsylvania Intergovernmental Cooperation Authority
1500 Walnut Street, Suite 1600, Philadelphia, PA 19102
Telephone: (215) 561-9160 ~ Fax: (215) 563-2570
Email: pica@picapa.org

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Executive Summary and Staff Recommendation

Based on a thorough analysis of the Plan, examination of PICA Act criteria and legislative intent, and an opinion by the City Controller, PICA staff recommends approval of the FY15-FY19 *Five-Year Financial Plan*. The following reasons present the rationale for approval:

Revenue and expenditure projections, as presented in the Plan, are "based on reasonable and appropriate assumptions and methods of estimation," which are "consistently applied," as required by the PICA Act. In addition, the preliminary revenue results for FY14 suggest another year of solid performance.

The fund balances in this year's Plan are higher than those in recent years. PICA staff is encouraged by the City's improved performance in this area. The initial version of the Plan submitted to PICA notably included a contribution to the budget stabilization fund in one of the years; unfortunately, this contribution was eliminated from the Plan due to changes in several actuarial assumptions adopted at the Pension Board's June meeting. However, the effort to set aside reserves in the stabilization fund was a positive step, in that it displayed the City's ultimate goal of focusing on that objective.

The current status of labor contracts is somewhat more stable than it was during last year's Plan review process. In the past fiscal year, the FY10-FY13 IAFF arbitration award was implemented retroactively, and a DC47 contract was negotiated to a conclusion. As a result, this year's estimates surrounding labor are less vulnerable. The City achieved progress by resolving the DC47 contract through FY17 and providing for increased employee contributions to pension costs for that union, as well as for non-represented civil service employees.

Preliminary investment results for FY14 suggest that the Pension Fund experienced higher than expected returns this past fiscal year. In the same vein, the Pension Board is continuing to apply its prudent strategy of lowering the expected rate of return. The Board also revised assumptions based on the most recent experience study. All of these efforts position the Pension Fund to pursue increased sustainability. However, in our analysis, we noted some challenges and risks that the City is facing related to pensions, which may adversely affect the Plan.

Despite the City's demonstrated ability to negotiate contracts, as displayed by the DC47 deal, the prevailing uncertainty regarding costs for DC33 presents a vulnerability for the Plan. Additionally, the Plan does not account for several of the smaller unions in its projections; many of these unions are in the early stages of arbitration/negotiations. Furthermore, although IAFF and FOP had contracts that were current through FY13 and FY14, respectively, they are both once again up for determination. The aggregate and potential cost for these groups is significant enough to present a risk.

Health costs are consistently on the rise, which has been a trend for years. This is an area of concern because the costs are rapidly increasing with limited provisions for savings and contingencies in the Plan.

Risk surrounding the School District is mostly unquantifiable due to a variety of unpredictable factors. The District's finances are precarious at best, with decreasing state funding and an uncertain cigarette tax. A positive turning point occurred when the new sales tax was approved, guaranteeing a $120 million revenue stream for the schools. Over time, the City has increased its role in providing assistance to the School District; however, this is a risk area because it remains unknown whether the City will need to provide additional assistance in the future.

Despite the above points on positive developments, the Pension Fund remains a very high risk area for the City. Similar to many municipalities around the country, Philadelphia is facing substantial challenges with regard to its unfunded liability, which is very high, especially as compared to the larger cities in the country. Although the Pension Board is incrementally lowering the expected rate of return, most agree that it still requires lowering. Furthermore, putting the funded ratio aside, assumptions always pose some level of risk to any pension fund.

I. Introduction

The PICA Act Criteria

The Pennsylvania Intergovernmental Cooperation Authority ("PICA") is mandated with assessing the strength of the City's annual Five Year Financial Plan (the "Plan"). The framework for evaluating the Plan is provided by the Pennsylvania Intergovernmental Cooperation Authority Act for Cities of the First Class ("PICA Act").

The City of Philadelphia's FY2015-FY2019 Five Year Financial Plan was submitted to PICA on June 26, 2014. This report will give an overview of the Plan, discuss potential risks, analyze projections, address spending, assess indicators of financial health, as well as comment on several areas of interest.

Legislative Intent

PICA was established for the main purposes of facilitating financial stability, helping to "achieve and maintain access to capital markets," eliminating deficits, and employing "sound budgetary practices."[1] In pursuing these goals, the PICA Act grants the Authority the opportunity to "make recommendations to an assisted city concerning its budgetary and fiscal affairs." In a section of the Act dedicated to legislative intent, the statute states that the Commonwealth created PICA based on its public policy interests to "foster the fiscal integrity of cities of the first class... and provide for proper financial planning procedures and budgeting practices." In a discussion of sound financial planning and budgetary practices, the Act "charge[s]" Philadelphia with the "responsibility to exercise efficient and accountable fiscal practices," which include: managerial accountability, consolidation/elimination of inefficient city programs, recertification of tax-exempt properties, increased collection of existing taxes, privatization of services, sale of city assets, improvement of procurement and competitive bidding practices, and review of compensation and benefits of city employees.

With these guiding principles in mind, PICA evaluates the Plan for reasonable and appropriate assumptions and methods of estimation. A key provision of the Act reads, "All revenue 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."

The legislative intent, evident throughout the Act, includes assuring that the City is prepared to manage not only the fiscal pressure the City was experiencing at the time PICA was established, but also to handle future pressure and safeguard against its consequences. In addition to evaluating assumptions, therefore, it is also important to consider the significance of a City safety-net. A reserve is something PICA has consistently advocated over the past decade. Although City Council created a Budget Stabilization Reserve Fund, the City has not been able to properly fund it because it has not reached the requisite surplus.

Evaluating Overall Plan Viability

In Section 209(2)(i), the Act outlines what a financial Plan ought to accomplish: "(i) eliminate any projected deficit for the current fiscal year and for subsequent fiscal 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."

The current Plan does eliminate deficits, as it has for years, and presents a balanced budget that projects General Fund revenues and expenditures for all five years. Furthermore, an increasing number of operating departments are working to enhance strategic planning in an effort to exercise better control over their expenditures, productivity, and in some cases, revenues. However, there still remains significant work to be done in this area. Although some operating departments are decidedly taking steps towards moving in the right direction, the approach to strategic planning needs to become more consistently

[1] Act of June 5, 1991, Pub. L. No. 9, 53 Pa. Stat. Ann. § 12720.203(a)-(b).

integrated into the financial planning process, so that the City will ultimately have the ability to "balance the... budget... in the financial plan through sound budgetary practices, including but not limited, reductions in expenditures, improvements in productivity, increases in revenues." Through this provision, as well as the legislative intent section of the Act, the language of the law points clearly to the idea that financial planning and strategic planning should come together to create an institutionalized, cohesive process.

Equally important is the need to "provide procedures to avoid a fiscal emergency condition in the future." This includes not only sound financial planning in the manner described in Section 209(2)(iii), but also refers to the establishment of a safety net. PICA has advocated for an employment of both of these strategies since its inception.

Assessing Assumptions

The language that assumptions must be "reasonable and appropriate" is limiting language in the Act and is intended to convey the idea that "reasonable" assumptions are those which take into account a worst case scenario, or at least provide some sort of safety net or strategy to minimize that scenario. This legislative intent has historically been interpreted by PICA staff to refer to certain risks over which the Authority has expressed consistent concern, including: the underfunded pension system, unsustainable and escalating annual health benefit costs, potential and/or pending labor costs, narrow fund balances, and the lack of reserve funds. PICA credits the City on facilitating larger fund balances in this year's Plan and hopes this will become a longstanding trend in the formulation of future Plans.

The terms "reasonable" and "appropriate" are not strictly defined in the Act, although there are some clarifying provisions that shed light on what constitutes reasonable and appropriate assumptions, especially with regard to revenue and expenditure projections.

The Act explains that estimates for tax revenues collected by the City should be "based on current or proposed tax rates, historical collection patterns, and generally recognized econometric models;" while revenues received from federal or state government should be based on "historical patterns," "currently available levels," or levels contained in a budget proposed by the Governor or President or in a Congressional budget resolution. Estimations of locally-generated non-tax revenues should be based on "current or proposed rates, charges or fees, historical patterns and generally recognized econometric models." The Plan does meet these criteria. Furthermore, the City derives projections on the growth of its tax base from forecasts created by IHS Global Insight. The forecasts are then reviewed by professional economists before they are used by the City to estimate the tax base.

With regard to expenditures, the Act explains that estimates should show "all obligations incurred during the fiscal year and estimated to be payable during the fiscal year or in the 24-month period following the close of the current fiscal year." Pursuant to this provision, the absence of some labor costs in assumptions may complicate the evaluation of any given Plan. The Act continues by stating that obligations from previous fiscal years "not covered by encumbered funds" should also be included in estimated expenditures. The current Plan does not take into account some obligations to labor that will likely become due "during the fiscal year or in the 24-month period following." The City sometimes anticipates prevailing in negotiations or litigation, and, as a result, leans on sensitive assumptions by not incorporating certain costs into the Plan.

These assumptions are referred to as sensitive because they are rooted in either pending negotiations or litigation. In other words, favorable outcomes for the City are uncertain, yet the Plan incorporates them as assumptions. The City has historically limited the obvious inclusion of all potential future labor costs. However, the question of unidentified wage and benefit increases is an important issue, as it proved to be last year in light of the substantial IAFF award. One could argue that because the FY15-FY19 Plan does not include costs associated with wage increases for some City employees and assumes limited increases in benefit costs for some of the unions, the expenditure assumptions in the Plan may pose a risk; there are potential wage and benefit costs not built into the Plan. Additionally, there are no provisions on how the City would handle a scenario where it potentially fails to achieve savings from pensions and health costs.

Structure of the Plan

First, the Act stipulates that the proposed operating budget and capital budget must be "consistent with the proposed financial plan." The Plan meets this test. Second, the Act states that the Plan must 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." Although the City has presented a Plan with supporting documents explaining most major assumptions, it does not provide a consolidated document that represents a reasonably detailed statement of how it calculated significant assumptions and what methods of estimation were used. Finally, the Act requires that estimates ought to be made on a modified accrual basis. The Plan meets this criterion, and all projections are shown in this manner. The City uses the modified accrual basis of accounting to recognize revenues and expenditures for budgeting purposes.

Overall, the Plan adheres to important provisions in the PICA Act with regard to structure, as well as how to formulate a significant portion of its assumptions. However, the Plan ought to consider the legislative intent of the Act in addressing certain core issues like institutionalizing the formulation of some assumptions and enhancing financial planning.

Risks to the Plan

Section III of this report quantifies some risks to the Plan. One of the main outstanding risks is the unresolved DC33 contract, which remains in limbo after five years. However, this Plan incorporates less risk than last year's because of the resolution of two major contracts, namely IAFF and DC47. Several of the bigger unions are again up for determination, including IAFF and FOP, however, these contracts are more up to date than in previous years, thus making the risk smaller and the current Plan less vulnerable than in the past.

Some of the quantifiable risks to the Plan involve wage increases and employee benefit costs, which have not yet been assumed. This includes benefit projections that do not anticipate increases in cost, as well as assumed pension savings that may not survive negotiations. Notably, the Plan does not account for benefit cost increases for several unions: DC33, DC47, IAFF, and City Administered. It is expected that, at least health care inflation, and possibly other factors, will lead to some form of increase in this area.

There are also unquantifiable risks to the Plan, including the potential for higher contributions to the Pension Fund if certain assumptions do not perform as expected, the state of the economy and its effect on revenues, potential for the provision of assistance to the School District, and other unforeseeable events like last year's winter.

In light of the aforementioned quantifiable and unquantifiable risks, the City's fund balance becomes important. One of PICA's consistent comments on each Plan throughout the years is the need for a more substantial fund balance. This year, the initial Plan submitted to PICA projected fund balances that were larger than usual, including a contribution to the budget stabilization fund in one of the years. Unfortunately, an update to one of the Pension Fund's assumptions reduced those projected fund balances and did away with the contribution to the stabilization fund. This illuminates the need for higher fund balances because it only takes one change to create a disturbance. The City ought to be prepared for several contingencies occurring at the same time. However, the Plan, as submitted, demonstrates the City's commitment to ensuring higher fund balances in the future. Although PICA recognizes that the City has demonstrated the ability to manage fiscal contingencies, we also maintain that this absolutely would be enhanced through the maintenance of a reserve.

Narrow fund balances, combined with a lack of money in the reserve fund, pose a risk to the Plan. Moreover, the Plan lacks information on where savings will come from in the future. While fund balances are higher in this Plan than in previous years, ideally they would become higher in the future, so as to meet GFOA standards. It is concerning that the fund balance is below optimal levels, while the Plan likely assumes insufficient increases to cover potential labor costs and potentially optimistic assumptions regarding pensions, among other sensitive projections mentioned above.

The GFOA recommends that governments, regardless of size, "maintain unrestricted fund balance in their general fund of no less than two months of regular general fund operating revenues or regular general fund operating expenditures." This is a general guideline that ought to be tailored based on the characteristics and needs of the government in question and an assessment of potential risks, previous impacts/problem areas, and other considerations.

Overall, the quantifiable risks posed to this year's Plan are less threatening than last year in light of the City's demonstrated ability to negotiate contracts, namely with DC47, as well as its ability to effectively manage costs associated with other unions, like IAFF. However, the best way to mitigate risks with upcoming contracts would be to account for more contingencies in the Plan and maintain a higher fund balance.

II. Analysis of Plan Projections

The Five-Year Financial Plan for Fiscal Years 2015 through 2019 was initially proposed by the Mayor on March 6, 2014. After passage of the FY15 operating and capital budgets by City Council, the City submitted to PICA, on June 26, a Five-Year Financial Plan for FY15-FY19. The June 26 Plan included refinements to the March 6 version to ensure that projected obligations were consistent with the FY15 operating budget enacted by City Council. Changes were also made to revenue estimates to take into account the latest revenue collections. In addition, the Plan changed the March 6 obligation projections to reallocate the projected cost of the FY10-FY17 District Council 47 labor contract from a single line item to individual agency line items. Table 2.1 below summarizes the primary elements of the Plan as a submitted on June 26.

The Plan projects significant operating deficits of $110.1 million in FY14 and $78.4 million in FY15. In FY14, the operating deficit reflects retroactive wages and benefits for uniformed firefighters and repayment of pension contributions deferred in FY10 and FY11. The FY15 operating deficit reflects retroactive wage and benefit costs included in the labor cost reserve, increased debt service, reduced business tax revenues due to tax reform, and the dedication of $120 million in sales tax revenues to the School District of Philadelphia. The projected operating deficit is reduced to $14.2 million in FY16, a reduction of $64.2 million. The projected sale of the Philadelphia Gas Works results in a one-time increase in General Fund revenues and expenditures of $700 million in FY15, as the Plan assumes that the net proceeds of the PGW sale will be received by the General Fund and paid to the Pension Fund in that year. Excluding the effect of this transaction, overall revenues increase $90.3 million from FY15 to FY16, while obligations increase $26.1 million, resulting in a substantial reduction in the operating deficit.

Beginning in FY17, the Plan projects operating surpluses. These surpluses are due to projected tax base growth, offset by lower tax rates for the wage, earnings, net profits, and business income and receipts taxes, and minimal projected labor cost growth after FY16. As detailed in Section III, there are substantial risks related to the Plan's projections of labor costs. These risks, if realized, and not offset by other cost saving or revenue generating initiatives, would result in operating deficits in the later years of the Plan and potentially result in negative fund balances.

The Plan, as submitted on June 26, projected a fund balance of $68.4 million in FY15 and $54.1 million in FY17. The Plan then projected an increase in the fund balance to $114.8 million in FY19. Notably, the Plan projected a $24.6 million contribution to the City's

Table 2.1 Summary of FY15-FY19 Five-Year Financial Plan ($ in Millions)

	FY13 Actual	FY14 Est.	FY15 Est.	FY16 Est.	FY17 Est.	FY18 Est.	FY19 Est
Plan as Submitted June 26							
Revenues	$3,698.0	$3,838.5	$4,425.7	$3,816.0	$3,899.7	$3,979.3	$4,053.6
Obligations	3,613.3	3,967.9	4,524.6	3,850.7	3,902.2	3,978.9	4,052.1
Prior Year Adjustments	25.4	19.4	20.4	20.4	20.4	20.4	20.4
Adjusted Operating Surplus/ (Deficit)	110.1	(110.1)	(78.4)	(14.2)	17.9	20.8	21.9
Prior Year Fund Balance	146.8	256.9	146.8	68.4	54.1	72.1	92.9
Current Year Fund Balance	256.9	146.8	68.4	54.1	72.1	92.9	114.8
July 14 Plan Supplement							
Increased Pension Obligations	--	--	--	14.5	14.9	9.9	7.4
Elimination of Payment to Budget Stabilization Reserve	--	--	--	--	--	--	24.6
Cumulative Impact	--	--	--	(14.5)	(29.4)	(39.3)	(22.1)
Fund Balance After Revision	256.9	146.8	68.4	39.6	42.7	53.6	92.7

Budget Stabilization Reserve Fund (BSRF) in FY19, reflecting a FY19 projected fund balance that exceeded 3 percent of appropriations. This was the first Five-Year Financial Plan submitted to PICA that included such a contribution. The BSRF was created by an amendment to the City Charter, approved by the voters in 2011. The Fund is designed to provide additional revenues to the City in the event of lower-than-budgeted revenues, or when necessary to prevent a disruption in services, or to fund emergency programs.

Even after the projected contribution to the BSRF, the Plan projected a $114.8 million fund balance in FY19. At 2.8 percent of appropriations, this fund balance was substantially higher than the fund balance projected in the final year of the initially approved FY14-FY18 Plan approved by PICA in September 2013. The initial version of the FY14-Fy18 Plan projected a FY18 fund balance of $15.4 million, or 0.4 percent of appropriations. The substantial increase in fund balance in the Plan, compared to the FY14-FY18 Plan, indicated improvement in the City's financial condition.

July 14 Plan Supplement

On July 14, the City Budget Director provided PICA with new pension obligation projections for the Plan,as a result of adjustments in actuarial assumptions adopted during the Pension Board's June meeting. These assumptions were changed as a result of an experience study, which suggested the need for revisions in key demographic assumptions. These changed assumptions alone increased the City's projected pension contributions by approximately $20 million per year, beginning in FY16.

The increase in pension obligations, according to an analysis provided by the Board of Pensions and Retirement's actuary, will be offset by the impact of experience gains due to higher than assumed investment returns in FY14. In addition, the actuary has indicated that increases in employee contributions, required as a result of recent legislation, will result in over $2 million in additional revenues to the pension system annually, beginning in FY16. These revenues, and the gains due to higher than expected investment returns, will offset the increased City costs due to revised actuarial assumptions. A copy of the actuary's analysis is included as an appendix to this report.

As shown in Table 2.1, the net effect of these changes is to increase City pension obligations by $14.5 million in FY16, $14.9 million in FY17, $9.9 million in FY18, and $7.4 million in FY19. The higher pension obligations have the effect of reducing the projected fund balance in FY19 below the threshold that requires a contribution to the Budget Stabilization Reserve Fund. Accordingly, the Plan does not include a contribution to the BSRF. The net impact of these changes is to reduce fund balances in each year of the Plan. The Plan projects a fund balance of $92.7 million in FY19, 2.3 percent of total appropriations.

The changes, required as a result of the adoption of new actuarial assumptions by the Board of Pensions and Retirement, are indicative of several important financial realities the City faces. Overall, the City's General Fund remains balanced by a slim margin. A change in one line item in the Plan, the pension obligation projection, was enough to reduce the fund balance to a point where a contribution to the City's BSRF is no longer required.

In addition, the impact of the change in actuarial assumptions on the FY15-FY19 Plan is another example of the sensitivity of City finances to the state of its pension system. With one of the lowest funding ratios of any major city pension system in the United States, the Philadelphia pension system remains a major financial challenge. It will remain a challenge for decades to fund the system on an actuarially sound basis, while also promoting tax competitiveness, fulfilling service requirements, and investing in economic development.

Pursuant to the supplemental information arising from the actuarial changes at the June Pension Board meeting, the reduction in fund balance underscores the importance of giving careful scrutiny to the financial risks faced by the City. Small deviations from Plan assumptions can have significant impacts on the General Fund. As described in Section III of this report, there are substantial risks associated with the Plan projections of employee wage and benefit costs. These risks could increase costs beyond Plan projections and further reduce fund balance.

The City is operating in a mode of limited financial resources and flexibility in the post-Great Recession environment. It should continue to seek savings and improve revenue collections whereever possible to maintain financial stability.

The discussion below focuses on major assumptions of the Plan's projections of revenues and obligations.

