

# **Pennsylvania Intergovernmental Cooperation Authority**



**Staff Report  
on the  
City of Philadelphia's  
Five Year Financial Plan  
For  
Fiscal Year 1994 - Fiscal Year 1998**

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**April 14, 1993**

# PENNSYLVANIA INTERGOVERNMENTAL COOPERATION AUTHORITY

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## Introduction

Representative democracy, by design, is neither orderly nor conducive to making unpopular decisions. Inflexible positions, or those which do not command or develop broad acceptance by both the public and their elected representatives, generally are not successful, and effective elected and appointed officials understand the context in which they must operate. Ultimately, the success of a public enterprise largely depends upon achieving and maintaining the delicate balance among competing interests and priorities required to reach consensus on the direction of public policy -- and thereafter carry it out.

The City of Philadelphia, in its efforts to address fiscal and budgetary problems, has benefited from a remarkable degree of cohesion on the question of what must be done to restore the City to financial stability. The election of a new mayor and a substantially new City Council and Council leadership in 1991 laid the groundwork for a series of events which have drawn Philadelphia back from the brink of insolvency and default. The avoidance of financial catastrophe is attributable in large degree to the dedication and diligence of Mayor Rendell, President Street and the members of Council, the City Controller and others.

There should be no doubt of the value, both short- and long-term, of the approval of two annual budgets and Five Year Financial Plans, as well as a significant re-organization of City spending within FY93, over the fifteen months since the Rendell administration assumed office. Linked with substantial achievements in labor negotiations (although the still-pending arbitration proceeding with the Fire union continues to offer reason for concern) Philadelphia has benefited as its political leaders have begun to address the City's underlying budgetary problems.

While the accomplishments of the City over the last year should not be minimized, the "fiscal equilibrium" which has been attained is but delicately balanced, and rests upon the thinnest of edges. Clearly, efforts which have been undertaken to stabilize and expand the City's revenue base, impose more discipline on the revenue estimation process and develop management and productivity initiatives have been necessary to both avoid fiscal collapse and place Philadelphia within striking distance of fundamental reform. Absent those achievements, it would have been unrealistic to expect any such changes even to have been seriously considered.

Measures proposed to bring the City's operating budget for the current fiscal year to near-balance, and to produce a budget and Plan which promise balanced budgets for FY94 and beyond, rely upon a degree of management capacity and fiscal control heretofore absent in Philadelphia government. In that light, those who over time have a stake in the City's capacity to deliver adequate services efficiently and economically should have substantial concerns about the long-term effectiveness of what has been done to date towards addressing the basic structural problems of

revenue-expenditure balance, fiscal accountability and management practices. As discussed below, only a small shortfall in either projected revenue or the results of efforts to address the operational problems of government, even after what has been achieved to date, would quickly cause the momentum of expenditure growth to once again outstrip the increases in City revenues. In short, Philadelphia still stands only steps away from insolvency.

As noted elsewhere in this report, PICA Staff believes that the potential for a reformation of Philadelphia city government is both great and attainable. The foundation laid in recent months, and the goodwill from all sectors of the community, provide an opportunity for the institutionalization of the advances which have been made, proposed and considered. The Chairman of the Authority, in recent testimony before the Appropriations and Urban Affairs Committees of the Pennsylvania House of Representatives, said:

Attention now should be devoted to underlying structural problems and the fundamental re-ordering of the way the City conducts its affairs with a goal of moving beyond just "balancing the budget." There is still broad acceptance in the community of the need for those fundamental changes, and it would be a terrible loss to the City if the opportunity to re-structure government were lost.

This report is intended to provide an overview and evaluation of the reasonableness of the assumptions, estimates and methodology of the Plan, as well as the corrective actions which have been taken to cure the "Variance" identified by the City and declared by the Authority in December of 1992, as required by The Pennsylvania Intergovernmental Cooperation Authority Act for Cities of the First Class (Act 6 of 1991, No. 9) (the "PICA Act"), in an effort to assist the Authority's Board in discharging its statutory responsibilities. Recommendations of the PICA Staff for Authority action in connection with the Plan and Variance are noted in the Section entitled "Executive Summary and PICA Staff Recommendations". Appendix A discusses statutory requirements, provisions for Authority review of a financial plan, and provides a chronology of significant events since PICA's creation in June of 1991.