Table 2.2 Projected General Fund Revenues in FY15-FY19 Five-Year Financial Plan ($ in Millions)							
	FY13 Actual	FY14 Est.	FY15 Est.	FY16 Est.	FY17 Est.	FY18 Est.	FY19 Est
Taxes Real Estate	$540.5	$533.2	$547.4	$559.8	$572.6	$585.6	$597.9
Wage and Earnings	1,221.5	1,250.5	1,294.7	1,339.0	1,382.2	1,390.3	1,396.0
Business Income and Receipts	450.9	461.3	453.2	444.6	454.5	467.4	480.0
Sales	257.5	264.9	154.6	164.4	175.2	186.1	196.6
Real Property Transfer	148.0	160.5	176.6	187.2	192.8	198.6	204.6
Parking	73.3	75.0	76.9	78.8	80.8	82.8	84.8
Other	41.7	43.3	44.8	46.4	47.7	48.5	49.4
Total	2,733.5	2,788.7	2,748.2	2,820.2	2,905.8	2,959.3	3,009.3
Locally-Generated Non-Tax Innovation and Technology	22.9	22.6	23.2	23.5	23.7	23.0	24.1
Streets	21.5	29.1	24.1	24.1	24.1	24.2	24.2
Fire	33.7	36.9	37.9	37.9	37.9	37.9	37.9
Public Property	7.9	37.2	708.4	8.4	8.5	8.5	8.6
Licenses and Inspections	54.8	48.2	49.5	50.5	50.8	51.2	51.2
Records	17.3	16.8	18.2	18.2	18.2	18.2	18.2
Finance	17.5	22.2	16.7	17.5	16.7	17.5	17.5
First Judicial District	36.5	40.1	40.8	41.1	41.3	41.6	41.6
Other	54.2	54.3	52.0	52.4	53.1	53.8	54.0
Total	266.2	307.4	970.7	273.5	274.3	275.8	277.3
Revenues from Other Governments Public Health	58.6	59.2	59.2	59.2	59.2	59.2	59.2
Public Property	18.0	18.0	18.0	18.0	--	--	--
Human Services	31.0	--	--	--	--	--	--
Finance	165.2	207.9	161.4	160.9	160.9	161.8	161.8
Revenue	37.7	39.0	35.0	35.0	35.0	35.0	35.0
PICA	314.0	323.4	338.0	353.4	368.5	391.6	414.1
Other	27.1	27.2	27.2	27.2	27.2	27.2	27.2
Total	651.5	674.8	638.9	653.9	650.8	674.9	697.4
Revenues from Other Funds	46.8	67.5	67.9	68.4	68.9	69.3	69.7
Total General Fund Revenues	3,698.0	3,838.5	4,425.7	3,816.0	3,899.7	3,979.3	4,053.6

The revenue discussion focuses on projected tax rates, changes in tax structure, and revenue growth. The obligation analysis focuses on overall obligation trends and factors that influence changes in projected obligations over the life of the Plan.

General Fund Revenues

Table 2.2 presents the FY15-FY19 Plan revenue projections. The most significant source of General Fund revenue is taxes. Taxes are projected to increase from $2.748 billion in FY15 to $3.009 billion in FY19. The projections for each tax reflect Plan assumptions about base growth rates, tax rates, and the impact of changes in tax structure. These assumptions are presented in Tables 2.3 and 2.4 below.

Non-tax revenues include locally-generated non-tax revenues, revenues from other governments, and revenues from other funds. Locally generated non-tax revenue is projected at $970.7 million in FY15. This amount includes $700 million in net proceeds from the sale of the Philadelphia Gas Works (PGW). Excluding this one-time revenue source, locally generated non-tax revenue is projected to remain roughly level over the course of the Plan, increasing from $270.7 million in FY15 to $277.3 million in FY19. Revenue from other governments is projected to increase from $638.9 million in FY15 to $697.4 million in FY19. Revenue from other funds is projeced to remain roughly constant during the Plan period, increasing from $67.9 million in FY15 to $69.7 million in FY19.

Overall General Fund revenues are projected at $4.425 billion in FY15. Excluding the one-time revenues from the PGW sale, General Fund revenues are projected to increase from 3.726 billion in FY15 to $4.054 billion in FY19.

Tax Revenue

The Plan projections of tax revenue are based on assumptions regarding tax rates, tax bases, and the impact of changes in tax structure. Table 2.3 presents the Plan's projected tax rates.

The Plan indicates the City's intention to continue lowering the rates of the wage and business taxes, as it has done fairly consistently since the mid-1990s. The resident rate of the wage, earnings, and net profits taxes is projected to decline from 3.92 percent in FY15 to 3.746 percent in FY19. The non-resident rate for these taxes is projected to decline from 3.4915 percent to 3.3365 percent. The most significant reductions in tax rates occur in FY18 and FY19. The business income and receipts tax (BIRT) is composed of two taxes, one on net income and another on gross receipts. The Plan projects a decline in the net income rate from 6.41 percent in FY15 to 6.25 percent in FY19, consistent with current law. The gross receipts rate is unchanged at 0.1415 percent over the term of the Plan. Other tax rates are projected to remain unchanged throughout the Plan period.

One of the ongoing challenges for the City is to find ways to shift the overall burden of its tax structure away from taxes on personal income and business, toward real estate. Research conducted over the past two decades has consistently found that these taxes are particularly damaging to the City's competitiveness. Philadelphia remains highly unusual among major cities in its degree of dependence on these sources. The challenge is to continue to reduce the City's dependence on these sources and increase its dependence on other sources, while maintaining fiscal stability.

Table 2.3 presents the Plan projections of tax base and revenue growth. The tax "base" indicates the level of taxable economic activity that occurs in each fiscal year. Projections of the tax base are made based on econometric modelling by the City's consultant, IHS Global Insight, and by judgment of City officials. In addition, local economists provide input to City officials about base growth assumptions at an annual meeting held at the Federal Reserve Bank of Philadelphia. The base growth assumptions range from 1 to 4 percent

Table 2.3 Projected City Tax Rates (Percent), FY15-FY19 Five-Year Financial Plan

	FY14 Est.	FY15 Est.	FY16 Est.	FY17 Est.	FY18 Est.	FY19 Est
Real Estate[1]	0.6018	0.6018	0.6018	0.6018	0.6018	0.6018
Wage, Earnings, and Net Profits						
Resident	3.9240	3.9200	3.9102	3.9004	3.8224	3.7460
Non-Resident	3.4950	3.4915	3.4828	3.4741	3.4046	3.3365
Business Income and Receipts						
Net Income	6.43	6.41	6.39	6.35	6.30	6.25
Gross Receipts[2]	0.1415	0.1415	0.1415	0.1415	0.1415	0.1415
Sales	2.0	2.0	2.0	2.0	2.0	2.0
Real Property Transfer	3.0	3.0	3.0	3.0	3.0	3.0
Parking	20.0	20.0	20.0	20.0	20.0	20.0

Notes:
[1]Includes City tax rate only. The combined City and School District tax rate is 1.3204 percent.
[2]Alternative gross receipts tax rates are available to manufacturers, wholesalers and retailers.

Table 2.4 Projected Percentage Growth in Tax Bases and Revenues, FY15-FY19 Five-Year Financial Plan						
	FY14 Est.	FY15 Est.	FY16 Est.	FY17 Est.	FY18 Est.	FY19 Est
Real Estate						
Base[1]	NA	2.8	1.3	1.3	1.3	1.3
Revenue	(1.4)	2.7	2.3	2.3	2.3	2.1
Wage and Earnings						
Base	1.8	3.7	3.7	3.6	3.3	3.1
Revenue	2.4	3.5	3.4	3.2	0.6	0.4
Net Profits						
Base	6.0	6.3	6.1	4.3	4.2	4.0
Revenue	1.5	5.4	5.5	3.7	1.8	1.7
Business Income and Receipts[2]						
Gross Receipts Base	NA	3.0	3.0	3.0	3.0	3.0
Net Income Base	NA	3.0	3.0	3.0	3.0	3.0
Total Revenue	2.3	(1.8)	(1.9)	2.2	2.8	2.7
Sales						
Base	3.3	3.7	3.6	3.8	3.7	3.4
Revenue	2.9	(41.6)	6.3	6.5	6.2	5.6
Real Property Transfer						
Base	8.5	10.0	6.0	3.0	3.0	3.0
Revenue	8.5	10.0	6.0	3.0	3.0	3.0
Parking						
Base	2.4	2.5	2.5	2.5	2.5	2.5
Revenue	2.4	2.5	2.5	2.5	2.5	2.5

Note:
[1]Represents projected growth in assessed value after appeals. Growth is not presented in FY14 due to the implementation of AVI, which resulted in an eightfold increase in city-wide assessed value.
[2]Amounts shown are calculated prior to the impact of tax reform measures.

in each year of the Plan, with the exception of the net profits and real property transfer taxes, which are projected to grow at higher rates.

The revenue growth projections reflect the combined impact of base growth assumptions, tax rate assumptions, and other changes that affect revenue collections. These changes are particularly significant in the case of BIRT. The implementation of an exemption of the first $100,000 in gross receipts and single factor apportionment is projected to result in a loss of $21 million in revenue in FY15, $43 million in FY16, and $47 million each year from FY17 through FY19. These revenue losses are the result of tax reforms enacted in 2012. The reforms were designed to reduce the impact of BIRT on economic growth. While the tax base, including both the net income and gross receipts base, is projected to increase 3 percent annually in each year of the Plan, revenues are projected to decline 1.8 percent in FY15 and 1.9 percent in FY16, due to tax reforms and lower tax rates for the net income tax. From FY17 through FY19, revenues are projected to increase at rates from 2.2 to 2.8 percent, below the 3 percent base growth assumption, due to reductions in the net income tax rate.

Wage and earnings tax revenue are projected to increase 0.6 percent in FY18 and 0.4 percent in FY19, well below the base growth rate, due to rapid tax rate reduction in those years. Sales tax revenue is projected to decline 41.6 percent in FY15 due to the dedication of $120 million in revenue to the School District of Philadelphia (SDP) beginning that year. However, because the level of SDP-dedicated sales tax revenue is unchanged after FY15, while the tax base continues to grow, City revenues increase more rapidly than the base, beginning in FY16.

Non-Tax Revenue

The other three major categories of General Fund revenue are locally-generated non-tax revenue, revenue from other governments, and revenue from other funds. Locally generated non-tax revenue is projected at $970.7 million in FY15, which includes $700 million in net proceeds from the sale of PGW. In FY14, the City received $29.2 million from the sale of the Love Park garage. (These one-time revenue sources are shown under Public Property in Table 2.2.) Excluding these sources of revenue, overall locally-generated non-tax revenue is projected to be fairly stable over the life of the Plan, decreasing 2.7 percent in FY15, and increasing at rates not exceeding 1 percent in each succeeding year.

Revenue from other governments is projected at $638.9 million in FY15. A major component of this category is PICA revenue. PICA receives a dedicated portion of the wage, earnings, and net profits taxes, which is utilized to pay debt service on PICA bonds. The remaining revenue not utilized for debt service is returned to the City. As a result of tax base growth and declining debt service, PICA revenue is projected to increase relatively rapidly, at rates ranging from 4.2 to 6.2 percent over the Plan period.

Other components of revenue from other governments include state and federal assistance for public health services, state pension aid, state funding of certain court costs, the City's share of state gaming proceeds, an annual rental payment from PGW, and the City's share of revenue generated by the Philadelphia Parking Authority (PPA) from on-street parking. Overall revenue from other governments, excluding PICA revenue, is projected to decline 14.4 percent in FY15, 0.2 percent in FY16, and 6.0 percent in FY17, before increasing 0.3 percent in FY18, and remaining essentially constant in FY19.

The 14.4 percent decrease in FY15 primarily reflects $45 million in one-time state aid for the School District of Philadelphia that passed through the City General Fund in FY14. Excluding this revenue source, overall non-PICA revenues from other governments declined 1.8 percent in FY15, primarily due to reductions in state pension aid and PPA revenue.

The 6 percent decrease in FY17 primarily reflects the impact of the Plan's projected sale of PGW, which will result in the loss of $18 million in revenue beginning in FY17. However it should be noted that this loss of revenue will be entirely offset by a reduction in the City's required pension payments resulting from the PGW sale. The Plan assumes that the entire net proceeds of the PGW sale will be paid to the Pension Fund in FY15. This will result in a one-time actuarial gain to the Fund that will reduce the City's state-mandated pension payment by approximately $40 million annually beginning in FY17. However, through a service agreement with the Philadelphia Authority for Industrial Development (PAID) the City intends to only reduce its payment by $18 million. The PAID agreement will ensure that the City's makes pension contributions

Table 2.5 Projected General Fund Revenue Growth by Category, FY15-FY19 Five-Year Financial Plan (Percent)

	FY14 Est.	FY15 Est.	FY16 Est.	FY17 Est.	FY18 Est.	FY19 Est
Taxes	2.0	(1.5)	2.6	3.0	1.8	1.7
Locally-Generated Non-Tax						
Excluding Asset Sale Proceeds[1]	4.5	(2.7)	1.0	0.3	0.6	0.5
Including Asset Sale Proceeds	15.5	215.7	(71.8)	0.3	0.6	0.5
Revenues from Other Governments						
PICA	3.0	4.5	4.6	4.2	6.2	5.7
Other	4.1	(14.4)	(0.2)	(6.0)	0.3	0.0
Total	3.6	(5.3)	2.3	(0.5)	3.7	3.3
Revenues from Other Funds	44.1	0.6	0.7	0.7	0.6	0.5
Total General Fund Revenues	3.8	15.3	(13.8)	2.2	2.0	1.9

Note:
[1]Assets include Philadelphia Gas Works and Love Park.

Table 2.6. Projected General Fund Obligations in FY15-FY19 Five-Year Financial Plan ($ in Millions)							
Agency/ Cost Center	FY13 Actual	FY14 Est.	FY15 Est.	FY16 Est.	FY17 Est.	FY18 Est.	FY19 Est.
Community College Subsidy	$25.4	$26.4	$26.9	$26.9	$26.9	$26.9	$26.9
School District Contribution	69.0	114.1	69.1	69.2	69.2	69.3	69.4
Convention Center Subsidy	15.0	15.0	15.0	15.0	15.0	15.0	15.0
City Council	13.5	16.2	16.3	16.1	16.1	16.1	16.1
Debt Service	209.8	216.8	247.8	247.9	267.3	286.5	274.8
District Attorney	31.4	32.6	34.1	33.5	33.5	33.5	33.5
Employee Benefits	1,119.1	1,233.9	1,817.3	1,157.6	1,177.6	1,217.7	1,273.7
Indemnities	--	41.0	33.7	33.7	33.7	33.7	33.7
Fire	200.5	246.7	206.8	209.2	209.7	210.2	210.7
First Judicial District	110.8	105.8	106.3	106.3	106.4	106.4	106.4
Fleet Management	60.8	62.4	59.8	59.8	59.9	60.9	56.4
Free Library	33.6	36.0	38.7	39.1	39.5	39.5	39.5
Human Services	90.9	99.1	99.5	99.9	100.4	100.4	100.4
Labor Cost Reserve	--	--	52.8	40.5	40.1	40.1	40.1
Law	14.8	13.2	13.4	13.3	13.3	13.3	13.3
Legal Services	38.7	40.6	41.8	42.2	42.2	43.2	43.2
Licenses and Inspections	21.6	25.8	27.9	24.8	25.0	25.0	25.0
Managing Director	34.5	34.3	34.7	34.5	34.5	34.5	34.5
Behavioral Health	14.1	13.9	13.9	13.9	13.9	13.9	13.9
Innovation and Technology	63.2	84.9	82.2	80.2	80.4	80.4	80.4
Property Assessment	11.6	13.7	14.3	12.7	13.0	13.0	13.0
Supportive Housing	42.1	45.2	44.0	44.1	44.2	44.1	44.1
Parks and Recreation	52.5	51.9	52.6	52.8	53.2	53.2	53.2
Police	585.1	585.9	592.5	592.8	593.5	601.0	602.6
Prisons	242.7	245.6	240.8	240.6	241.0	241.0	241.0
Public Health	109.1	115.1	115.4	116.0	116.6	116.6	116.6
Public Property	57.6	87.3	57.7	58.8	59.9	61.0	62.3
Revenue	18.7	21.1	22.4	22.6	23.8	23.8	23.8
SEPTA Subsidy	65.2	67.1	70.4	73.9	77.6	81.5	85.6
Sheriff	15.1	18.0	18.5	18.1	18.2	18.2	18.2
Space Rentals	18.2	19.1	20.5	21.0	21.4	20.7	20.3
Streets	118.7	118.1	116.9	118.4	119.5	120.3	121.2
Utilities	31.5	30.3	31.0	30.3	31.2	32.3	33.4
Total	3,613.3	3,967.9	4,524.6	3,850.7	3,902.2	3,978.9	4,052.1

in excess of the state minimum requirement, resulting in a more rapid reduction in the actuarial liability and a reduced risk that pension contributions will continue to increase at rates in excess of payroll.

Obligations

Table 2.6 presents the Plan's projections of obligations for all major agencies and cost centers. Most cost categories change minimally over the course of the Plan. There are significant changes in the following line items: debt service; employee benefits; contributions to the School District of Philadelphia; SEPTA subsidy; and reserve for future labor costs.

Debt Service. The City's debt service obligations are projected to increase from $247.8 million in FY15 to $274.8 million in FY19. The increase reflects new debt issuances for the new Police Department headquarters in West Philadelphia and other capital projects. The Plan assumes the City will issue new general obligation debt in 2016 and 2018. Debt service is projected to increase $31 million in FY15, due to a projected $15 million in debt service on bond issues to provide operating funding to SDP and an increase in principal payments on City general obligation debt.

Employee Benefits. Total employee benefits costs are projected at $1.817 billion in FY15. This amount includes the net proceeds of the PGW sale that the Plan projects will be deposited in the Pension Fund. Exclusive of this amount, total employee benefit costs are projected to be $1.117 billion in FY15. The Plan projects these costs will increase to $1.274 billion in FY19.

School District Contribution. A one time state grant of $45 million passed through the City General Fund in FY14, resulting in a one-time increase in City contributions to SDP.

SEPTA Subsidy. The Plan projects an increase in the City's required subsidy to the Southeastern Pennsylvania Transportion Authority (SEPTA). The subsidy is projected to increase from $70.4 million in FY15 to $85.6 million in FY19. The subsidy amount reflects legal requirements for the City to match operating and capital subsidies received from the state and federal governments.

Labor Cost Reserve. The Plan includes a provision for future labor obligations of $52.8 million in FY15, $40.5 million in FY16, and $40.1 million in FY17 through FY19. Thte total reserve for potential future labor costs is $213.6 million over the life of the Plan. As described further in Section III of this report, there is significant risk that this reserve will be insufficient to cover the net costs of future labor contracts over the entire life of the Plan. The reserve is made up of three components as follows:

- *Future FOP Award.* The most recent contract for uniformed police officers represented by the Fraternal Order of Police (FOP) expired on June 30, 2014. A currently ongoing labor arbitration will determine the contract for FY15 and beyond. The reserve for the potential costs of this contract is $121.1 million over the life of the Plan. This amount represents the costs of two consecutive 2.5 percent wage increases in FY15 and FY16. If the actual awarded wage increase exceeds 2.5 percent in FY15 or FY16, and these additional costs are not offset by savings in employee benefits or management efficiencies allowed under the new contract, the actual costs to the City will exceed the amount reserved in the Plan. Further, the potential costs of wage increases in any of the final three years of the Plan are not included in the labor reserve.

- *Future IAFF Award.* The most recent contract for uniformed firefighters represented by the International Association of Fire Fighters (IAFF) expired on June 30, 2013. The arbitration process to determine the contract for FY14 and beyond is ongoing. The reserve for potential costs of a future IAFF contract is $53.0 million over the life of the Plan, an amount that represents the costs of two consecutive 2.5 percent wage increases in FY14 and FY15. To the extent that actual wage increases exceed 2.5 percent in FY14 or FY15, these additional costs will need to be offset with savings as a result of changes to employee benefits or other terms of the contract. Otherwise, actual costs will exceed the reserve. Similar to the reserve for the FOP, the IAFF reserve does not cover potential costs for the final four years of the Plan.

- *Future District Council 33 Contract.* The labor reserve includes $39.5 million to fund the potential cost of a future contract with District Council 33 (DC 33). The most recent contract for this bargaining unit expired on June 30, 2009. The City is seeking Court of Common Pleas approval to impose the terms of its final contract offer to the union. The $39.5 million in the Plan represents the City's estimate, at the time the offer was made, of the net cost of implementing the final contract offer. The offer included: wage increases of 2.5 percent effective at the later of 30 days after ratification or March 2013, and 2.0 percent effective January 2014; a $25 million lump sum contribution to the union health fund; revisions to overtime rules; provisions that would allow furloughs for up to 15 days per employee, per year; a requirement that newly-hired employees participate in Plan 10, the City's hybrid pension plan; increases in employee contributions to the pension system; and restoration of longevity and step increases that had been frozen as of June 30, 2009, the date the most recent contract expired.

III. Risks to the Plan

This section describes potential risks to the Plan's projections of obligations. Risks related to employee wage and benefits costs are quantified. Other major risks that are not easily quantifiable are described.

PICA staff's analysis of the Plan is based in significant part on the risk assessment in this section. The PICA Act requires that the Plan projections of revenues and obligations be based on reasonable assumptions and methods of estimation. This requirement was included in the Act to ensure that the Five-Year Financial Plan process works to provide adequate assurance that the City will continue to maintain financial stablity. Without reasonable assumptions and methods of estimation, the Plan process cannot provide reasonable assurance that the City can maintain General Fund balance over the next five years without additional budget balancing measures.

While the analysis in this section suggests there are substantial, quantifiable and non-quantifiable risks facing the Plan, staff is recommending approval because we believe that the City has available to it sufficient options to compensate for these risks, should they occur. Particularly significant, in the view of the staff, is that the City has successfully concluded a labor agreement with DC47 covering FY10-FY17, and has demonstrated, through the Plan process, its ability to finance the full cost of this agreement.

Wage Risks

Among the most significant risks faced by the Plan is that actual wage increases could exceed projections. For those union employees who are covered by contracts determined through arbitration, the risk is that actual arbitration awards will include wage increases beyond the Plan assumption. For unionized workers whose contracts are determined through collective bargaining, there is a risk that the actual contracts agreed to by the City and the union will include wage increases beyond the Plan assumption. For non unionized workers, although wages are controlled by management, actual wage increases in the past have moved consistently with those for non-uniformed unionized workers. The risk for these workers is that contract settlements with DC 33 and DC 47 could lead to additional wage increases for non-union employees that are not assumed in the Plan.

Table 3.1. Wage Risk by Bargaining Unit, FY15-FY19 Five-Year Financial Plan ($ in Millions)

	FY15 Est.	FY16 Est..	FY17 Est.	FY18 Est.	FY19 Est.	FY15-FY19 Total
FOP-Police	--	--	$11.4	$23.0	$35.0	$69.4
FOP-Sheriff	0.3	0.5	0.8	1.1	1.4	4.0
FOP-Register of Wills	0.2	0.3	0.3	0.4	0.5	1.8
IAFF	--	4.0	8.2	12.4	16.6	41.2
DC 33	4.1	8.4	12.7	17.0	21.5	63.7
DC 33 - Local 159	2.3	4.7	7.1	9.5	12.0	35.6
DC 47 - Local 2186	--	--	--	0.9	1.7	2.6
DC 47 - Local 2187	--	--	--	1.6	3.3	4.9
DC 47 - Local 810	0.4	0.8	1.1	1.5	2.0	5.8
Non Union Civil Service	--	--	--	1.1	2.3	3.4
Total	7.3	18.6	41.6	68.6	96.2	232.4

Source: PICA staff estimates. Risk is calculated as the impact of a 2 percent wage increase in years for which the proposed Plan does not assume any increase. Amounts include FICA tax.

The Plan makes assumptions about wage increases for each bargaining unit. These assumptions are described below. For each union, wage risk is estimated as the cost of a 2 percent wage increase in each year for which the Plan assumes no increase.

Fraternal Order of Police (Police). Uniformed Police officers represented by the Fraternal Order of Police (FOP) are currently working without a contract. The most recent contract expired on June 30,2014. It is expected that an arbitration panel will issue a new contract award in the coming months. The Plan assumes wage increases of 2.5 percent in FY15 and FY16, and no additional increases in the final three years of the Plan. The estimated wage risk is the impact of a 2 percent wage increase in FY17, FY18, and FY19.

International Association of Fire Fighters (IAFF). Uniformed firefighters represented by the IAFF are currently working without a contract. The most recent contract expired on June 30, 2013. An arbitration process for the new contract is ongoing. It is unclear when an award will be issued. The Plan assumes a wage increase of 2.5 percent retroactive to the beginning of FY14, and an additional 2.5 percent increase in FY15. No additional wage increases are assumed. The wage risk for the IAFF is the estimated impact of 2 percent increases in FY16, FY17, FY18, and FY19.

District Council 47 (DC 47). In February 2014, the City and DC 47 entered into a new contract covering the period from FY10 through FY17. The contract covered supervisory employees in Local 2186 and non-supervisory employees in Local 2187. It provided for a 3.5 percent wage increase effective within 30 days after ratificaiton, a 2.5 percent increase in FY16, and a 3 percent increase in FY17. In addition, the contract lifted a freeze on step and longevity salary increases that had been in place since the expiration of the previous contract on June 30, 2009. The proposed Plan includes all costs related to the new FY10-FY17 contract. No additional wage increases beyond FY17 are assumed. The wage risk associated with DC 47 is the esimated impact of 2 percent annual raises in FY18 and FY19.

District Council 33 (DC 33). This bargaining unit is currently working without a contract. The most recent contract expired on June 30, 2009. The City made its final offer to the union on January 16, 2013 and is currently seeking court approval to impose the terms of this offer. It is unclear when the court will rule on the City's request. The final offer included a wage increase of 2.5 percent effective at the later of 30 days after ratification or March 2013, and an additional 2 percent effective in January 2014. The costs of this final offer, as estimated at the time it was made, are included in the Plan. Since the final offer did not include wage increases during FY15 or any subsequent years, the wage risk for DC 33 is estimated as the impact of 2 percent raises in each of the five years of the Plan.

Fraternal Order of Police (Sheriff and Register of Wills). Employees of the Sheriff's Office and Register of Wills represented by the FOP are working without a contract. The most recent contract expired on June 30, 2014. The Plan does not assume additional wage increases for these employees. The wage risk for these bargaining units is estimated as the impact of a 2 percent annual increase in each year of the Plan.

District Council 33 (Correctional Officers). Correctional officers in the Prison System and in the Department of Human Services are represented by DC 33, Local 159. These employees are working without a contract, with the most recent agreement expiring on June 30, 2014. The Plan does not assume any wage increase for these employees. The wage risk is estimated as the impact of a 2 percent increase in each year of the Plan.

District Council 47 (Court Employees). Certain First Judicial District employees are represented by DC 47, Local 810. These employees are working without a contract. The most recent agreement expired on June 30, 2014. The Plan does not assume any wage increases for these workers. The wage risk is estimated as the impact of a 2 percent wage increase in each year of the Plan.

Non-Represented Employees. After concluding the FY10-FY17 contract with DC 47, the City agreed to adjust wages for non-represented civil service employees in a manner consistent with the requirements of the new DC 47 contract to assure consistency across pay scales. These costs are included in the Plan. The Plan does not include additional costs for these employees beyond those in the DC47 FY10-FY17 contract. Wage adjustments similar to those of unionized non-uniform workers are likely to be needed over the life of the Plan. The wage risk is estimated as the impact of a 2 percent wage increase in FY18 and FY19.

Table 3.1 summarizes the impact of the wage risks estimated for each group of General Fund employees.

Table 3.2. Employee Benefit Cost Risk, by Health Plan, FY15-FY19 Five-Year Financial Plan ($ in Millions)						
	FY15 Est.	FY16 Est..	FY17 Est.	FY18 Est.	FY19 Est.	FY15-FY19 Total
FOP	($0.4)	($6.1)	($12.6)	($19.8)	($27.8)	($66.7)
IAFF	--	2.1	4.2	6.5	8.8	21.6
DC 33	7.2	11.0	15.0	19.1	23.4	75.7
DC 47	2.9	4.5	6.1	7.8	9.6	31.0
Total	9.7	11.5	12.8	13.6	14.0	61.6
Source: PICA staff estimates. Risk is calculated as the impact of the difference between the Plan assumed annual growth rate for each health plan and a 4 percent annual cost increase.						

Employee Health Benefit Costs

The Plan makes specific assumptions about the cost of each of the five major health plans of the City. These include plans sponsored by the FOP, the IAFF, DC 33, DC47, and the City-administered Plan. The Plan assumes a base rate of growth of 8.5 percent for the FOP plan, but no growth for the other four plans. In the opinion of PICA staff, a base growth assumption of 4 percent is likely to be sufficient in light of recent trends in the health care marketplace.[1] Accordingly, staff projected costs for the DC 33, DC 47, and IAFF plan assuming a 4 percent annual growth rate. This results in additional costs that are not included in the Plan.

Since the 8.5 percent base growth rate assumed for the FOP health plan is considerably higher than 4 percent, there is an opportunity to realize savings for the FOP health plan. Accordingly, the risk estimate calculated potential savings from a 4 percent rate of growth for the FOP plan. These savings offset the possible increased cost for the other three health plans.

With respect to the City-administered plan, management controls the design of this plan and can make adjustments to benefits or to employee cost-sharing provisions, as necessary to achieve financial targets. Accordingly, the projection of zero growth for the cost of this plan is achievable through management actions. No risk is believed to be associated with the City-administered plan cost projection.

Total employee health benefit cost risks are summarized in Table 3.2.

Impact of Risks on Fund Balance

Table 3.3 presents the overall quantified risks to the Plan and calculated the impact they could potentially have on fund balance. The combined impact of the wage and health benefits risks is $293.8 million.

The Plan, as submitted to PICA, had a projected fund balance of $114.8 million in FY19. The updated actuarial projections, resulting from the newly adopted assumptions by the Pension Board, meant that the projected FY19 fund balance was reduced to $92.7 million. If the wage and health benefit cost risks estimated in this Section were to occur, the General Fund would incur a deficit of $201 million in FY19. The risks would cause a deficit of $7.5 million in FY16, and the deficits would increase each year through FY19, reaching $201.1 million in FY19.

It is important to note that the purpose of this risk analysis is to guage the potential for deficits, should the wage and health benefit cost scenarios described actually occur. They are a measure of the estimated size of the budget gap that would occur under reasonable assumptions about future wage and benefit cost growth. This is not to say that these deficits will in fact occur. The City has various policy options available to close deficits. These include measures to reduce costs through more efficient operations, reductions in personnel levels, reductions in service levels, increases in revenues through higher tax rates, improved tax

[1]Pricewaterhouse Coopers projects that, in 2015, per capita medical costs for large self-insured employers will increase 4.8 percent, after taking into account changes in benefit plan design. The medical cost trend is influenced by changes in the unit cost of medical services and employee utilization. See *Medical Cost Trend: Behind the Numbers 2015*, Pricewaterhouse Coopers Health Research Institute, June 2014.

enforcement, and adoption of new tax or non-tax revenue sources. This analysis suggests that the City may have to adopt some combination of these measures to maintain budget balance over the Plan period.

In part because of the settlement of the contract with DC 47, the total risk associated with wage and benefit costs estimated this year is somewhat below the risk estimated in last year's analysis of the FY14-FY18 Plan. That analysis presented three scenarios, one based on an assumption of 1 percent annual wage increases in years for which the FY14-FY18 Plan assumed no increase, another scenario of 2 percent annual increases, and another of 3 percent increases. The 1, 2, and 3 percent wage increase scenarios, respectively, resulted in risk estimates of $267.3 million, $427.1 million, and $590.5 million over the life of the FY14-FY18 Plan. This year's analysis, which was based only on the mid-range, 2 percent wage increase scenario, suggested a $293.8 million risk. The reduction in this year's analysis primarily reflects the settlement of a contract with DC 47 through FY17. In addition, the calculation this year did not estimate a risk associated with employees exempt from civil service, since it was deemed more appropriate to classify these wage levels as within management's control.

Despite the lower overall risk assessment, labor cost risks remain substantial. For three of the four major unions, and every smaller bargaining unit, wage levels that will be determined through arbitration awards or collective bargaining remain unknown for *every* year of the FY15-FY19 Plan. As future contracts become finalized, the City will be required to revise the Five-Year Financial Plan in cases where the net costs of the contracts exceed the level of costs assumed in the Plan. This PICA Act requirement will help to ensure that the City maintains financial stability as it continues to cope with the effects of reduced economic growth in the wake of the recession.

Non-Quantified Risks

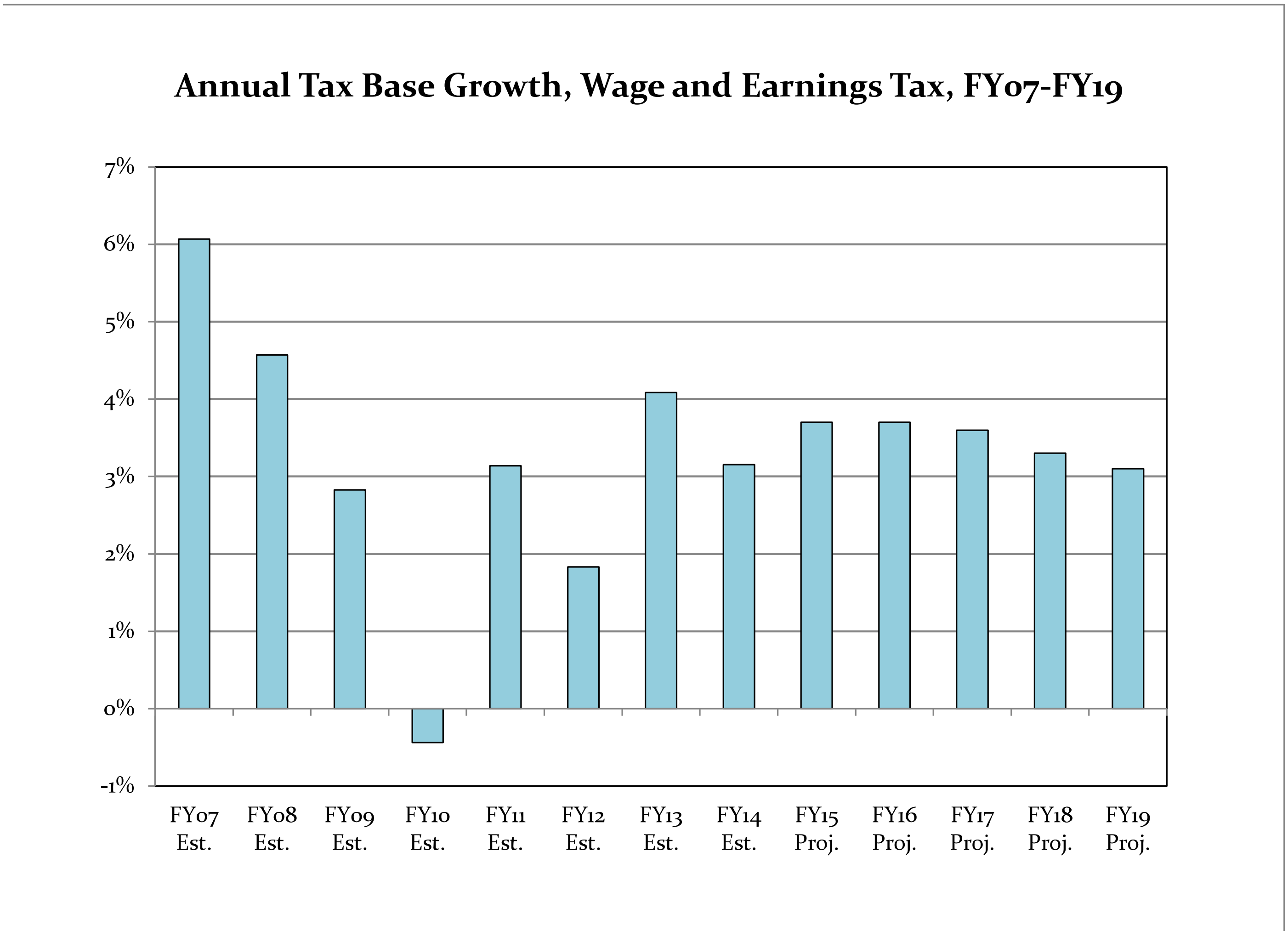
This section describes three additional major risks to the Plan that are difficult to quantify: the risk of reduced economic growth, financial instability at the School District of Philadelphia, and risk that pension costs will exceed projections.

Macroeconomic Growth. The Plan generally assumes modest growth for each of the major General Fund tax bases for each of the next five fiscal years. The wage and earnings, business income and receipts, and sales tax bases are projected to increase at 3 percent annually, or higher, each year. The real property transfer tax base is projected to increase 10 percent in FY15, 6 percent in FY16, and 3 percent in each of the following three years. Implictly, this assumes a continuation of the recovery in the real estate market over the next two years.

Table 3.3. Summary of Risks and Potential Impact on Plan Fund Balance, FY15-FY19 Five-Year Financial Plan ($ in Millions)

	FY15 Est.	FY16 Est..	FY17 Est.	FY18 Est.	FY19 Est.	FY15-FY19 Total
Risks						
Wages	7.3	18.6	41.6	68.6	96.2	232.4
Employee Health Benefits	9.7	11.5	12.8	13.6	14.0	61.6
Total	17.0	30.1	54.4	82.2	110.2	293.8
Plan Fund Balance as Submitted	68.4	54.1	72.1	92.9	114.8	
Increased Pension Costs Based on Revised Assumptions	--	(14.5)	(14.9)	(9.9)	(7.4)	(46.7)
Elimination of Contribution to Budget Stabilization Reserve Fund	--	--	--	--	24.6	24.6
Revised Fund Balance	68.4	39.6	42.7	53.6	92.7	
Revised Fund Balance Taking Risks Into Account	51.3	(7.5)	(58.8)	(130.1)	(201.1)	

Source: PICA staff estimates. Risk is equal to the Plan assumed General Fund savings from pension changes for District Council 33.



These assumptions in general suggest the recovery from the Great Recession will continue unabated for five more years. Any significant slow-down, or another recession during this period, will likely result in significant revenue shortfall from the Plan projection.

The Plan generally assumes stability and continued growth over the next five years. In the case of the wage and earnings tax, the wage tax base declined in nominal terms in FY10 and increased by less than 2 percent in FY12. The Plan assumes growth between 3 and 4 percent through FY19. The real estate transfer tax base declined precipitously from FY07 through FY10, stabilized from FY11 through FY12, and increased by more than 10 percent annually in FY13 and FY14. The Plan projects a continuation of the recent relatively rapid growth for FY16, and then moderate growth for the following four years. The sales tax base declined 8.7 percent in FY12 and has increased at a moderate pace since then, with growth of 4.2 percent in FY11, 0.9 percent in FY12, 2.8 percent in FY13, and 2.5 percent in FY14. The Plan projects that this growth will accelerate somewhat, to rates exceeding 3 percent in each year from FY15 through FY19.

The City has a sound track-record of projecting tax revenues in recent years. Actual General Fund tax revenues have exceeded projections in the initial Five-Year Financial Plan for the past three years. In FY11, actual tax revenue exceeded the projection in the FY11-FY15 Plan by 0. 5 percent. In FY12, actuals excceded the FY12-FY16 Plan by 1.2 percent. FY13 revenues exceeded the FY13-FY17 Plan by 4.7 percent. However, these results have occurred during a period of steady economic recovery. The risk to the Plan is that the recent pattern of steady growth will not continue, either as a result of national economic trends, or trends specific to the city or region. Such a development would adversely impact City revenues.

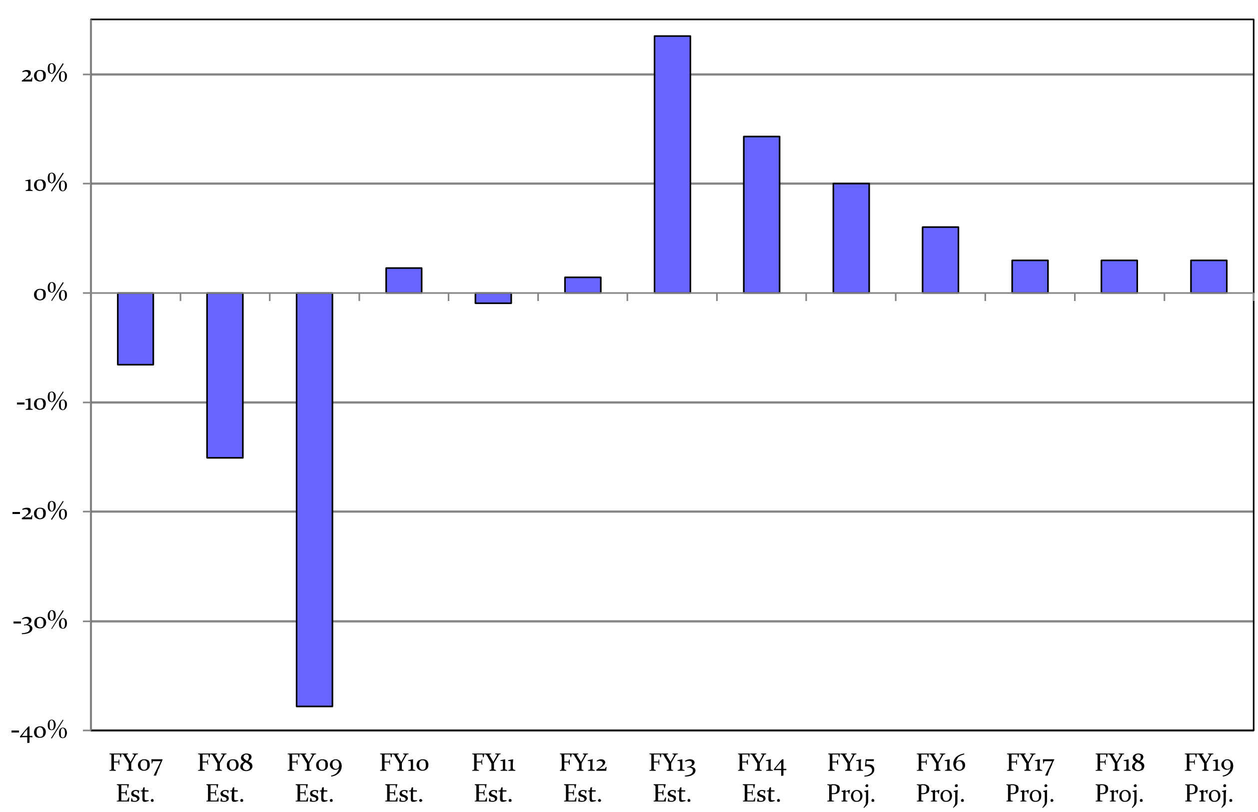
Financial Challenges at the School District of Philadelphia. In recent years, the School District of Philadelphia (SDP) has struggled with declining revenues and significant budget deficits. In FY14, the City borrowed $27 million to help close the SDP's operating deficit, and a similar borrowing is planned for FY15. School personnel have been reduced by thousands, and top school officials have indicated that the current staffing level is inadequate.