## **Executive Summary and PICA Staff Recommendations**

The City's approval and submission to PICA of its second Five Year Financial Plan is a landmark in the effort to return Philadelphia to fiscal stability. PICA Staff in its reports over the last year has evaluated both Plan performance and prospects. This report is directed towards the same goal, but places a greater emphasis on issues which over the term of the Plan will have a major impact on it and the City than has been the case with other PICA Staff reports.

Of equal importance as the submission of the FY94-FY98 Plan are the measures taken by the City to address its FY93 fiscal problems. In its report for the first quarter of the 1993 fiscal year, the City projected an operating deficit at June 30, 1993 of \$57 million, or 2.5 % of its budgeted General Fund revenues, and Mayor Rendell on January 21, 1993 proposed a series of measures to bring the budget back into balance. The December 9, 1992 PICA Staff Report noted that while the City had experienced shortfalls in revenues, and overruns in critical areas of its budget which traditionally have been problem areas (notably the Department of Human Services), the City's variance estimates probably were too high, although the City ran the risk of exceeding the \$7.8 million in PICA funding allocated to the FY93 deficit. The still-pending Police and Fire arbitration proceedings made taking such a conservative approach appropriate. Regardless of whether the estimates might have been too conservative, the actions of the Mayor and City Council to take steps to bring the budget to near-balance in the second half of the current fiscal year represent a dramatic departure from prior practice.

### **Overview**

Methodology and Staff Report Date. The Plan was submitted by the City to PICA on March 19, 1993, and under the PICA Act the 30-day period for review expires on April 19, 1993. Authority Staff has had the benefit of ongoing consultations with the City, both on the departmental level and otherwise, since the Plan was presented to City Council on January 21, 1993, and has based a significant amount of its work on those sessions. It has also utilized material presented to City Council and the Controller's Office, as well as information included in the monthly reports submitted by the City since the December PICA Staff Report. This report includes reference to materials received by the Authority through April 13, 1993.

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

Relationship to Future Plan Revisions. The City is obligated under both the Cooperation Agreement and the PICA Act to submit a revised Plan in the event it enters into a collective bargaining agreement, or receives a labor arbitration award, at variance with that which was assumed in the Plan. The City has indicated, and PICA Staff agrees that the result of the Police arbitration did not impact the Plan to the degree that such revision is necessary. There can be no assurance that such would be the case upon conclusion of the ongoing Firefighters' arbitration. The Cooperation Agreement anticipates that the Plan will be revised to deal with any such arbitration-caused variance within 20 days after an arbitration award at variance with the Plan.

Apart from labor-related revisions, or those required by declaration by PICA of a variance in the Plan in the future, the Plan is subject to mandatory revision on March 22, 1994 (100 days prior to the end of FY94). At that time, the City is required to add the 1999 fiscal year to the Plan and make any other alterations necessary to reflect changed circumstances. Under the PICA Act, the City may determine to revise the Plan at any time and submit it to the Authority for its review.

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

Estimates of revenues shall recognize revenues in the accounting period in which they become both measurable and available....

Appropriation estimates shall include, at a minimum, all obligations incurred during the fiscal year and estimated to be payable during the fiscal year or in the twenty-four (24) month period following the close of the current fiscal year...

The Plan as submitted meets the requirements of the PICA Act and Cooperation Agreement, although PICA Staff still has concerns as to the adequacy of the presentation of the City's accounting results in its monthly and quarterly reports. For that reason, PICA Staff will direct particular attention to the remaining City reports for the current fiscal year and will continue to press for more realistic and informative presentation of accounting data.

Underlying Assumptions. This Plan is superior to earlier efforts in its description of assumptions and methodology only insofar as there is better background information which has been made available to the Authority than has been the case with either the initial Plan or interim reports. The basic change in the structure of the Plan -- away from the initial Plan's initiative-driven arrangement -- has changed the manner in which the City has dealt with assumptions. The risk, as is noted in greater detail below, is that the minimal detail concerning implementation in the Plan review process may be indicative of the absence of such information in general, which will threaten both the achievement of the initiatives and the ability of City managers to understand and control what goes on in the agencies for which they have responsibility.