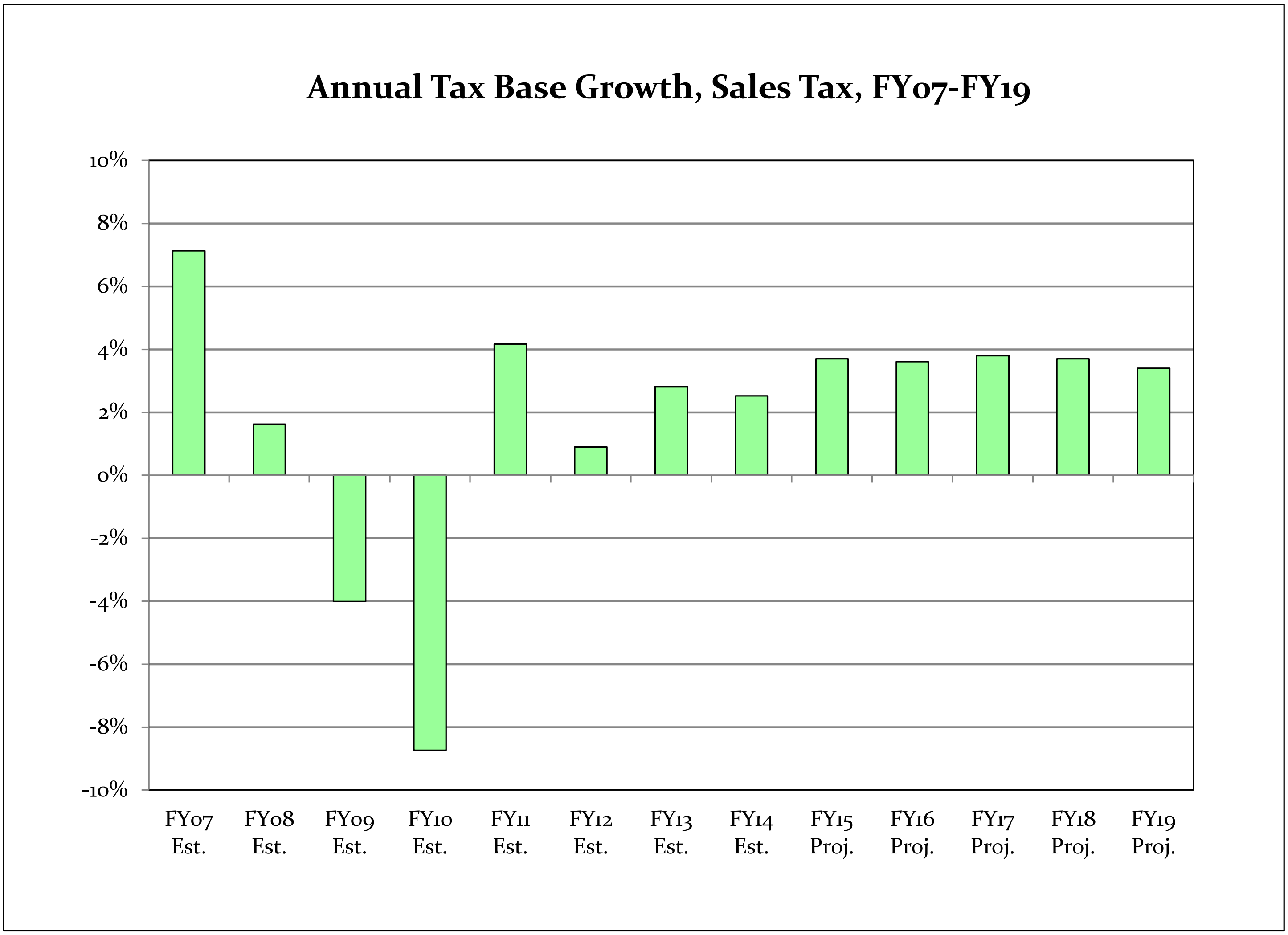
In June, City Council authorized the dedication of $120 million in annual funding from the 2 percent local sales tax to SDP. This funding will continue permanently. The authorization of an additional $120 million in local tax support for SDP represents a major step toward long-term structural balance. In addition, state legislation to authorize a local cigarette tax is under consideration. This tax, should also provide fiscal relief to the District.

Even with these measures, however, it is unclear whether SDP will have sufficient resources to provide an adequate education that is competitive with other school districts in the region. The fiscal and operational stability of the School District is a risk to the City's finances for two primary reasons. First, the potential need for additional local tax increases could reduce economic growth and divert resources away from the City. Second, over the long term, inadequate public education in the city will hurt the economy, both because it would reduce the attractiveness of Philadelphia as a location, and because it would diminish the economic prospects of its youth.

Pension Obligations. A final significant risk that has not been quantified is the City's pension system. The pension cost projections in the Plan include three components: (1) the Board of Pensions and Retirement actuary's projection of the state-mandated minimum municipal obligation (MMO), adjusted for the estimated proportion of the MMO that will be charged to the General Fund; (2) City pension related debt service; and (3) a portion of the City sales tax revenues

Annual Tax Base Growth, Real Estate Transfer Tax, FY07-FY19

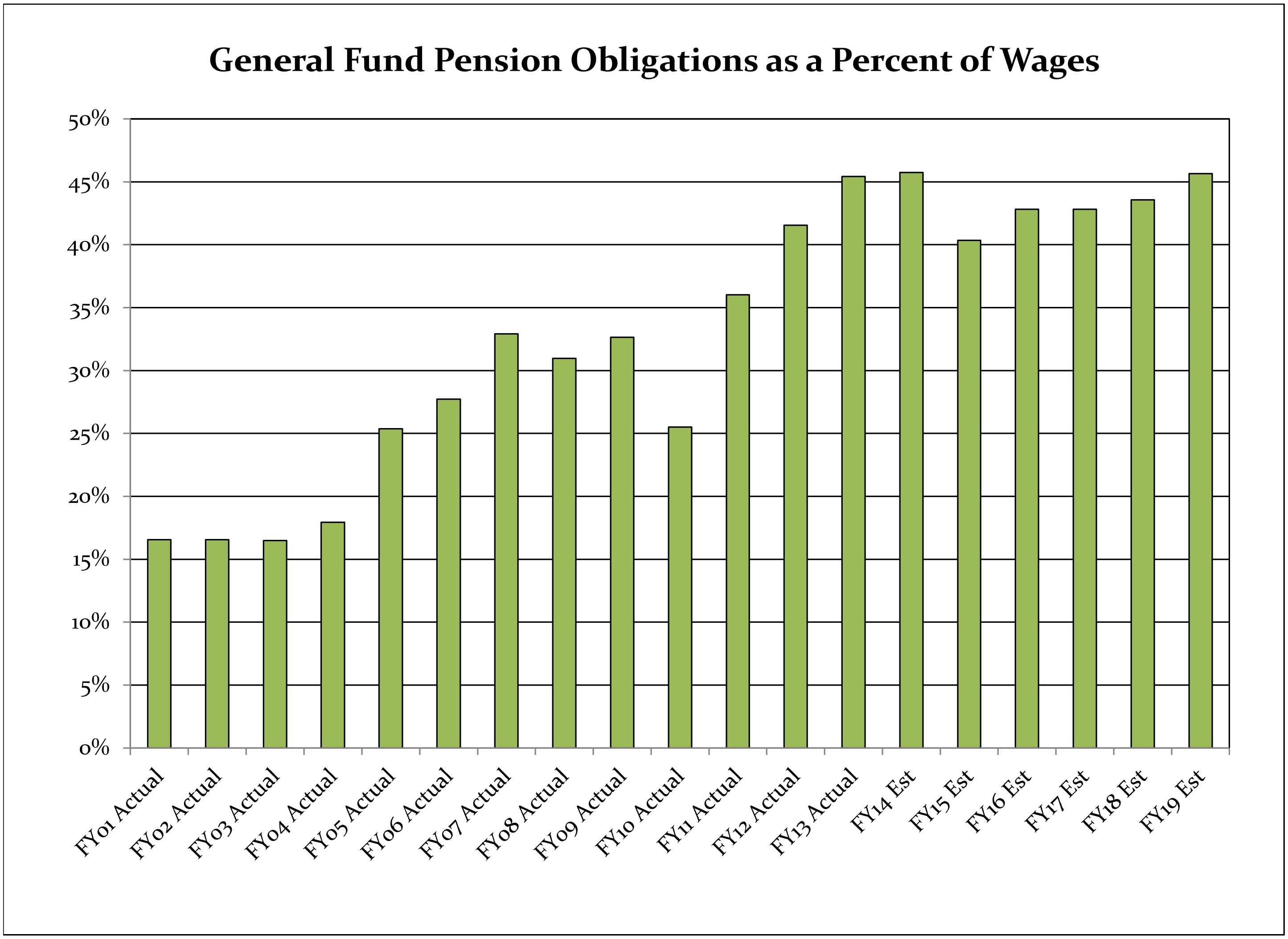




generated by the extension of the 2 percent local sales tax after FY14. The projected MMO component is based on an actuarial model that incorporates many assumptions about variables that impact the level of contributions required to fund the ongoing normal costs of the system and pay down its unfunded liability. The risk to the Plan is that the actual MMO contributions required by state law will in fact be higher than the Plan projections due to actual experience deviating from expectations, assumption changes adopted by the Board of Pensions and Retirement, or as a result of changes to the benefits.

As described in Section II, at its June meeting, the Board adopted new actuarial assumptions relating to salary increases, retirement rates, disability rates, and mortality. The net impact of these assumptions is to increase the MMO by approximately $20 million annually in FY16, when the new assumptions will first impact the City's required contribution. Further, the City's mortality assumptions may need to be revised in the future, in light of a new Actuarial Standard of Practice, which indicates that actuaries should assume future improvements in mortality rates consistent with past trends. The City's retirement system has not yet fully adopted these new standards. A move to do so could result in further cost increases in the future.

Another particularly sensitive assumption is the rate of return on investments. While the City has reduced its assumption from 9 to 7.85 percent over the past eight years, there will likely be pressure for further reductions to decrease the risk faced by the system. The market value returns of the Philadelphia pension system over the period from 1995 to 2013 averaged 7.6 percent. Continued incremental reductions in the assumed rate of return from the current 7.85 percent will reduce the risk of unsustainable increases in the City's required contributions in the future. They will also allow City policy makers to adopt a less risky investment strategy, which would result in less volatile returns and more predictable funding requirements. However, the



price of a lower return assumption will be increased contributions in the short term.

The City has adopted a number of initiatives to restrain pension cost growth. These include efforts to increase employee contributions and mandate participation in a new, lower cost hybrid pension plan, known as Plan 10. The City has been successful to date in marginally increasing employee contributions. However, to date, as a result of the arbitration and collective bargaining process, only new employees of the Register of Wills have been required to participate in Plan 10.[2] Other employees have the option of participating in the tradiitonal Plan 87 once hired. Without mandatory participation of new employees in a lower cost system, the City's ability to limit cost growth over the long term will be greatly constrained.

The pension system will remain a risk to City finances for decades to come. The risk to the Plan is that over the next five years contributions required under state law will escalate more rapidly than the Plan projects.

[2] Newly-hired correctional officers are required under a 2012 arbitration award to participate in Plan 10. However, the legislation required to implement this provision of the award had not yet been enacted.

IV. Financial and Personnel Trends

This section contains an overview of financial and personnel data for some of the larger City agencies, covering the period of FY08 through FY15. Unlike the section on Spending and Performance in last year's PICA Staff Report on the Plan, this section only covers obligations and personnel. An analysis of agency performance will be presented in a later report, which PICA intends to issue in the fall. Performance is an issue PICA staff decided would be better and more comprehensively addressed outside of the context of the Plan review process.

Data on obligations in the General Fund and other operating funds through FY13 are actual. Obligations for FY14 and FY15 are estimates drawn from the proposed FY15-FY19 Plan and the Mayor's budget document. Therefore, the figures for FY14 and FY15 are not fully comparable to those for FY13 and before. Estimates tend to be higher than actual numbers because they relate closely to appropriation levels, which are usually higher than actual spending. Under the Charter, the City cannot increase overall appropriation levels for each operating department during the year, except in emergency situations. This necessitates overall appropriation levels that are somewhat higher than likely spending. Estimates based on appropriation levels, therefore, also tend to be higher than actual spending. Personnel data from FY08 through FY13 represent filled positions as of June 30, as shown in the *Quarterly City Managers Report*. Position levels for FY14 use the most recent QCMR data and show filled positions as of March 31, 2014. No data are available for FY15.

Indemnities costs are excluded from the agency obligations data. When the City reports actual spending in the *Supplemental Report of Revenues and Obligations*, it allocates indemnities costs to various agencies. However, in the Five-Year Plan, indemnities are reported in a separate category because they are projected only for the General Fund overall, instead of by department. To allow comparability over time, therefore, indemnities are excluded from the agency data for all years and are shown only for the General Fund in aggregate.

Police

Obligations for the Police Department increased by $55.4 million between FY08 and FY13. Between FY12 and FY13 alone, obligations increased by $20.6 million, thus accounting for almost half of aforementioned total increase in just one year. The increase mainly comes from personal services, largely resulting from the FOP arbitration award granted in 2009. The FOP is again due for a new contract, which is projected to lead to further wage increases.

Filled full-time positions declined by 174 from FY08 to FY13, 33 of those positions were lost in FY13, and the trend is estimated to continue downward for FY14.

Table 4.1. Police Department Obligations and Personnel, FY08-FY15 ($ in Millions)

	FY08 Actual	FY09 Actual	FY10 Actual	FY11 Actual	Fy12 Actual	FY13 Actual	FY14 Est.	FY15 Est.
General Fund Obligations								
Personnel	$509.1	$517.4	$512.5	$520.7	$536.5	$555.2	$570.0	$576.1
Other	14.8	16.9	16.4	15.5	15.7	16.6	15.9	16.4
Total	524.0	534.3	528.9	536.2	552.3	571.9	585.9	592.5
All Funds Obligations								
Personnel	526.4	534.6	530.2	540.8	556.1	574.0	588.7	597.4
Other	19.1	24.2	24.2	19.4	24.4	27.1	29.4	35.5
Total	545.6	558.8	554.4	560.2	580.4	601.0	618.1	632.8
Filled Positions								
General Fund	7,367	7,443	7,378	7,219	7,225	7,193	7,083	
All Funds	7,531	7,605	7,546	7,384	7,390	7,357	7,247	

Source: Obligations data from *Supplemental Report of Revenues and Obligations*, Proposed FY15-FY19 *Five-Year Financial Plan*, and Mayor's Operating Budget. Personnel data from *Quarterly City Managers Report*.

Fire

Total obligations between FY08 and FY13 experienced little variation, ultimately leading to an overall increase of $13.9 million for that time period. However, FY14 estimates show a $62 million increase from the prior fiscal year. This change is due to an increase of $55.3 million in personal services, arising from the most recent IAFF award. Retroactive wage costs covering the period FY10 through FY13 account for $31.4 million of the FY14 personal services obligations.

Full time positions increased by 58 between FY12 and FY13. There is a further estimated increase for positions during FY14.

Streets

Total obligations fell by $16.2 million between FY08 and FY13; however, estimates for FY14 show a rise in obligations from the prior fiscal year. This increase is largely due to the unusually harsh winter the City experienced this year. Another factor contributing to the rise in obligations was the new DC47 award. Positions have remained relatively flat since FY10.

First Judicial District

Obligations decreased by $13.3 million from FY08 to FY13, almost half of that overall decrease ($6.5 million) occurred between FY12 and FY13. The decline in obligations up until FY12 was mostly due to a decline in personal services, however those costs begin an upward trend starting FY13, and FY14 figures are expected to reach FY08 levels.

Meanwhile positions in FJD continue to decline, showing 100 less positions between FY12 and FY13, with a continued estimated decline for FY14.

Prison System

Obligations for FY13, amounting to $241.7 million, exceeded the previous recent high point obligations had reached in FY09 of $241.4 million. This accounts for an almost $10 million increase between FY12 and FY13, and the number is expected to be higher for FY14. The main driver for obligations in the Prison System is the inmate census, which guides costs for staffing, food, and medical services. The FY14 numbers are a result of overtime and inmate housing costs, which are projected to go away in FY15.

Between FY12 and FY13, 104 full time positions were added, with estimates being higher still in FY14.

Human Services

Department of Human Services (DHS) obligations have declined since FY08, representing a decrease of $96.2 million leading up to FY13. The decline was primarily due to a reduction of children in out-of-home placement. Total obligations are estimated to increase between FY13 and FY14; mostly due to an increase in the Grants Revenue Fund; however, it is important to note that estimates concerning this fund are usually

Table 4.2. Fire Department Obligations and Personnel, FY08-FY15 ($ in Millions)

	FY08 Actual	FY09 Actual	FY10 Actual	FY11 Actual	Fy12 Actual	FY13 Actual	FY14 Est.	FY15 Est.
General Fund Obligations								
Personnel	$169.9	170.0	169.5	174.4	173.5	179.8	222.8	182.9
Other	19.3	19.1	19.4	19.4	21.5	20.2	23.9	23.9
Total	189.2	189.1	188.9	193.8	195.0	200.0	246.7	206.8
All Funds Obligations								
Personnel	175.1	175.6	174.7	180.0	179.9	186.7	242.0	201.4
Other	19.8	19.6	20.5	20.4	22.7	22.1	28.7	27.4
Total	194.9	195.2	195.3	200.4	202.6	208.8	270.8	228.9
Filled Positions								
General Fund	2,326	2,259	2,187	2,146	2,072	2,125	2,087	
All Funds	2,390	2,327	2,256	2,218	2,144	2,202	2,283	

Source: Obligations data from *Supplemental Report of Revenues and Obligations*, Proposed FY15-FY19 *Five-Year Financial Plan*, and Mayor's Operating Budget. Personnel data from *Quarterly City Managers Report*.

Table 4.3. Streets Department Obligations and Personnel, FY08-FY15 ($ in Millions)								
	FY08 Actual	FY09 Actual	FY10 Actual	FY11 Actual	Fy12 Actual	FY13 Actual	FY14 Est.	FY15 Est.
General Fund Obligations								
Personnel	66.2	73.1	69.8	66.6	66.0	65.1	68.3	67.5
Other	62.4	58.3	60.5	57.5	49.9	44.1	53.9	50.1
Total	128.6	131.4	130.4	124.1	115.9	109.2	122.2	117.6
All Funds Obligations								
Personnel	78.1	79.7	77.0	74.5	73.4	73.4	76.8	75.5
Other	82.3	81.3	85.4	81.5	73.6	70.8	98.2	104.3
Total	160.4	161.0	162.4	156.0	147.0	144.2	175.0	179.8
Filled Positions								
General Fund	1,839	1,719	1,693	1,689	1,682	1,690	1,690	
All Funds	1,840	1,719	1,693	1,689	1,682	1,690	1,690	

Source: Obligations data from *Supplemental Report of Revenues and Obligations*, Proposed FY15-FY19 *Five-Year Financial Plan*, and Mayor's Operating Budget. Personnel data from *Quarterly City Managers Report*.

higher, than actuals, often by a significant margin, as mentioned earlier.

Positions are expected to increase slightly between FY13 and FY14; however, FY13 was a baseline year due to restructuring changes within the department. Thus, there is not enough data to draw conclusions regarding personnel levels at this point.

Public Health

Total obligations grew significantly between FY08 and FY12, although General Fund obligations during this period experienced insignificant changes. Total obligations in FY13 remained near FY12 levels. Figures for FY14 are expected to rise due to an increase in personal services, however, these are estimates and are not fully comparable to actual figures for prior years. Although the number of positions is almost unchanged during this time period, there is an increase in personal services costs in light of the new DC47 wage increase.

Licenses and Inspections

Obligations for the Department of Licenses and Inspections have fluctuated since FY08. In FY13, obligations rose by $10.7 million, which was a significant increase from the estimated figure for that year. An

Table 4.4. First Judicial District Obligations and Personnel, FY08-FY15 ($ in Millions)								
	FY08 Actual	FY09 Actual	FY10 Actual	FY11 Actual	Fy12 Actual	FY13 Actual	FY14 Est.	FY15 Est.
General Fund Obligations								
Personnel	96.8	95.2	85.8	85.0	90.0	91.8	93.6	93.2
Other	28.1	26.0	26.0	30.2	27.0	18.8	12.2	13.0
Total	124.9	121.3	111.7	115.2	116.9	110.7	105.8	106.3
All Funds Obligations								
Personnel	114.7	112.8	107.4	107.3	109.8	111.1	114.0	118.5
Other	34.3	32.7	31.9	36.1	32.7	24.6	17.3	22.7
Total	149.0	145.5	139.4	143.4	142.5	135.7	131.3	141.1
Filled Positions								
General Fund	2,087	2,008	1,862	1,869	1,957	1,909	1,871	
All Funds	2,526	2,459	2,410	2,372	2,460	2,360	2,334	

Note: Includes Clerk of Quarter Sessions. This office was merged with the First Judicial District effective in FY11.
Source: Obligations data from *Supplemental Report of Revenues and Obligations*, Proposed FY15-FY19 *Five-Year Financial Plan*, and Mayor's Operating Budget. Personnel data from *Quarterly City Managers Report*.

Table 4.5. Prison System Obligations and Personnel, FY08-FY15 ($ in Millions)	FY08 Actual	FY09 Actual	FY10 Actual	FY11 Actual	FY12 Actual	FY13 Actual	FY14 Est.	FY15 Est.
General Fund Obligations								
Personnel	122.7	124.6	120.9	117.9	121.5	130.1	133.2	129.2
Other	99.3	116.7	112.9	113.2	110.0	111.4	112.5	111.6
Total	222.0	241.3	233.8	231.2	231.5	241.5	245.6	240.8
All Funds Obligations								
Personnel	122.7	124.6	120.9	117.9	121.5	130.1	133.2	129.2
Other	99.4	116.8	114.4	114.7	110.7	111.7	112.5	111.6
Total	222.1	241.4	235.3	232.6	232.2	241.7	245.7	240.8
Filled Positions[1]	2,131	2,067	2,254	2,166	2,144	2,248	2,310	

Note:
[1]All Prison System employees are paid through the General Fund.
Source: Obligations data from *Supplemental Report of Revenues and Obligations*, Proposed FY15-FY19 *Five-Year Financial Plan*, and Mayor's Operating Budget. Personnel data from *Quarterly City Managers Report*.

infusion of $3 million for demolitions occurred in FY14 and is set to expire in FY16.

There were 10 positions vacated between FY12 and FY13; however, 7 of them are estimated to have been filled during FY14.

Innovation and Technology

Obligations between FY08 and FY13 increased by $74.8 million, and estimates point to a further increase in FY14. Estimates will likely come below projections; costs are associated with purchase of services related to technology needs, and payments to other funds for the 911 emergency system.

Positions have not experienced much variation since FY11.

Law

Obligations continue their steady decline since FY08, representing an overall reduction of approximately 46 percent. A large portion of that decrease is due to a decline in personal services, another contributor was the transfer of the Tax Unit from the Law Department

Table 4.6. Department of Human Services Obligations and Personnel, FY08-FY15 ($ in Millions)	FY08 Actual	FY09 Actual	FY10 Actual	FY11 Actual	FY12 Actual	FY13 Actual	FY14 Est.	FY15 Est.
General Fund Obligations								
Personnel	96.3	98.4	94.1	93.0	23.2	22.3	21.6	24.3
Other	518.5	501.4	467.0	449.9	78.7	68.1	77.5	75.1
Total	614.8	599.8	561.1	542.9	101.9	90.4	99.1	99.5
All Funds Obligations								
Personnel	100.0	102.1	97.9	96.7	93.5	92.3	99.0	99.5
Other	525.4	506.6	477.4	457.5	438.2	437.0	519.2	520.9
Total	625.4	608.7	575.3	554.3	531.7	529.2	618.2	620.3
Filled Positions								
General Fund	1,784	1,741	1,751	1,668		377	392	
All Funds	1,825	1,807	1,803	1,716		1,549	1,586	

Source: Obligations data from *Supplemental Report of Revenues and Obligations*, Proposed FY15-FY19 *Five-Year Financial Plan*, and Mayor's Operating Budget. Personnel data from *Quarterly City Managers Report*.

Table 4.7. Department of Public Health Obligations and Personnel, FY08-FY15 ($ in Millions)								
	FY08 Actual	FY09 Actual	FY10 Actual	FY11 Actual	FY12 Actual	FY13 Actual	FY14 Est.	FY15 Est.
General Fund Obligations								
Personnel	42.1	42.9	41.4	37.7	39.1	40.5	48.2	48.5
Other	70.6	73.4	69.7	71.2	68.1	68.5	66.9	67.0
Total	112.7	116.2	111.1	108.8	107.2	109.0	115.1	115.4
All Funds Obligations								
Personnel	54.6	54.6	53.8	53.0	52.8	52.8	61.5	64.8
Other	134.6	185.6	237.4	282.8	275.9	274.0	283.6	288.1
Total	189.2	240.3	291.1	335.8	328.7	326.8	345.1	352.8
Filled Positions								
General Fund	665	675	662	661	669	673	674	
All Funds	880	890	875	885	893	842	844	
Source: Obligations data from *Supplemental Report of Revenues and Obligations*, Proposed FY15-FY19 *Five-Year Financial Plan*, and Mayor's Operating Budget. Personnel data from *Quarterly City Managers Report*.								

to the Department of Revenue in 2012, and a third factor was a reduction in Community Development Fund obligations.

After a significant decrease in staffing between FY08 and FY12, there was an increase of 32 positions in FY13. A smaller increase is further estimated for FY14.

Revenue

Total obligations increased by $14.4 million between FY08 to FY13 and are estimated to increase for FY14. The reasons are a rise in personal services obligations, as well as purchase of consulting services for office reconfigurations and job analysis.

Positions have been declining since FY09; 16 positions were lost in FY14.

Property Assessment

Total obligations have steadily increased, beginning at $5.7 million in FY11, reaching $11.6 million in FY13, while estimates for FY14 show another $2 million increase, which will likely be lower than projected. This represents an overall increase of almost 50 percent from

Table 4.8. Department of Licenses and Inspections Obligations and Personnel, FY08-FY15 ($ in Millions)								
	FY08 Actual	FY09 Actual	FY10 Actual	FY11 Actual	FY12 Actual	FY13 Actual	FY14 Est.	FY15 Est.
General Fund Obligations								
Personnel	17.8	16.6	14.2	13.7	13.9	14.1	15.4	16.9
Other	12.5	10.1	8.5	4.4	7.3	7.4	10.4	11.0
Total	30.3	26.7	22.7	18.1	21.2	21.5	25.8	27.9
All Funds Obligations								
Personnel	18.7	17.4	15.1	14.5	14.8	14.8	15.9	17.4
Other	16.0	10.1	8.6	18.2	11.9	22.7	14.9	15.5
Total	34.7	27.5	23.7	32.7	26.7	37.4	30.8	32.9
Filled Positions								
General Fund	356	309	305	290	298	292	299	
All Funds	374	323	316	302	310	300	307	
Source: Obligations data from *Supplemental Report of Revenues and Obligations*, Proposed FY15-FY19 *Five-Year Financial Plan*, and Mayor's Operating Budget. Personnel data from *Quarterly City Managers Report*.								

Table 4.9. Office of Innovation and Technology Obligations and Personnel, FY08-FY15 ($ in Millions)								
	FY08 Actual	FY09 Actual	FY10 Actual	FY11 Actual	FY12 Actual	FY13 Actual	FY14 Est.	FY15 Est.
General Fund Obligations								
Personnel	9.6	9.0	10.5	16.9	16.4	17.2	19.5	19.7
Other	24.4	27.4	28.0	44.4	46.9	46.0	65.4	62.5
Total	34.0	36.4	38.5	61.3	63.3	63.2	84.9	82.2
All Funds Obligations								
Personnel	11.0	10.1	11.8	21.7	21.0	21.9	24.5	25.6
Other	26.6	29.2	50.5	98.9	89.7	90.4	137.2	129.1
Total	37.6	39.3	62.2	120.6	110.7	112.4	161.7	154.7
Filled Positions								
General Fund	141	146	174	258	255	255	256	
All Funds	158	162	190	325	322	324	326	
Source: Obligations data from *Supplemental Report of Revenues and Obligations*, Proposed FY15-FY19 *Five-Year Financial Plan*, and Mayor's Operating Budget. Personnel data from *Quarterly City Managers Report*.								

FY08 to FY13, mostly due to an increase in personal services.

Positions have fluctuated significantly since FY11; having declined by 330 in FY12, and increased by 16 in FY13. Positions are projected to remain stable for FY14.

Pension Payments

Between FY08 and FY13, total obligations for pension payments increased by $237.8 million. In just one fiscal year, between FY12 and FY13, the payments increased by $83.7 million. These figures illustrate a substantial overall increase that is occurring at a rapid rate each year. The projected payment in FY15 represents additional revenues from the sales tax, as well as $700 million in proceeds from the pending PGW sale.

School District Contributions

Although the School District of Philadelphia (SDP) is not an operating department and is not under the financial control of the City, we are including it in this discussion because it is pertinent to the overall health of Philadelphia in numerous ways. The City provides two sources of financial support to SDP: (1) local taxes levied by the City which generate revenue that is entirely dedicated to SDP; and (2) appropriations from

Table 4.10. Law Department Obligations and Personnel, FY08-FY15 ($ in Millions)								
	FY08 Actual	FY09 Actual	FY10 Actual	FY11 Actual	FY12 Actual	FY13 Actual	FY14 Est.	FY15 Est.
General Fund Obligations								
Personnel	10.9	12.7	10.1	9.2	6.4	6.5	6.8	7.2
Other	10.2	6.6	7.8	7.7	8.0	7.9	6.3	6.3
Total	21.1	19.3	17.9	17.0	14.3	14.4	13.2	13.4
All Funds Obligations								
Personnel	14.9	16.4	13.9	13.1	10.1	10.2	10.9	11.3
Other	27.2	20.2	22.7	17.0	9.4	9.2	7.7	7.5
Total	42.0	36.6	36.7	30.1	19.5	19.5	18.6	18.7
Filled Positions								
General Fund	192	182	176	160	105	138	147	
All Funds	249	235	236	215	160	192	200	
Source: Obligations data from *Supplemental Report of Revenues and Obligations*, Proposed FY15-FY19 *Five-Year Financial Plan*, and Mayor's Operating Budget. Personnel data from *Quarterly City Managers Report*.								

Table 4.11. Revenue Department Obligations and Personnel, FY08-FY15 ($ in Millions)								
	FY08 Actual	FY09 Actual	FY10 Actual	FY11 Actual	FY12 Actual	FY13 Actual	FY14 Est.	FY15 Est.
General Fund Obligations								
Personnel	11.9	12.5	11.6	11.5	14.5	14.5	16.2	17.8
Other	4.5	4.5	4.8	2.6	4.3	4.2	4.8	4.7
Total	16.4	17.0	16.4	14.2	18.8	18.7	21.1	22.4
All Funds Obligations								
Personnel	21.4	22.5	21.5	21.1	24.3	24.5	27.5	28.3
Other	13.7	12.1	19.1	6.7	20.1	25.1	30.9	30.7
Total	35.2	34.5	40.6	27.8	44.4	49.6	58.3	59.0
Filled Positions								
General Fund	252	256	250	248	286	282	282	
All Funds	474	490	486	487	525	521	505	
Source: Obligations data from *Supplemental Report of Revenues and Obligations*, Proposed FY15-FY19 *Five-Year Financial Plan*, and Mayor's Operating Budget. Personnel data from *Quarterly City Managers Report*.								

the City General Fund that are transferred to SDP.

Table 4.13 shows trends in the General Fund allocation to the School District. There have been significant increases in this allocation since FY08, with an increase of $32 million through FY13, thus nearly doubling the contributions in this time period. Future contributions are relatively unquantifiable due to various unpredictable circumstances surrounding School District funding. However, there will be an additional $120 million allocated from the local sales taxes to the District that will form a predicable permanent revenue stream for SDP.

Indemnities

Indemnities are included in a separate table because, as mentioned above, that is how they are presented in the Plan. There has been an overall upward trend in indemnities since 2008. In FY13, indemnities dropped by $2.3 million; however, they are projected to experience a substantial increase in FY14, representing $10.7 million since the previous fiscal year – this cost is for a case settlement, which once paid, should decrease indemnities in FY15.

Table 4.12. Office of Property Assessment Obligations and Personnel, FY08-FY15 ($ in Millions)								
	FY08 Actual	FY09 Actual	FY10 Actual	FY11 Actual	FY12 Actual	FY13 Actual	FY14 Est.	FY15 Est.
General Fund Obligations[1]								
Personnel	0.0	0.0	0.0	5.3	7.0	8.1	10.6	10.7
Other	0.0	0.0	0.0	0.5	1.0	3.4	3.2	3.6
Total	0.0	0.0	0.0	5.7	8.0	11.6	13.7	14.3
General Fund Filled Positions[1]	0	0	0	132	157	173	173	
Note: [1]All Office of Property Assessment obligations are recognized in, and all employees are paid through, the General Fund. Source: Obligations data from *Supplemental Report of Revenues and Obligations*, Proposed FY15-FY19 *Five-Year Financial Plan*, and Mayor's Operating Budget. Personnel data from *Quarterly City Managers Report*.								

Table 4.13. Pension Obligations, FY08-FY15 ($ in Millions)[1]								
	FY08 Actual	FY09 Actual	FY10 Actual	FY11 Actual	FY12 Actual	FY13 Actual	FY14 Est.	FY15 Est.
General Fund	430.8	459.0	346.7	490.2	547.8	618.9	667.5	1,278.4
All Funds	497.4	529.8	400.5	568.0	651.5	735.2	765.5	1,363.6

Note:
[1]Includes direct payments to Pension Fund and debt service on pension-related debt. The amounts in FY13 and FY14 include repayments of FY10 and FY11 contributions that were deferred. The FY15 projection includes $700 million in estimated net proceeds from the sale of the Philadelphia Gas Works.
Source: Obligations data from *Supplemental Report of Revenues and Obligations*, Proposed FY15-FY19 *Five-Year Financial Plan*, and Mayor's Operating Budget. Personnel data from *Quarterly City Managers Report*.

Table 4.14. Contribution to School District, FY08-FY15 ($ in Millions)								
	FY08 Actual	FY09 Actual	FY10 Actual	FY11 Actual	FY12 Actual	FY13 Actual	FY14 Est.	FY15 Est.
General Fund[1]	37.0	38.5	38.5	38.6	48.9	69.0	114.1	69.1

Note:
[1]The City's annual subsidy to the School District of Philadelphia (SDP) is recognized entirely in the General Fund. The FY14 amout includes a $45 million one-time transfer of state aid to SDP that passed through the City General Fund.
Source: Obligations data from *Supplemental Report of Revenues and Obligations*, Proposed FY15-FY19 *Five-Year Financial Plan*, and Mayor's Operating Budget. Personnel data from *Quarterly City Managers Report*.

Table 4.15. Indemnities Obligations, FY08-FY15 ($ in Millions)								
	FY08 Actual	FY09 Actual	FY10 Actual	FY11 Actual	FY12 Actual	FY13 Actual	FY14 Est.	FY15 Est.
General Fund[1]	24.7	34.5	32.6	33.7	32.6	30.3	41.0	33.7

Note:
[1]The aggregate indemnity costs for all funds was not available.
Source: Obligations data from *Supplemental Report of Revenues and Obligations*, Proposed FY15-FY19 *Five-Year Financial Plan*, and Mayor's Operating Budget. Personnel data from *Quarterly City Managers Report*.

V. Indicators of Financial Health

This section discusses trends in key indicators of the City's financial health. The indicators are presented in two categories: economic and financial. The economic indicators are measures of Philadelphia's economic health in relation to the region and the nation as a whole. The financial indicators are focused on key aspects of fiscal stability and sustainability, including General Fund balance, debt, pension liabilities, and liabilities arising from other post-employment benefits.

Economic Indicators

Major indicators of the city's economic health include payroll employment, the unemployment rate, the poverty rate, and median household income. Trends in these indicators are described in this section.

Employment. Table 5.1 presents average monthly payroll employment for the city, the Philadelphia region, and the nation. Average monthly payroll employment in the city increased from 662,000 in 2012 to 667,000 in 2013. The city's share of regional employment decreased slightly from 24.3 percent in 2012 to 24.2 percent in 2013. As a share of national payroll employment, city employment declined from 0.494 percent in 2012 to 0.489 percent in 2013.

Since 2004, the City's share of regional employment has remained fairly constant, ranging from 23 to 24 percent. The city's share increased somewhat during the early years of the recession in 2010 and 2011 and has since declined slightly, indicating a less robust recovery from the recession than the rest of the region. This could reflect Philadelphia's relatively high employment concentration in health services and education, two sectors that tend to be more stable over the business cycle. While the city's share of national employment did increase from 2007 to 2010, it has since declined, indicating that the city may be returning to the long term trend of a declining share of national employment. The general loss of employment share relative to the nation over the last decade is an indication that the city's economy continues to face challenges relative to the nation as a whole.

Unemployment Rate. Table 5.2 presents average annual unemployment rates in the city, region, and nation from 2004 to 2013. After peaking at 10.8 percent in 2010, the city's unemployment rate declined to 10 percent in 2013. The city's unemployment rate has been consistently higher than the regional rate, although the gap between the city and region has narrowed since 2004. In 2004, the city's average unemployment rate was 43 percent higher than the region, while in 2013, the city's rate was 28 percent above the region. The gap between the city and region narrowed substantially during the recession, with the city's rate 17 percent higher than the region in 2009. Again, this suggests the relative stability of the city economy across the business cycle compared to the region, reflecting the industry mix in the city with its concentration in health services and education.

The gap between city and national unemployment rates also narrowed considerably during the recession, with the city rate only 3 percent above the national rate in 2009. Since 2009, the city's rate relative to the nation has increased, with the city's rate 35 percent higher

Table 5.1. Non-Farm Payroll Employment, Philadelphia City, Region, and Nation, 2004-2013.

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
City (Thousands)	658	660	663	663	663	653	657	660	662	667
Region (Thousands)	2,745	2,773	2,798	2,811	2,807	2,711	2,697	2,707	2,725	2,750
Nation (Millions)	131.7	134.0	136.4	137.9	137.2	131.2	130.3	131.8	134.1	136.4
City as Percent of Region	24.0	23.8	23.7	23.6	23.6	24.1	24.4	24.4	24.3	24.2
City as Percent of Nation	.499	.493	.486	.480	.484	.497	.505	.501	.494	.489

Source: Bureau of Labor Statistics, Current Population Survey. Philadelphia region is the Philadelphia-Wilmington-Camden PA-NJ-DE-MD metropolitan statistical area. Amounts are annual averages, seasonally adjusted.

Table 5.2. Unemployment Rate, Philadelphia City, Region, and Nation, 2004-2013.										
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
City	7.3	6.7	6.2	6.0	7.1	9.6	10.8	10.9	10.8	10.0
Region	5.1	4.7	4.5	4.3	5.4	8.2	8.9	8.6	8.5	7.8
Nation	5.5	5.1	4.6	4.6	5.8	9.3	9.6	8.9	8.1	7.4
City as Percent of Region	143	143	138	140	131	117	121	127	127	128
City as Percent of Nation	133	131	135	130	122	103	113	122	133	135
Source: Bureau of Labor Statistics, Local Area Unemployment Statistics and Current Population Survey. Philadelphia region is the Philadelphia-Wilmington-Camden PA-NJ-DE-MD metropolitan statistical area. Amounts are annual averages of monthly unemployment rates, not seasonally adjusted.										

than the nation in 2013. By 2013, the gap between the city and national unemployment rate had returned to pre-recession levels. As the nation and city recover from the recession, it can be expected that both the city and national unemployment rates will continue to decline in 2014 and beyond. The relationship between the city and national rates will remain an important indicator of the strength of the city economy relative to the nation's.

Poverty Rate. Table 5.3 presents trends in the poverty rate in the city compared to that of the Commonwealth of Pennsylvania and the nation as a whole. The city's poverty rate has increased substantially over the past decade, from 21.6 percent in 2004 to 26.7 percent in 2012, the most recent year for which data are available. Over the same period, the state poverty rate increased from 11.2 percent to 13.7 percent, while the national rate increased from 12.7 percent to 15.9 percent. The overall increase reflects primarily the impact of the recession. The city's rate decreased from 27.9 percent in 2011 to 26.7 percent in 2012, potentially indicating the impact of the economic recovery.

The city's poverty rates have consistently been higher than the state and national poverty rates since 2004. Over this period, the city rate has generally been about twice that of the state. The city's rate relative to the national rate has improved since 2006, with the gap between the city and nation declining from 87 percent in 2006 to 68 percent in 2012. The declining gap relative to the nation may be an indication that the impact of the recession was less severe in the city than in the nation as a whole.

Table 5.3. Poverty Rate and Median Household Income, Philadelphia, Pennsylvania, and Nation, 2004-2012.									
	2004	2005	2006	2007	2008	2009	2010	2011	2012
Poverty Rate (Percent) City	21.6	24.2	24.9	23.5	23.8	24.5	26.4	27.9	26.7
State	11.2	11.9	12.0	11.6	12.1	12.5	13.4	13.7	13.7
US	12.7	13.3	13.3	13.0	13.2	14.3	15.3	15.9	15.9
City as Percent of State	193	203	208	203	197	196	197	204	195
City as Percent of US	170	182	187	181	180	171	173	175	168
Median Household Income City	$30,892	$32,671	$33,368	$35,431	$37,090	$36,959	$34,667	$34,433	$35,518
State	43,714	44,545	46,256	48,562	50,702	49,501	49,245	50,221	51,225
US	44,334	46,242	48,451	50,740	52,029	50,221	50,046	50,502	51,371
City as Percent of State	71	73	72	73	73	75	70	69	69
City as Percent of US	70	71	69	70	71	74	69	68	69
Source: US Bureau of the Census, Small Area Income and Poverty Estimates.									

Table 5.4. General Fund Year-End Fund Balance and Total Obligations, FY04-FY13 ($ in Millions)										
	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12	FY13
Fund Balance	($46.8)	$96.2	$254.5	$297.9	$119.5	($137.2)	($114.0)	$0.1	$146.8	$256.9
Obligations	3,428.2	3,386.3	3,426.0	3,736.7	3,919.8	3,915.3	3,653.7	3,785.3	3,484.9	3,613.3
Fund Balance as a Percent of Obligations	(1.4)	2.8	7.4	8.0	3.0	(3.5)	(3.1)	0.0	4.2	7.1
Source: *Comprehensive Annual Financial Report*, Office of the Director of Finance, City of Philadelphia, various years.										

Overall, the city has one of the highest poverty rates among the major cities. Since poverty rates tend to move consistently with macroeconomic trends, it could be expected that the city rate will decline as the nation and city recover from the recession. However, the gap between Philadelphia and other cities, the state, and the nation, will be an important indicator of the health of the city's economy, the effectiveness of state and local anti-poverty strategies, and the overall integration of the population into the labor market. Perhaps the most effective anti-poverty strategy for the city will be an effort to improve the overall economic competitivess of the city relative to the state and nation.

Median Household Income. The city's median household income is an indicator of the overall economic well-being of residents. This measure includes both earned and unearned income, and transfer payments. As such, it is influenced both by economic trends and federal and state policies that influence the availability of transfer payments and the extent to which households participate in programs for which they are eligible.

The city's median household income in 2012 was $35,518, a substantial increase from the 2004 level of $30,892. Median household income in Philadelphia peaked at $37,090 in 2008 and declined through 2011. The increase in 2012 was the first annual increase since 2007, indicating recovery from the recession. State and national median household income also peaked in 2008. However, at the state and national level, income declined through 2010 and began to increase in 2011, while the city's increase did not begin until 2012.

Consistent with the other economic indicators above, median household income trends suggest that the impact of the recession on the city was less pronounced than in the region and nation. City median household income as a percentage of state income increased from 71 percent in 2004 to 75 percent in 2009, and declined to 69 percent in 2012. Similarly, city income as a percent of the nation increased from 70 percent in 2004 to 74 percent in 2009 and declined to 69 percent in 2012. The recession's impact on household income in Philadelphia may have been less severe, in part due to the relative stability of the city economy during the recession compared to the state and nation. Also, household income in the city may have been less impacted by the recession due to a large proportion of income from transfer payments.

Financial Indicators

Fund Balance. A primary measure of the City's financial stability is the General Fund balance as a percentage of total obligations. This indicator suggests the extent to which the fund balance provides an adequate level of resources to cover the financial impact of events that could adversely affect revenues or expenses. Table 5.4 presents a ten-year trend of General Fund balance, obligations, and fund balance as a percentage of obligations.

Since FY04, the fund balance has generally moved in a pattern consistent with the macroeconomy. The city's fund balance increased from FY05 to FY07, indicating the broad pattern of economic growth in that period. Fund balance declined in FY08, and the City incurred deficits in FY09 and FY10, primarily as a result of the recession. Another factor influencing the negative fund balance in FY10 was the timing of state and federal grants to reimburse costs of services offered by the Department of Human Services. The fund balance turned positive in FY11 and increased from FY11 to FY13.

As a percentage of General Fund obligations, the fund balance peaked at 8.0 percent in Fy07, before declining to negative 3.5 percent in FY09. Fund balance has since increased to 7.1 percent of obligations in FY13.

Table 5.5. Debt Indicators, City and School District of Philadelphia, 2004-2013.										
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Debt Outstanding ($ in Millions) City Pension-Related	1,416	1,430	1,439	1,445	1,447	1,444	1,428	1,407	1,379	1,595
City Other	2,589	2,629	2,544	2,801	2,689	2,867	2,843	2,876	2,764	2,685
School District	2,319	2,397	2,389	2,640	2,614	2,825	2,994	2,981	3,144	3,295
Total	6,325	6,456	6,373	6,885	6,750	7,136	7,266	7,264	7,287	7,575
Debt Per Capita City	2,683	2,723	2,676	2,843	2,758	2,846	2,794	2,784	2,675	2,756
School District	1,554	1,608	1,605	1,768	1,743	1,865	1,959	1,938	2,030	2,121
Total	4,237	4,330	4,281	4,611	4,501	4,711	4,753	4,721	4,706	4,877
Debt as a Percent of Personal Income City	9.0	8.8	8.2	8.3	7.4	7.6	7.2	6.8	6.5	6.5
School District	5.2	5.2	4.9	5.2	4.7	5.0	5.0	4.8	4.9	5.0
Total	14.2	14.0	13.2	13.5	12.1	12.5	12.2	11.6	11.4	11.5
City Debt Service as a Percent of General Fund Obligations Pension-Related Debt	2.2	2.4	2.5	2.4	2.4	2.5	3.1	3.0	3.0	5.6
Other	6.2	5.8	5.6	5.5	5.2	5.6	6.0	6.1	5.9	6.0
Total	8.4	8.1	8.0	7.9	7.6	8.2	9.1	9.1	8.9	11.5

Note: Measures of City indebtedness include only debt related to governmental activities. Personal income for 2013 is a PICA staff estimate based on past trends. To ensure comparability, General Fund obligations exclude Department of Human Services (DHS) obligations. DHS grant-funded obligations were recognized in the Grants Revenue Fund beginning in FY12.
Source: *Comprehensive Annual Financial Report* for City and School District of Philadelphia; US Census Bureau population estimates; US Bureau of Economic Analysis estimates of personal income.

There are a number of factors that could negatively impact fund balance trends in the future, including labor contracts, pension obligations, and slower economic growth or a recession. These factors are discussed in Section III. The Plan as submitted, supplemented based on an updated projection of pension costs, projects a decline of fund balance from a projected $146.8 million in FY14 to $92.7 million in FY19. The actual decline could be greater, if the risks described in Section III actually occur, and the City does not take other measures to reduce expenses or increase revenues.

The relatively low fund balances in the Plan, combined with the significant risks detailed in Section III, underscore the need for the City to take measures to ensure that it will build up an adequate fund balance to cover unexpected costs and major adverse events such as a recession. The City Charter was amended in 2011 to establish a Budget Stabilization Reserve Fund. This is an important institutional change to promote fiscal stability. The City will be required to make contributions to the Fund when its fund balance exceeds 3 percent of appropriations. Appropriations from the Fund will only be allowed in cases of lower-than-budgeted revenues, in the event of emergencies, or if necessary to avoid service disruptions. To date, no contributions have been made to the Fund due to low fund balances.

The FY15-Fy19 Plan, as submitted to PICA on June 26, did contain a projected contribution to the Fund in FY19 due to a fund balance exceeding the 3 percent threshold. However, the subsequent modification pursuant to a change in actuarial assumptions, caused a reduction in the projected fund balance below the 3 percent level, so that no contributions to the Fund are projected in the Plan. Over the course of the next few fiscal years, the City should take steps to ensure that contributions to this fund will occur, either through revisions in spending plans, adoption of new revenue sources, or improvements in collections of exisitng revenues. The current period of economic stability is an opportunity for the city to build up its General Fund balance and make contributions to the Budget Stabilization Reserve Fund to ensure that funds are available to provide stability in the future.

Debt. Another indicator of the City's financial health is the total debt outstanding, measured in relation to the City's ability to service that debt. Table 5.5 presents several measures of City indebtedness. For purposes of this measure, debt includes outstanding obligations of the City and the School District of Philadelphia (SDP). SDP is a coterminous local government, and its debt is paid in part through taxes levied on City residents and businesses. As such, SDP should be included in an overall measure of local government debt in Philadelphia.

The capacity to pay debt service is assessed by presenting outstanding debt on a per capita basis and as a percentage of resident personal income. Debt burdens are also assessed by presenting General Fund debt service as a percentage of total General Fund obligations.

At the end of FY13, City and SDP debt outstanding was $7.575 billion. This amount represented $4,877 per capita and 11.5 percent of resident personal income. Total City debt service payments totaled 11.5 percent of General Fund obligations. Philadelphia's total local government debt burden per capita increased 15.1 percent from FY04 to FY13, compared to an increase in the Consumer Price Index of 24.9 percent.[1] Local government debt, as a percentage of personal income, declined from 14.2 percent in FY04 to 11.5 percent in FY13.

City debt service, as a percentage of General Fund obligations, increased from 8.4 percent in FY04 to 11.5 percent in FY13. The increase occurred primarily between FY12 and FY13 due to a temporary increase in pension-related debt service. This increase reflected the cost of debt service on bonds issued to finance repayment of pension payments that were deferred during FY10 and FY11.

Overall, city debt levels remain relatively high as a percentage of personal income, but they have remained stable over the past decade. The City will need to ensure that debt levels remain manageable so that adequate resources are available in the General Fund to finance current services.

Pension Funding Status. The funded status of the City's Municipal Retirement System (MRS) is one of the most critical financial challenges facing the city. Issues related to pension funding are described in more detail in Section VI. Table 5.6 presents a multi-year trend in the primary indicators of pension funding status. These measures are drawn from the annual actuarial valuation reports.

The City's funding is determined by state law, which mandates that the City annually contribute a minimum municipal obligation (MMO) to the Pension fund. The MMO includes costs accrued during the year as a result of services provided by current employees, and an amortization payment sufficient to amortize the unfunded liability of the MRS over a defined period, as determined by an actuarial valuation.

An actuarial model of the MRS makes various assumptions that determine the City's MMO requirement each year. The assumptions address returns of pension fund investments, timing of retirement, salary growth, and mortality and disability rates. Based on these assumptions and standard actuarial methods, the actuary calculates, as of June 30 of each year, the value of assets, liabilities, funded ratio of the System, and MMO contribution, as well as the level of contributions required under the City's funding policy. The funding policy is based upon a different method of amortizing the unfunded liability. The funding policy contribution in recent years has been higher than the MMO.

Since 2004, the actuarial value of assets of MRS has increased from $4.458 billion to $4.799 billion. Over the same period, the actuarial liability has increased from $7.248 billion to $10.126 billion. The funded ratio of the system has declined from 59.8 to 47.4 percent. The unfunded liability has increased from 230 to 373 percent of covered payroll.

[1] US Bureau of Labor Statistics, Consumer Price Index - All Urban Consumers, Philadelphia-Wilmington-Atlantic City metropolitan area.

Table 5.6. Pension Funding Status, 2004-2013 ($ in Millions).										
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Actuarial Value of Assets	4,458	4,333	4,168	4,422	4,624	4,042	4,381	4,719	4,717	4,799
Actuarial Liability	7,248	7,851	8,084	8,197	8,402	8,975	9,317	9,487	9,800	10,126
Unfunded Actuarial Accrued Liability	2,915	3,692	3,915	3,775	3,779	4,933	4,936	4,768	5,083	5,327
Actuarial Funded Ratio	59.8%	53.0%	51.6%	53.9%	55.0%	45.0%	47.0%	49.7%	48.1%	47.4%
Covered Payroll	1,266	1,271	1,319	1,352	1,457	1,463	1,421	1,371	1,372	1,430
Unfunded Liability as a Percent of Covered Payroll	230%	291%	297%	279%	259%	337%	347%	348%	370%	373%
Annual Required Contribution	254	358	395	528	537	540	581	716	723	738
Percentage of ARC Paid	79.9%	83.6%	84.0%	81.9%	79.5%	84.4%	53.8%	65.7%	77.0%	105.9%

Note: The Annual Required Contribution (ARC) reported in the City's financial statements equals the contribution required under the City's funding policy. The City has not followed this policy since 2003. Pension contributions since that time have been equal to, or above, the "minimum municipal obligation" (MMO) required under State law.
Source: City of Philadelphia Municipal Retirement System Actuarial Valuation Reports, various years.

The most troubling aspect of these trends is that, despite the state law mandating the gradual reduction of the unfunded liability of the system through the MMO amortization payment, the actual funded ratio of the system has declined over the past decade. This decline reflects, in part, the adoption of more conservative actuarial assumptions with respect to the rate of return on investments. It also reflects actual investment returns that have often been below the assumed rate. In particular, the large investment losses of 2008 and 2009 resulted in returns well below the assumed rate of return. Going forward, a primary agenda item for MRS should be to ensure that all its actuarial assumptions are realistic. The City has reduced its assumed rate of investment return in recent years. Further, as a result of the most recent experience study, the City made changes to demographic assumptions. Efforts to move the assumptions in a more conservative direction will reduce the risk that contributions will continue their recent unsustainable growth. In addition, they will increase the probability that state-mandated funding levels will increase the funded ratio of MRS over time.

Table 5.6 also presents the Annual Required Contribution (ARC) reported in the City's *Comprehensive Annual Financial Report*, as required under GASB Statement 25. Under GASB 25, the ARC is defined as a payment sufficient to pay system normal costs and amortize any unfunded liabilities over a period not to exceed 30 years. According to the City Finance Department, the Board of Pensions and Retirement has historically presented the funding policy requirement as the ARC payment, although the MMO would also qualify as an appropriate measure of the ARC under GASB rules. The MMO has historically been below the funding policy requirement, due to different amorization methods. The City's actual contributions since 2003 have been based on the MMO rather than the funding policy. Accordingly, the actual contributions have been below the ARC in most years. In the most recent year, contributions were 105.9 percent of the ARC since, in FY13, the City's pension payment included repayment of a portion of required payments for FY10 and FY11 that were deferred in accordance with state authorization granted in 2009.

Other Post-Employment Benefit Funding Status. The City has a substantial unfunded liability related to future obligations to pay for post-employment benefits other than pensions, referred to as "other post-employment benefits" (OPEB). For City retirees, these benefits include health coverage in the first five years

Table 5.7. Other Post-Employment Benefits (OPEB) Funding Status, 2004-2013 ($ in Millions).						
	2008	2009	2010	2011	2012	2013
Actuarial Value of Assets	--	--	--	--	--	
Actuarial Liability	1,156	1,120	1,170	1,213	1,512	
Unfunded Actuarial Accrued Liability	1,156	1,120	1,170	1,213	1,512	
Actuarial Funded Ratio	0%	0%	0%	0%	0%	
Covered Payroll	1457	1462	1420	1469	1372	
Unfunded Liability as a Percent of Covered Payroll	79.4%	76.6%	82.4%	82.5%	110.2%	
Annual OPEB Cost	83.4	98.7	93.8	101.7	105.8	114.4
Payments Made	79.7	81.3	71.7	65.5	76.3	57.1
Percentage of OPEB Cost Paid	95.6%	82.3%	76.4%	64.4%	72.1%	49.9%
Note: Amounts are disclosed as required under GASB Statement 45. Source: *Comprehensive Annual Financial Report*, City of Philadelphia, various years.						

after retirement and life insurance. The City finances OPEB on a pay-as-you-go basis, rather than on an actuarial basis. Under GASB Statement 45, the City is required to disclose actuarial liabilities related to OPEB. Table 5.7 presents trends in these liabilities since 2008.

The total OPEB liability has increased from $1.156 billion in 2008 to $1.512 billion in 2012. This entire liability is unfunded. The liability increased from 79.4 to 110.2 percent of covered payroll from 2008 to 2012. Under GASB Statement 45, the City is required to report an annual OPEB cost, which is the contribution that would be required to fund OPEB liabilities on an actuarially sound basis. Since the City finances OPEB on a pay-as-you-go basis, actual payments have been below the annual OPEB cost since 2008. In FY13, the City's actual payments were $57.1 million, 49.9 percent of annual OPEB cost.

In the future, to promote the long term sustainability of its OPEB commitments, the City may need to consider funding OPEB on an actuarial basis.

VI. Policy and Management Issues that Impact Financial Health

This Section discusses policy and management issues that are important from the standpoint of PICA and the City's fiscal health: the Nutter Administration's proposal to sell the Philadelphia Gas Works, the City pension system, and strategic planning. The former two issues have been studied extensively and remain the subject of ongoing public debate. In this Section, the issues are discussed from the perspective of PICA staff. These issues are important not only to the City's financial condition over the life of the FY15-FY19 Plan, but also over the very long term.

Philadelphia Gas Works

In last year's Staff Report, PICA devoted a section to a discussion of the benefits of privatization of City services in the past, as well as the benefits of certain similar initiatives in other municipalities around the country. This year, the developments surrounding the potential and pending sale of Philadelphia Gas Works (PGW) warrant additional comment on this issue.

The basis for the discussion of privatization is a section in the PICA Act, which states that the City is "charged with the responsibility to exercise efficient and accountable fiscal practices..." Examples of such practices in the Act include "privatization of appropriate city services..." and the "sale of city assets as appropriate..." For the reasons outlined below, it is our position, after reviewing several studies and a presentation by the City, that the currently proposed sale of PGW awaiting approval by City Council is an opportunity for the City. Our discussion of this issue comes before the release of the Council commissioned study by Concentric Energy Advisors, a consulting firm currently examining the transaction. Thus, the findings from the upcoming report of this consultant may supersede some of the discussion herein.

Notwithstanding the new study's potential findings, the PICA staff's support for the City's proposed sale of PGW is based on an array of evidence presented by the City that the sale would be in the best interests of taxpayers and gas ratepayers. Some of the benefits that PICA considered include the following: a large contribution to the Pension Fund, resulting in an accelerated increase in the funded ratio; the elimination of capital costs associated with maintenance of the utility; repayment of PGW debt; full funding of PGW's pension obligations; an improvement in rates for consumers in the long-term, with a rate-freeze for the first three years; advancements in public safety due to the significant acceleration of pipe replacement; among other advantages.

After years of deliberation, extensive research, and financial challenges, the City began the PGW sale exploration process in April, 2013. At the May 20, 2014 PICA Board meeting, City Finance Director Rob Dubow and First Deputy Chief of Staff Suzanne Biemiller explained the process and potential benefits of the pending transaction.

Previous Studies on PGW. The argument for selling PGW was first made in a comprehensive 2008 study by the Economy League of Greater Philadelphia entitled, The Philadelphia Gas Works: Challenges and Solutions. A 2012 strategic assessment commissioned by the City and conducted by Lazard, also made the case for selling PGW. These two studies concluded that private ownership would likely generate significant financial benefits to the City, a likely reduction in gas rates, and improved public safety through continued oversight by the state Public Utility Commission (PUC). Again, we acknowledge that Council is currently awaiting analysis of its own commissioned study. Because that report is not yet complete, we cannot comment on its findings; therefore, we base our analysis on the recommendations of prior studies and the City's presentation.

The Lazard strategic assessment outlined several benefits of privatization: "The proceeds from the divestiture could enable the City to exit its PGW ownership and operating requirements at little or no cost (and potentially at a profit) to the City, while achieving the City's public policy criteria." According to Lazard, "[t]he City would also be able to transfer ownership, operational control and administrative responsibility to the private sector, establishing PGW as an investor-owned utility similar to most large-city utilities in the United States." Lazard's recommendation to privatize was based on the study's valuation of PGW between $1.4 to $2.15 billion; the current sale price of $1.86 billion comes in on the higher end of Lazard's anticipated range.

The 2008 Economy League study similarly concluded: "Selling PGW would remove its liabilities from the City's balance sheet" and that "a new operating structure ultimately could lower cost to customers." It is important to note that the City is currently presented with a much more favorable outcome with the pending sale than envisioned by either of these studies, which both supported privatization even if the sale would result in a financial loss to the City. In fact, rarely in recent history has the City been presented with a viable economic alternative with so many tangible benefits to citizens, ratepayers, and employees alike.

Benefits to the Pension Fund. The benefit of the sale to the City's Pension Fund is a particularly important consideration regarding the UIL offer. The impact of depositing the proceeds of the PGW sale in the Pension Fund is analyzed in an April 2014 report by Cheiron, the Pension Board's actuary for the City Municipal Retirement System. The City has indicated that the net sale proceeds – the amount available after paying closing costs, defeasing PGW debt, fully funding PGW's pension obligations, and setting aside funds for potential contingencies – will likely range from $420 million to $630 million. These funds would be available for a one-time contribution into the City Pension Fund, which would supplement the annual state-required minimum municipal obligation (MMO) payment. The effect of this additional one-time contribution will be to accelerate the rate of reduction in the City's unfunded pension liability.

The deposit of the PGW sale proceeds would occur in FY15, and the initial reduction in the City's required annual MMO payment would occur in FY17, since the July 1, 2015 actuarial valuation would not impact contributions until FY17. The Cheiron analysis finds that the FY17 MMO would be reduced by $40 million, assuming conservatively that the PGW sale generates $420 million for the Pension Fund. It is the City's intention, however, to reduce its pension contribution by $18 million from the currently-projected MMO, reflecting its commitment that the PGW transaction will be budget-neutral to the General Fund (the loss of the $18 million PGW rental payment would be exactly offset by lower pension payments). The result would be $22 million in additional pension payments beyond the currently anticipated MMO. These additional payments would increase over time, reaching $114 million by 2033. The overall impact of the PGW deposit, and the City's contributions in excess of the MMO, would be to increase the actuarial funded ratio from a currently projected 80 percent to 88 percent by 2033.

Thus, the PGW sale, even under a conservative assumption about net proceeds, would increase the rate at which the unfunded liability of the Pension Fund is reduced over the next two decades. The more rapid pay-down of the unfunded liability – currently over $5.3 billion – would reduce the potential impact of higher required MMO contributions from the General Fund over the next two decades, and enhance retirement security for the over 64,000 active members, retirees, and beneficiaries of the City's retirement system.

Effects of Retaining Ownership. In addition to examining the benefits of the transaction, it is also important to acknowledge the risks of not selling the utility. The 2008 Economy League study discussed several specific problems related to the City's retained ownership of PGW, including: a low-income customer base, burdensome capital obligations, an inefficient governance structure, and high labor costs.

The Economy League study noted that, in order to reduce debt service obligations, PGW has had to reduce the pace of investment in modernizing its capital infrastructure, which gives rise to safety concerns. These concerns were underlined several years ago, when a December, 2011 gas explosion in Tacony killed a 19-year-old PGW worker and resulted in six other hospitalizations. The cause of the explosion was a leak in a 68-year-old cast iron pipe. According to the Philadelphia Inquirer's coverage of the incident, "Philadelphia has some of the oldest gas pipes still in service in America." Addressing the need to replace existing gas mains seems likely to remain a challenge as long as PGW remains in City ownership. At the May PICA Board meeting, City officials explained that the current schedule for pipe replacement is 88 years. If the proposed sale to UIL goes through, that timetable would be reduced by half to meet industry standards.

Retaining Ownership & Effects on Philadelphia's Fiscal Health. Philadelphia's gas rates are among the highest of any northeastern city. The City also faces long-term fiscal challenges that include a pension fund with one of the lowest actuarial funding ratios among the major cities. Its ability to pay for the cost of current public services is challenged by the City's precarious fiscal position and a relatively weak tax base, with among the lowest per capita incomes and highest poverty rates of other major cities. Only one other major U.S. city owns and provides utility services, San Antonio, which owns and operates an electric and gas utility. However San Antonio's fiscal and economic position is considerably stronger than Philadelphia's, with a competitive tax burden (including no local income tax), a lower poverty rate (19.5 percent as of 2009), and population growth of 23.1 percent since 2000. In comparison, Philadelphia has a poverty rate of 26.9 percent, with recent modest increases in population growth, according to the current Five Year Plan. Moreover, Philadelphia has the third highest poverty rate of the top 20 most populous cities, while San Antonio ranks twelfth.

Conclusion. As the City's analysis demonstrates, the sale of PGW would reduce costs for ratepayers and increase the funded status of the Pension Fund with no net negative impact to the City General Fund in the short term, and a potential positive impact into the future. The sale would not only mitigate risks associated with retained ownership, but would actually benefit the City in multiple ways. Absent the City Council study underway pointing to the contrary, the City's proposed course of action should advance its economic health and fiscal stability.

Pensions

The City's pension system, like that of many other state and local government around the country, remains a major financial challenge. In the wake of the stock market declines of 2008 and 2009, the system's funding ratio declined dramatically. The resulting increase in the City's state-mandated contributions to the Pension Fund has been a major financial challenge to the City since 2009.

The best summary measure of the system's financial condition is its actuarial funding ratio. The ratio for Philadelphia's pension system is among the lowest of any pension system for employees of the ten largest cities in the country. This low funding ratio reflects a combination of factors.

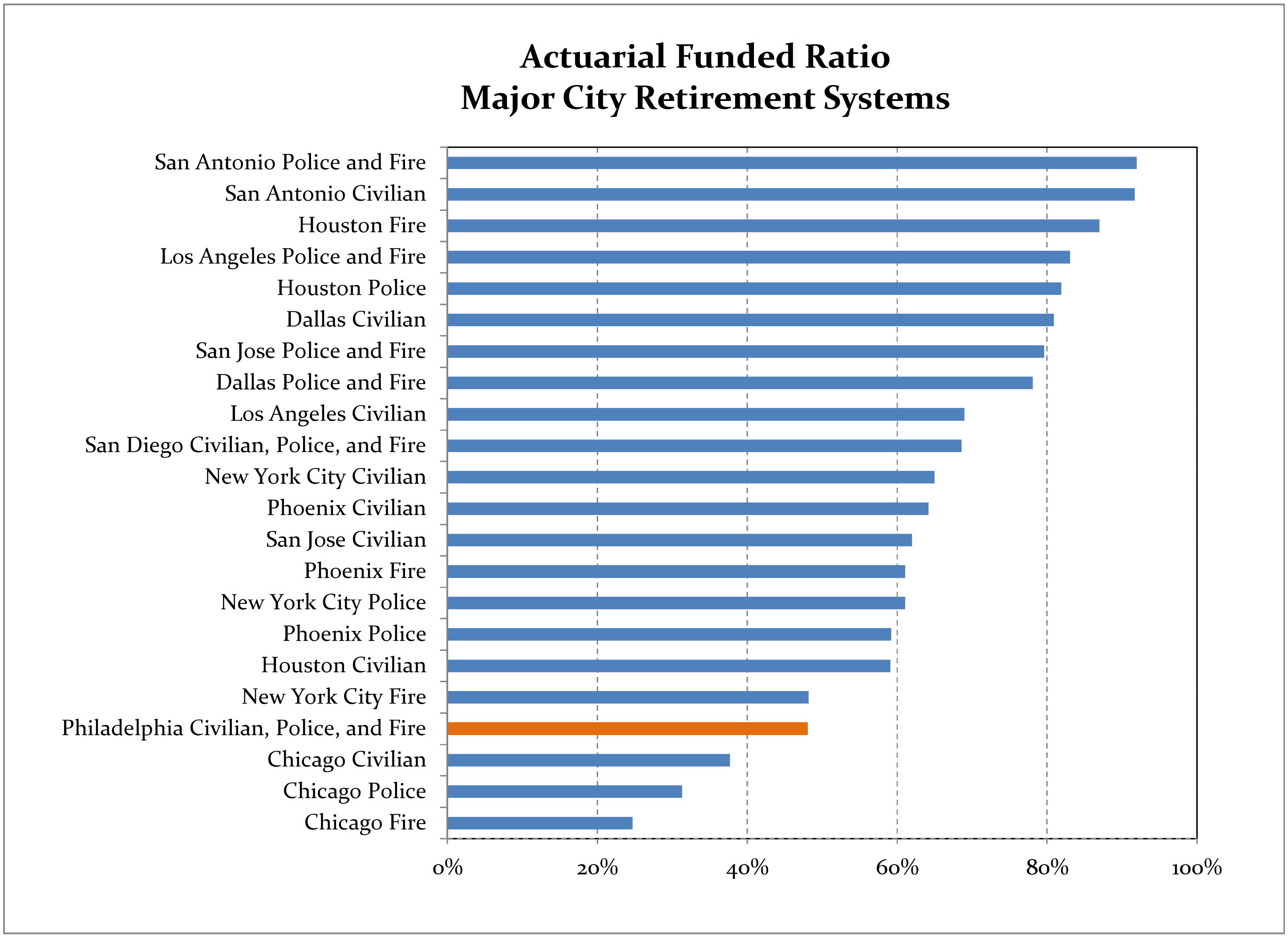
First, the system's funding levels for many years were based on an unrealistic investment return assumption, which resulted in actuarial contributions that were too low to cover normal costs and to appropriately make amortization payments to reduce the unfunded liability over time. Most systems have reduced their assumed rate of return on investments in recent years. Since 2006, Philadelphia has reduced its assumed rate from 9 percent to 7.85 percent. However, the impact of the divergence between assumed and actual returns over the past two decades has challenged the system's ability to make adequate progress toward increasing its funding ratio.

Second, the demographics of Philadelphia's pension system are a significant challenge. As an older city that has been losing population up until recently, the workforce that accrued benefits for many years was significantly larger than today's workforce, which has downsized to reflect a lower population. The result is that the number of system beneficiaries exceeds the number of active members by a significant margin. The ratio between beneficiaries and active members is significantly larger in Philadelphia than in other cities. This challenges the ability of the system to provide adequate levels of funding necessary to increase the actuarial funding ratio.

Third, contributions of active members to the system are extremely low in Philadelphia, compared to other cities. Even with the increases for active member contributions that have occurred as a result of recent labor arbitrations and collective bargaining, City employees will continue to make contributions that, as a percent of salary, are well below the level typical in other cities. The typical uniformed employee contribution in major city pension plans is 8 percent, while the typical non-uniformed employee contribution is 6 percent. Philadelphia's contribution rates are generally at least 2 percentage points below this level. This disparity increases the burden on the employer -- and the taxpayers -- for funding. This increased burden in turn makes it more difficult for the City to afford to increase contributions to a level that will result in a gradual increase in the funded ratio.

The problems of Philadelphia's system are daunting. Over time, the City needs to move along three fronts to address its pension challenges: adoption of more conservative actuarial assumptions; continuing institution of a mandatory lower-cost pension plan for new hires; and increased employee contributions for all active members, including current employees.

More conservative assumptions will result in higher required City contributions in the short run, but over time, they should increase the ability of the City to reduce the unfunded liability and increase the funding ratio. Two assumptions have been identified by PICA's actuarial consultant as particularly important: the investment return assumption and the mortality assumption. The City needs to gradually move to an investment return assumption closer to the historical



average return. The arithmetic average of reported returns for the Fund over the past 19 years is 7.6 percent. A lowering of the return to this level from the current 7.85 percent would be a good first step to reducing risk.

The City should also consider adopting a mortality scale that projects future mortality improvements consistent with past trends. This is becoming common among major pension plans. The Actuarial Standard of Practice regarding demographic assumptions issued by the Actuarial Standards Board was recently revised so that actuaries are required to consider mortaility improvements when making assumptions. The City has recently revised its mortality assumptions based on the most recent experience study; however, its assumptions do not currently assume mortality improvements.

The benefits of more conservative assumptions is that they increase the probability that the assumptions will in fact be accurate. Such accuracy is essential if the City's contributions are to be sufficient to meet not only the cost of benefits accrued in each year, but also to reduce the unfunded liability over time. The actuarial model used by the Board of Pensions and Retirement currently projects an increase in the funded ratio to 80 percent by 2033. If this projection is to be realized, the assumptions must be accurate on the whole. Inaccurate assumptions will result not only in the inability to increase the funding ratio, but also in continual increases in pension contributions as a percentage of payroll.

Through the arbitration and collective bargaining process, the City has been successful in creating a new hybrid defined benefit-defined contribution pension plan, known as Plan 10, and making this plan mandatory for newly hired employees of the Register of Wills. (Plan 10 is also mandatory for correctional officers under a 2012 arbitration award, but the requirement has not been implemented since the necessary legislative action has not yet occurred.) For other employees, new hires can choose to participate in the defined benefit plan, Plan 87, or Plan 10, with higher required contributions for Plan 87. To date, few employees have elected to participate in Plan 10. A primary agenda item for the City should be to make Plan 10 a requirement for new hires. Only with a lower cost pension plan for all new employees will the City be able to significantly lower its pension costs in the future. The impact of this change is primarily over the long term. It will not dramatically lower City costs in the near term, since the majority of employees will remain in Plan 87 for decades. However, over time, the benefits of a lower cost plan for all new employees will become significant.

The issue is one of competiveness. Other cities around the country have been taking steps to lower pension costs through the institution of new, lower cost pension tiers to new hires. The City will need to do so as well to ensure that its tax levels and service levels remain competitive.

The most promising avenue to reduce costs in the short term is to increase contributions for current employees. These costs directly reduce the City and taxpayer financed portion of the actuarially determined minimum municipal obligation (MMO) each year. The City has been successful to date in increasing these contributions. However, further increases are necessary to bring the City to a level comparable with other cities. Even after the most recent increases for District Council 47 are effective in 2016, contributions for most employees will not exceed 4.75 percent. Uniformed contribution rates generally range from 5 to 6 percent. Contributions of the order of 6 percent for non-uniformed and 8 percent for uniformed employees are typical in other cities. Around the country, this level of contribution has been viewed as appropriate, given the substantial benefit provided by public pensions.

PICA staff plans to issue a report on the challenges facing the City pension system in the fall.

Strategic Planning

The PICA Board and staff have long advocated for systematic strategic planning. This advocacy stems in part from the PICA Act, which states that the intent of the General Assembly in enacting the PICA statute was to "foster sound financial planning and budgetary practices that will address the underlying problems which result in...deficits..." Strategic planning forms a foundation upon which sound financial planning can occur. By identifying critical policy and program priorities, and developing plans to address them, City agencies are in a better position to create value for taxpayers and deliver higher quality services at lower cost. In the long run, this type of planning can only benefit the City's fiscal health.

PICA staff has noted that the City continues to upgrade the quality of its strategic planning. A number of agencies have issued new strategic plans in recent years, including the Procurement Department, Free Library of Philadelphia, and Office of Innovation and Technology. The Fire Department is in the process of developing a strategic plan to address its key challenges. In addition, the City continues to focus on developing public plans focused on key issues that span the jurisdicitonal boundaries of City agencies, such as youth violence.

The development of high quality public strategic plans should continue to be a priority. Many agencies with major service delivery challenges are likely to benefit from a formal strategic planning process and publication of a strategic plan that is periodically updated. The benefit is likely to be both internal and external to the agency. Agency managers can better focus on performance when objectives are clear and performance measures are rooted in a broad strategic planning process. The public will benefit from a clear presentaiton of issues faced by agencies with specification of performance indicators. Agencies can be held accountable for making progress toward key programs when progress is clearly defined, measured, and publicized.

Appendices

Appendix A

Office of City Controller
Report on the FY15-FY19 Plan

C I T Y O F P H I L A D E L P H I A

12th Floor, Municipal Services Bldg.
1401 John F. Kennedy Boulevard
Philadelphia, PA 19102
(215) 686-6680
FAX (215) 686-3832
Email: alan.butkovitz@phila.gov

ALAN BUTKOVITZ
City Controller
www.philadelphiacontroller.org

July 15, 2014

Mr. Harvey M. Rice, Executive Director
Pennsylvania Intergovernmental Cooperation Authority
1500 Walnut Street, Suite 1600
Philadelphia, PA 19102

Dear Mr. Rice:

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 each of the fiscal years ending June 30, 2015 through June 30, 2019 (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 June 26, 2014.

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 the presentation of the statements and 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 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 were reasonable. However, the forecasted statements do not include any additional potential costs above $214 million, in obligations for future labor contract settlements over the life of the plan. Because this forecasted amount is dependent on the successful completion of negotiations with American Federation of State, County and Municipal Employees District Council 33, and arbitration with the Fraternal Order of Police and the International Association of Fire Fighters, it is a particularly sensitive assumption.

In addition, and as I have stated in the past, I believe there are still significant challenges regarding finances of the Philadelphia School District. For example, anticipated funding from the cigarette tax is still questionable, and negotiations with School District labor unions are still ongoing. PICA should consider such challenges when reviewing the plan as it could place additional burden on the City of Philadelphia's finances.

With any forecast, events and circumstances frequently do not occur as expected. Therefore, I advise PICA to be cautious when using the forecast because of the unpredictability of the assumptions and uncertainties described above.

In closing, I would like to express our thanks to PICA, and the management and staff of the city's Office of Budget and Program Evaluation within the Office of the Director of Finance 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 GENERAL FUND
STATEMENTS OF OPERATIONS

CITY OF PHILADELPHIA

ACCOUNTANT'S REPORT

FISCAL YEARS 2015 – 2019

City Controller
ALAN BUTKOVITZ

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CITY OF PHILADELPHIA

OFFICE OF THE CONTROLLER
1230 Municipal Services Building
1401 John F. Kennedy Boulevard
Philadelphia, PA 19102-1679
(215) 686-6680 FAX (215) 686-3832

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, 2015 through June 30, 2019 (the forecasted statements). The City of Philadelphia's management is responsible for the forecasted statements. 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.

In our opinion, the accompanying forecast is presented in conformity with guidelines for presentation of a forecast established by the American Institute of Certified Public Accountants, and the underlying assumptions provide a reasonable basis for management's forecast. However, there will usually be differences between the forecasted and actual results, because events and circumstances frequently do not occur as expected, 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 statements referred to in the preceding paragraph include assumptions that are particularly sensitive as described in Note C.6. The assumptions pertaining to wage and benefit costs are particularly sensitive due to the uncertainty in the outcome of the City of Philadelphia's negotiations with the American Federation of State, County and Municipal Employees District Council 33, and arbitrations with the Fraternal Order of Police and the International Association of Fire Fighters.

Gerald V. Micciulla

July 15, 2014

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, 2015 through June 30, 2019

(Amounts in thousands)

NO.	ITEM	FY 2015 Estimate	FY 2016 Estimate	FY 2017 Estimate	FY 2018 Estimate	FY 2019 Estimate
(1)	(2)	(3)	(4)	(5)	(6)	(7)
	OPERATIONS OF FISCAL YEAR					
	REVENUES					
1	Taxes	2,748,205	2,820,247	2,905,754	2,959,283	3,009,323
2	Locally Generated Non-Tax Revenues	970,712	273,533	274,290	275,817	277,264
3	Revenue from Other Governments	638,912	653,852	650,787	674,858	697,381
4	Sub-Total (1)+(2)+(3)	**4,357,829**	**3,747,632**	**3,830,831**	**3,909,958**	**3,983,968**
5	Revenue from Other Funds of City	67,903	68,400	68,912	69,339	69,661
6	Total - Revenue (4)+(5)	**4,425,732**	**3,816,032**	**3,899,743**	**3,979,297**	**4,053,629**
7	Other	0	0	0	0	0
8	**Total Revenue and Other Sources (6)+(7)**	**4,425,732**	**3,816,032**	**3,899,743**	**3,979,297**	**4,053,629**
	OBLIGATIONS/APPROPRIATIONS					
9	Personal Services	1,433,919	1,443,026	1,449,299	1,456,753	1,458,348
10	Personal Services-Pensions	576,053	596,310	592,863	606,748	620,214
11	Personal Services-Add'l Pensions (Sales Tax)	2,321	7,224	12,600	18,061	38,311
12	Personal Services-Add'l Pensions (PGW Sale)	700,000	0	0	0	0
13	Personal Services-Other Employee Benefits	538,940	554,028	572,166	592,883	615,203
14	**Sub-Total Employee Compensation**	**3,251,233**	**2,600,588**	**2,626,928**	**2,674,445**	**2,732,076**
15	Purchase of Services	814,898	806,362	819,361	834,526	805,780
16	Materials, Supplies and Equipment	92,612	87,126	87,131	88,131	88,131
17	Contributions, Indemnities, and Taxes	145,192	142,665	141,477	142,789	142,853
18	Debt Service	136,578	140,712	152,970	163,033	180,994
19	Capital Budget Financing	0	0	0	0	0
20	Advances & Misc. Pmts. / Labor Obligations	52,837	40,526	40,090	40,090	40,090
21	Sub-Total (14 thru 20)	4,493,350	3,817,979	3,867,957	3,943,014	3,989,924
22	Payments to Other Funds	31,215	32,684	34,228	35,852	37,559
23	Payment to Budget Stabilization Reserve Fund	0	0	0	0	24,649
24	**Total - Obligations (21+22+22+23)**	**4,524,565**	**3,850,663**	**3,902,185**	**3,978,866**	**4,052,132**
25	Oper.Surplus (Deficit) for Fiscal Year (8-24)	(98,833)	(34,631)	(2,442)	431	1,497
	Prior Year Adjustments:					
26	Revenue Adjustments	0	0	0	0	0
27	Other Adjustments	20,388	20,388	20,388	20,388	20,388
28	Total Prior Year Adjustments	20,388	20,388	20,388	20,388	20,388
29	**Adjusted Oper. Surplus/ (Deficit) (25+28)**	**(78,445)**	**(14,243)**	**17,946**	**20,819**	**21,885**
	OPERATIONS IN RESPECT TO					
	PRIOR FISCAL YEARS					
	Fund Balance Available for Appropriation					
30	June 30 of Prior Fiscal Year	146,813	68,368	54,125	72,071	92,890
31	Residual Equity Transfer	0	0	0	0	0
32	Fund Balance Available for Appropriation					
	June 30 (29)+(30)+(31)	**68,368**	**54,125**	**72,071**	**92,890**	**114,775**

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 FY2015 budget and the FY2015-2019 Five Year Financial Plan (FYP) submitted by the Mayor to the Pennsylvania Intergovernmental Cooperation Authority (PICA) on June 26, 2014. 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 June 26, 2014, 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 will usually be differences between the forecasted and actual results because events and circumstances frequently do not occur as forecasted or expected and those differences may be material.

B. Summary of Significant Accounting Policies

The Forecasted 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 FY15 total $4.426 billion. Excluding the one-time $700 million revenue from the sale of PGW, approximately 74% of the city's budget comes from local taxes, and 17% 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 $2.748 billion in the adopted FY15 budget, as well as $970.7 million of Locally Generated Non-Tax revenues (including the $700 million one-time revenue from the sale of PGW), and $638.9 million in Revenue from Other Governments. These three sources comprise 98% of the revenues anticipated for the FY15 budget.

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

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 forecasts 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 forecast tax revenues for the city. IHS focused on six taxes – Wage and Earnings Tax, Net Profits Tax, Business Income and Receipts Tax, Real Property Tax, Real Estate Transfer Tax, and Sales Tax. These forecasts were refined by OBPE after discussions with leading economists at the Federal Reserve Bank of Philadelphia.

2. The National and Local Economic Context

The strength of the economy is a key determinant of the fiscal health of the city since tax revenues, which are directly tied to the economy's strength, account for 74% of the city's General Fund revenue. The national economic recovery after the recession and related fiscal crisis continues to be slow. The Blue Chip consensus forecast for U.S. Real Gross Domestic Product (GDP) which provides a forecast based on combining multiple leading separate economic forecasts, shows projected growth of 2.2% for 2014, slightly higher than the 1.9% growth in 2013. Growth is expected to accelerate in 2015 to 3.1%. The consensus forecast projects pre-tax corporate profits to grow 2.2% in 2014 and 6.0% in 2015, compared to 4.6% in 2013.[1]

[1] Blue Chip Economic Indicators June 10, 2014.

Households are starting to show more confidence through spending; personal consumption expenditures are estimated to grow 2.8% in 2014 and 2.8% in 2015, higher than the 2.0% growth in 2013. Unemployment is expected to decline from 7.4% in 2013 to 6.3% in 2014 and then to 5.8% in 2015[2]

Like the nation, Philadelphia's economy continues to recover from the deep recession of 2007-2009. The number of people employed dropped from a high of 597,154 in January 2009 to a low of 566,234 in January 2010, rebounding to 598,849 in April 2014, a 0.3% increase over the highpoint in January of 2009. Unemployment had a sizable increase, from 5.5% in April 2007 to a high of 11.6% in July 2012 and has improved significantly to 6.8% in April 2014.[3] 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 which are budgeted to contribute 74% of the expected General Fund revenue in FY15(excluding the $700 million in proceeds from the sale of PGW. These include:

1. Wage and Earnings and Net Profit Tax (Wage),
2. Real 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, are budgeted to provide less than 1% of General Fund revenue. Philadelphia's reliance on the Wage Tax (35% of the General Fund) and the BIRT (12%) 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.

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[2] Blue Chip Economic Indicators June 10, 2014.
[3] Bureau of Labor Statistics. Retrieved on July 2, 2014 from the bls.gov website.

a. Wage Tax

The largest tax revenue source (comprising 47% of tax revenues) is the Wage Tax, which encompasses the wage, earnings, and net profits taxes. The Wage Tax is collected from all employees working within city limits, and all city residents regardless of work location. In FY15, the Wage Tax rate has been reduced from 3.9240% to 3.9200% for residents and from 3.4950% to 3.4915% 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 it was first established. The PICA statute permits the Authority 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 $1.295 billion in FY15. This projection includes a 3.68% growth rate in the Wage Tax.[4]

The city resumed cuts to the Wage Tax in FY14 that were suspended in FY10 and plans to continue Wage Tax cuts in each year of the FYP assuming that the city's fund balances remains consistent with or higher than those in the FYP. The level of cuts to the Wage Tax rates increase over the course of the plan as the economy is projected to recover. By FY19, the Wage Tax rates in the FYP are 3.7460% for residents and 3.3365% for non-residents.

b. Real Property Tax

The Real Property Tax (Property) is the city's second largest source of tax revenue (20%), estimated to contribute $547.4 million of the FY15 tax revenues. This tax is levied on the assessed value of residential and commercial property in the city. The Adopted FY15 Budget has a combined city/School District property tax rate for FY15 of 1.34%, unchanged from FY14. The city portion of the tax is 0.6018% and the School District portion is 0.7382%. The property tax projection takes into account the continuation of the homestead exemption of $30,000 for eligible property owners and relief measures with a cap of $20 million for the city and School District combined.

c. Business Income and Receipts Tax

The Business Income and Receipts Tax (BIRT, formerly the Business Privilege Tax) is projected to produce $453.2 million in FY15, 16% of total tax revenue. The majority of the BIRT is

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

derived from corporate profits which 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. Real Estate Transfer Tax

While economic conditions negatively affected the Real Estate Transfer Tax (RTT) since the housing market decline began in 2007, the city is now seeing solid growth in this tax. The RTT is projected to provide $176.6 million in FY15; a growth rate of 10.0% over FY14 anticipated collections. Lower growth rates of 6.0%, 3.0% and 3.0% are projected for FY16, FY17 and FY18, respectively. Even with projected solid growth for transfer tax revenues, the $205 million the Plan includes for FY19 is still 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.

e. Sales Tax

Sales Tax revenues are projected to generate $154.6 million in FY15, 6% of tax revenues, down from 10% of tax revenues in FY14 due to the portion of the local Sales Tax directed to the city's General Fund declining from 2% to 1%. As part of its response to projected budget deficits in 2009, the Commonwealth of Pennsylvania (the Commonwealth) provided authorization and the city passed legislation to temporarily increase the Sales Tax rate from 1% to 2% through the end of FY14. This raised the total Sales Tax rate to 8%, with 6% going to the Commonwealth and 2% to the city. Starting in FY15, 1% of the local Sales Tax is for the benefit of the School District of Philadelphia and the city's pension fund whereby $120 million of the sales tax goes directly to the School District and remaining amounts flow through the city's General Fund to pay for debt service on a borrowing on behalf of the School District and for additional contributions to the Pension Fund.

f. Parking Tax

The Parking Tax is levied on the gross receipts from all parking transactions. Parking Tax revenue is projected to generate $77 million in FY15.

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

Tax	FY13 Actual	FY14 Estimate	FY15 Estimate	FY16 Estimate	FY17 Estimate	FY18 Estimate	FY19 Estimate
Wage - Current & Prior	1,240.7	1,269.9	1,315.2	1,360.6	1,404.6	1,413.1	1,419.2
% change from prior year	n.a.	2.4%	3.6%	3.5%	3.2%	0.6%	0.4%
Real Property - Current & Prior	540.5	533.2	547.4	559.8	572.6	585.6	597.9
% change from prior year	n.a.	-1.4%	2.7%	2.3%	2.3%	2.3%	2.1%
Bus. Inc. & Receipts - Current & Prior	450.9	461.3	453.2	444.6	454.5	467.4	480.0
% change from prior year	n.a.	2.3%	-1.8%	-1.9%	2.2%	2.8%	2.7%
Real Estate Transfer	148.0	160.5	176.6	187.2	192.8	198.6	204.6
% change from prior year	n.a.	8.5%	10.0%	6.0%	3.0%	3.0%	3.0%
Sales	257.6	264.9	154.6	164.4	175.2	186.1	196.6
% change from prior year	n.a.	2.9%	-41.6%	6.3%	6.5%	6.2%	5.6%
Parking	73.3	75.0	76.9	78.8	80.8	82.8	84.8
% change from prior year	n.a.	2.4%	2.5%	2.5%	2.5%	2.5%	2.5%
Other Taxes	22.6	23.9	24.3	24.8	25.3	25.7	26.2
% change from prior year	n.a.	5.9%	1.8%	1.8%	1.9%	1.8%	1.8%
Total Taxes	**2,733.5**	**2,788.7**	**2,748.2**	**2,820.2**	**2,905.8**	**2,959.3**	**3,009.3**
% Change from prior year	n.a.	2.0%	-1.5%	2.6%	3.0%	1.8%	1.7%

Note: Wage Taxes include rate reductions that resumed in FY14. Business Income & Receipts Tax incorporate rate reductions and changes in recently passed legislation that began in FY13. The reduced estimate for the Sales Tax in FY15 is the result of the reauthorization by the Commonwealth of the 1% increase with $120 million of this revenue going directly to the School District. 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 forecasted 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 forecasted based on historical trends and state and federal budget information. The PICA city account which represents 53% of Revenue from Other Governments is forecasted using Wage Tax variables.

6. Obligation Estimates

OBPE provided obligation estimates to the Director of Finance and the Mayor for discussion and inclusion in the revised annual FY2015 budget and FY2015-2019 FYP submitted by the Mayor to the PICA on June 26, 2014. OBPE provides forecasts of all major expenditure categories. Expenditures total $4.52 billion, an increase of $557 million due largely to the $700 million appropriation to Pension Fund from PGW sale. Excluding one-time items in both FY14 and FY15, expenditures are forecasted to increase $107 million in FY15, about $53 million due to amounts set aside for labor and $30 million due to rising pension and debt service costs. The remaining $24 million represents an increase of only 0.6%.

a. Labor Agreements

The Fraternal Order of Police (FOP) received a five-year arbitration award for uniformed police department employees in 2009 covering the period of FY10-FY14. The city is currently in arbitration with the FOP regarding a contract starting in FY15 and is in arbitration with the International Association of Fire Fighters (IAFF) as their contract expired at the end of FY13. An agreement was reached with District Council 47 which was ratified on March 5, 2014 for a contract covering the period FY10-FY17. The agreement with District Council 33 expired on June 30, 2009 and no new agreement has been reached.

American Federation of State, County and Municipal Employees (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. The group covered by the award includes approximately 2,100 employees who work as Correctional Officers, Youth Detention Counselors, guards in the police detention unit and certain prison maintenance trades 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 were:

- Two and one-half percent wage increases for covered employees on July 1, 2012 (FY 2013) and July 1, 2013 (FY 2014).
- Prospective restoration of step and longevity increments that were frozen by the city in July 2009.
- No specific changes to the Health Plan. Any future changes agreed to with 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, 2013, current employees who are not participating in Plan 10 increase their contributions to the pension fund to no less than 50% of the normal cost of the plan in which they participate, without any offset. The changes to pensions require city Council approval.
- 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.

Because the award had an expiration date of June 30, 2014, the union requested bargaining for a contract to begin July 1, 2014 and has now declared impasse and requested interest arbitration. The interest arbitration panel has been selected but no hearing dates have yet been scheduled.

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 were:

- Two and one-half percent wage increases for covered employees on July 1, 2012 (FY 2013) and July 1, 2013 (FY 2014).
- No specific changes to the Health Plan.
- 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 above pension provision required City Council approval which did not occur. However, under legislation passed by Council, Local 810 employees are now covered under the District Council 47 pension structure described on page 14.
- The contract expired on June 30, 2014. Negotiations for a future contract are on-going.

I.A.F.F.

A four-year interest arbitration award with the IAFF was issued in October 2010. The award included the following key provisions:

- No wage increase for FY10.
- Wage increases of 3% of pay in each of FY11, FY12, and FY13.
- Pension changes for new hires – IAFF members now choose between either increasing their pension contribution from 5% to 6% of pay or enrolling in Plan 10.
- The city's required contributions to the IAFF- controlled health fund were substantially increased from $1270 per member per month (PMPM) at the start of the award to $1679 PMPM as of July 1, 2012 then modified to $1619.64 PMPM as of October 1, 2014. The award also included more than $20 million in retroactive payments.

Because this contract expired on June 30, 2013, the city and the IAFF are currently in interest arbitration for a new award. The arbitration panel was selected and hearings were held from August 2013 – January 2014. An award is expected later this summer 2014. The FYP includes a reserve of $53 million for IAFF future labor obligations.

F.O.P. Lodge 5

On December 18, 2009, a five year interest arbitration award with the FOP, Lodge No. 5 for employees of the Police Department was issued to cover FY10 through FY14. Important financial components of the award were:

- No wage increase for FY10.
- Three percent pay increases for each of FY11 and FY12, along with a reopener for FY13 and FY14 which yielded an additional 3% raise in both years.
- An increase in the stress pay that police officers receive by 1% in FY11 and 1% in FY14.
- 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.

- 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.
- Up to 30 furloughs (days off without pay) in a fiscal year.

The award had an expiration date of June 30, 2014. In accordance with Act 111, the parties exchanged proposals for a successor agreement on December 31, 2013 and the FOP made a demand for interest arbitration. A neutral arbitrator was appointed and hearings are currently ongoing. An award is expected later in the summer of 2014. The FYP includes a reserve of $121 million for FOP future labor obligations.

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

A five-year interest arbitration award covering the unionized employees of the Sheriff's Office and Register of Wills was issued in 2011 for the period of FY10-FY14. Important financial components of the award were:

- A 2.5% increase for Deputy Sheriffs in FY11 and FY12 and a re-opener for FY13 and FY14 which yielded an award of 3% raise in both years.
- Register of Wills employee wage increases will be based on what is negotiated between District Council 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. Register of Wills employees will continue to participate in the city Administered plan.
- Pension changes for new hires. Deputy Sheriffs 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.

Because the award had an expiration date of June 30, 2014, the union requested bargaining for a contract to begin July 1, 2014. No bargaining sessions have yet been scheduled.

AFSCME District Council 33

After having spent more than five years in negotiations, the city has been unable to reach an agreement with District Council 33.

On January 16, 2013, the city made a final offer to District Council 33 for a contract to run July 1, 2009 through June 30, 2014. The city's offer included the following:

- Wage increases of 2.5% following ratification and an additional 2% in January 2014.
- Restoration of step and longevity increments prospectively following ratification.
- Lump sum payments in the amount of $25 million to the union managed health fund. Under the city's proposal, the city's PMPM contribution to the union's health fund would remain at $975.76 for the term of the contract with the health fund using the lump sum payments to offset any cost increases it has experienced.
- Pension changes: (1) to require all new employees to enter Plan 10; and (2) increased pension contributions from current employees as was ordered for corrections officers represented by District Council 33.
- Changes in overtime rules based on the changes made in FY13 for non-represented employees and those represented by Local 2186 of District Council 47 and the right to furlough employees when economic circumstances warrant, similar to the FOP award.

The city estimates the FYP cost of its final offer at $39.5 million. On February 1, 2013, the city filed an action in the Court of Common Pleas of Philadelphia County, asking the court for a declaration that the city has the right to implement its final offer for the currently-expired contract. The case continues in the Court of Common Pleas and is now listed for the July 2014 trial pool. The FY15-FY19 FYP includes the cost to implement the final offer to District Council 33.

AFSCME District Council 47

The city reached agreements with District Council 47 Local 2187 and Local 2186 on February 25, 2014 for a contract term from July 1, 2009 through June 30, 2017. The new contract includes the following provisions:

- No retroactive pay increases.
- Members received ratification bonuses of $2,000 per person.

- Wage increases of 3.5% 30 days after ratification and across the board wage increases of 2.5% effective July 1, 2015 and 3% effective July 1, 2016.
- Step and longevity increments, which were frozen in July 2009 pending agreement on a new contract, were restored but no retroactive increases were paid.
- In terms of pensions, current employees will see their employee contributions rise by 1% of pay by January 1, 2016. Employees hired after ratification of the contract can choose Plan 10, the city's hybrid plan, or they can remain in the current pension plan and pay 1% more than current employees are then paying towards their pensions.
- Under the agreement, sick time will no longer be counted as hours worked when determining when overtime is due on a weekly basis.
- On health care, through December 2014, the city's contribution to the health fund will be $1,100PMPM, up from $975 PMPM, and the city made a one-time lump sum payment to the health fund of $5.0 million in addition to an earlier $2.5 million payment. Effective January 1, 2015, the health fund will move to a self-insured arrangement similar to the contract with the FOP. Employees will contribute 9% of the health plan's costs.

The costs of this agreement are included in the FYP.

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 FOP, Lodge No. 5 also switched to self-insurance. For non-union employees, FY13 actual expenditures were 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, FY13 actual expenditures were used to estimate the annual cost. However, because the city has no control over the design of the FOP health plan, an increase of 8.5% per year based on medical cost trends has been included.

Cost estimates for District Council 33 are based on FY13 actual expenditures under the provisions of the expired contract ($975.76 PMPM). Because there is no new contract for this group and therefore no change in the PMPM city contribution, it is assumed costs for FY15-FY19 will approximate the FY13 average expenditure. The Plan does, however, include the lump sum payments described above to the District Council 33 health plan. For District Council 47, additional costs for the health insurance under the new agreement have been included in the FYP.

The cost estimate for the IAFF is based on the FY13 actual costs adjusted for the additional annual health insurance costs implemented in FY14 related to the 2009 award.

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's Act 111 interest arbitration award with the 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. 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 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(b) 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 the District Council 33 Local 159 arbitration award, pending City Council approval. Newly-hired unionized employees of the Sheriff's office have the option of entering Plan 10 or raising their employee contribution from 30% of normal cost to 50% of normal cost, without offset, while newly-hired unionized employees of the Register of Wills are required to enter Plan 10. 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 potential 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 union negotiations.

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) which was repaid by end of the fiscal year ending June 30, 2014 with 8.15% 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 to be paid (including interest due annually as accrued on the outstanding deferral) over the period ending in FY14; $106 million was budgeted to be paid back in FY13 with the balance of $124 million in FY14. The city has applied the proceeds of certain bonds issued in October 2012, together with other available amounts, to repay the Municipal Pension Fund the entire outstanding $230.0 million of the deferred minimum municipal obligation payment and interest due on such deferred contributions. The change in amortization period and the partial deferral were approved by the Pennsylvania General Assembly as part of Act 44.

- 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 7.85%. 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.

Based on the results of the 2013 Experience Study which made recommendations for changes in assumptions about salaries, retirement rates, disability rates and mortality rates; certain actuarial assumption changes were approved by the Pension Board on June 26, 2014. These changes were costed out by the city's actuary after the submission to PICA of the Five Year Plan so are not included in the Five Year Plan. The General Fund cost of these changes, together with the impact of the additional pension contributions required by District Council 47 members and non-represented civil service employees, is estimated to be an additional $46.7 million over FY16-FY19.

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 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. 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. Summary

The Administration hopes to resolve all outstanding contract issues as soon as possible in a way that is fair to both employees and other taxpayers. The Forecasted Statements include a total of $214 million in obligations for future labor contract settlements over the life of the plan. Because this forecasted amount is dependent on the successful completion of civilian negotiations with AFSCME District Council 33 and arbitration with the FOP and the IAFF, this is a particularly sensitive assumption. If any final labor agreements result in significant unbudgeted costs across the plan, budget cuts to many departments are likely to be necessary.

D. Sale of PGW

The planned sale of PGW effects general fund revenues and expenditures in several ways but has no overall net impact on general fund balances. The effects on the revenues and expenditures are as follows:

- $700 million in anticipated proceeds from the sale is shown as Non-Tax Revenues in FY15.
- A corresponding $700 million in appropriations for the deposit of sale proceeds into the Pension Fund.
- A reduction in the PGW Annual Payment (shown in Revenue from Other Governments) of $9 million in FY15 and $18 million thereafter as the General Fund will not receive this payment from a privatized PGW. The $9 million reduction assumes that the sale closes in December 2014, resulting in one-half of the scheduled annual payment.
- An increase in Revenue from the PGW Sale Trust (shown in Revenue from Other Governments) of $9 million in FY15 and $18 million in FY16. The Sale Trust is a reserve fund which will be funded at closing from a portion of sale proceeds. The reserve fund will be used to mitigate the risks associated with retained liabilities after the sale of PGW, as well as to make the general fund whole for the loss of the $9 million in FY15 and $18 million in FY16.
- Beginning in FY17, the Pension Fund Payment has been reduced by $18 million per year. It is important to note that the MMO will be reduced by amounts far greater than the $18 million beginning in FY17 (assuming the sale closes in FY15), but it is the City's plan to contribute above the MMO while holding the General Fund harmless for the loss of the annual payment from PGW.

Appendix B

Letter from Cheiron, Inc.
to Board of Pensions and Retirement
Regarding FY15-FY19 Pension Obligations

Via Electronic Mail

July 18, 2014

Mr. Francis Bielli
Executive Director
City of Philadelphia Municipal Retirement System
Two Penn Center Plaza, 16th Floor
Philadelphia, Pennsylvania 19102

Re: MMO projections

Dear Fran:

As requested, we are writing to provide projections of the Minimum Municipal Obligation (MMO) for the City of Philadelphia Municipal Retirement System illustrating the impact of:

- Recently adopted changes in assumptions in response to the experience study,
- Changes in employee contribution rates for District Council 47 and non-represented civil service employees and
- Estimated asset returns for the year ending June 30, 2014.

The table on the next page shows four projections of the City's future MMOs reflecting these three changes.

Column 1 - Shows the baseline projected MMOs prior to any changes.

Column 2 - Shows the projected MMO under the Board adopted changes in assumptions, effective July 1, 2014, resulting from the 5 year experience study of the System.

Column 3 - The MMO in this column builds on the previous projections and adds the impact of the estimated asset returns underlying the growth in estimated market asset value as of June 30, 2014 of $4.88 billion.

Column 4 - Shows the MMO after reflecting the impact of Bill 140205 passed in May 2014 requiring additional employee contributions over the current member rate for employees represented by AFSCME, District Council 47 and municipal employees in the civil service not represented by a union. Current employees in these groups will pay an additional 0.5% of compensation from January 1, 2015 to December 31, 2015 and 1.0% from January 1, 2016 onwards. New employees hired into these groups who opt to participate in Plan 87 Municipal will also contribute 1% of compensation on top of the additional contributions above.

MMO Projections
(millions)

Fiscal Year End	MMO Before Changes (1)	MMO with Assumption Changes (2)	Assumption Changes and $4.88 B Market Asset Value (3)	MMO with Additional Employee Contributions (4)	Delta MMO (Reduction) /Increase (4) - (1)
2014	$523.4	$523.4	$523.4	$523.4	$0.0
2015	$556.0	$556.0	$556.0	$556.0	$0.0
2016	$577.2	$596.7	$597.0	$596.1	$18.9
2017	$594.6	$615.9	$614.9	$612.3	$17.7
2018	$611.2	$632.7	$625.7	$621.9	$10.7
2019	$627.3	$648.8	$638.8	$634.6	$7.3
2020	$642.9	$664.4	$650.1	$645.5	$2.6
2021	$646.5	$668.0	$648.2	$643.3	($3.2)
2022	$651.3	$672.8	$647.7	$642.3	($9.0)
2023	$660.4	$681.8	$651.6	$645.6	($14.8)
2024	$666.8	$688.1	$652.9	$646.0	($20.8)
2025	$674.4	$695.7	$655.1	$647.2	($27.2)
2026	$682.2	$703.5	$660.9	$651.9	($30.3)
2027	$674.0	$695.3	$650.4	$640.2	($33.8)
2028	$676.1	$697.3	$649.9	$638.4	($37.7)
2029	$672.2	$693.4	$643.2	$630.3	($41.9)
2030	$664.2	$685.3	$632.1	$617.6	($46.6)
2031	$671.2	$669.4	$612.9	$596.6	($74.6)
2032	$689.8	$685.6	$625.4	$607.3	($82.5)
2033	$714.9	$710.1	$643.9	$623.6	($91.3)

These projections are based upon the census data used in our July 1, 2013 Actuarial Valuation. The actuarial methods and assumptions are the same as those shown in our July 1, 2013 Actuarial Valuation Report **except** for each of the changes discussed above reflecting the estimated status for the July 1, 2014 Actuarial Valuation.

In preparing these estimates, we relied on information (some oral and some written) supplied by Retirement Board. This information includes, but is not limited to, the plan provisions, employee data, and financial information. All of these projections rely on the occurrence of future events occurring exactly in accordance with the underlying assumptions. As that is an unlikely event, the actual future costs of the System should be anticipated to change. To the extent future experience differs materially from the information provided to perform this study, results could all be significantly altered. However if the experience of the System is fairly consistent with the assumptions, then the trends demonstrated in these projections should be relatively consistent with expected future costs of the System.

This information was prepared exclusively for the City of Philadelphia Municipal Retirement System at the request for the purpose of projecting the estimated MMO over the next 20 years. It is not intended to benefit any third party, and Cheiron assumes no duty or liability to any such party.

To the best of my knowledge, this letter and its contents have been prepared in accordance with generally recognized and accepted actuarial principles and practices, which are consistent with the Code of Professional Conduct and applicable Actuarial Standards of Practice set out by the Actuarial Standards Board. Furthermore, as a credentialed actuary, I meet the Qualification Standards of the American Academy of Actuaries to render the opinion contained in this letter. This letter does not address any contractual or legal issues. I am not an attorney and my firm does not provide any legal services or advice.

Please do not hesitate to call if you have any questions.

Sincerely,
Cheiron

Kenneth A. Kent, FSA, FCA
Principal Consulting Actuary

cc: Rob Dubow, Director of Finance
Harvey Rice, Executive Director, Pennsylvania Intergovernmental Cooperation Authority
Anu Patel, FSA
Karen Zangara, FSA