As we have noted in our previous reports, there is an underlying problem of consistency in presentation, which is indicative of a problem of coordination. The statements made in the December 9, 1992 Staff Report are still largely true today: "Data and projections presented for one purpose (such as salary expenditures) appear to be based upon different assumptions from that presented for other purposes and in other sections of the Quarterly Report (such as determining the impact of labor negotiations and implementation delays, initiative variances or the estimation of employee benefits costs) Nowhere, however, is there any comprehensive mention made of what those assumptions are..."

### **Tax Revenues**

The Plan's estimates of tax revenues, while on the whole reasonable, are optimistic, and require a series of positive events to reach their goals. The exposure was moderated to some degree by the reduction of approximately \$135 million in projected revenues over the Plan's term during Council deliberations and PICA's informal evaluation of the Plan. Additionally, it appears that there are improved prospects for increased assistance from the Commonwealth for Human Services' programs, which if received will be of some benefit in FY94 and (if continued) in the out years of the Plan as well. The Plan process was disadvantaged by omission of a detailed description of underlying assumptions for revenue growth based on more than an intuitive standard; and problems which the Authority found in the calculation and allocation of the PICA Tax should not be permitted to occur either in future Plans or periodic City reports.

In general, the projected growth in the Wage Tax, PICA Tax, Real Estate Tax and local Sales Tax all depend upon increased economic activity in the City, although the Wage and PICA Taxes assume no growth in employment over the Plan's term (in fact, the Plan anticipates a net *loss* of approximately 10,000 more Philadelphia jobs through June 30, 1995). There is an additional complication concerning the 1% local Sales Tax, beyond the prospects for local business activity, in light of continuing collection problems at the State level, which make it difficult to accurately project FY93 revenues from this source, and which in turn makes the base for future years' projections more suspect than might otherwise be the case.

### **Personnel**

The PICA Staff report on the FY93-FY96 Plan expressed reservations about the success of anticipated labor negotiations and arbitration proceedings, and whether the personnel assumptions in the Plan were reasonable in the absence of aggressive management of complement. Also, PICA Staff noted that the solution to Philadelphia's fiscal problems over the term of the Plan would depend on achievements in non-collective bargaining areas.

The conclusion of the major portion of the City's labor negotiations through June 30, 1996 has given the Administration some breathing room to make more far-reaching personnel and management decisions about what the course of the City should be in the years ahead. Questions still remain about the implementation and institutionalization of the various work rule and procedural changes which the City obtained, and the results of that process will do much to determine whether the concessions will be as meaningful as they could be.

One of the major concerns which PICA Staff expressed in its assessment of the initial Plan, and in its other reports, was the Finance Department's use of its authority to control hiring as a way to control expenditures. The Administration has committed itself to drive down the cost of overtime (with some success), while at the same time providing adequate staffing for agencies to perform their assigned tasks. The number of positions budgeted for departments have, however, often been much higher than the actual number of positions filled at any point during the year. The budgeted personnel level becomes an upper cap on the number of positions and during the year departments must again justify their need to hire to fill them. The budget and Plan should reflect a policy determination as to the level of staffing which is necessary, rather than an upside target with departments thereafter forced to negotiate with central administration for resources. The practice is antithetical to the concept of letting managers manage their agencies. Too much time and effort is required to get something done in City government under the best of circumstances, without the additional burden of re-negotiating the budget with each department after its approval. Complement control is a device which is helpful if used judiciously in concert with a good management system with larger policy goals -- not in replacement of such a system.

### **Management and Productivity**

This report in several areas asserts that the basic challenge to be dealt with by the City of Philadelphia in the months ahead is to upgrade its management systems and practices. The Plan is intended to be an integrated document which describes fiscal results and measures being taken to attain them; but it is deficient in its treatment of the process by which the City will make the structural alterations necessary to institutionalize the changes which have been accomplished, those which have been proposed, and those which remain to be developed. The City's recent monthly reports, although improved over earlier efforts, reflect this weakness by not consistently tying together the results from departments which are related in their expenditures (*i.e.*, direct costs being reported for departments without due regard being given to consistent treatment of related indirect costs incurred in others). The City has indicated a desire to improve its cost accounting, but this budget and Plan cycle has shown only marginally better coordination in this area.

PICA Staff is concerned that the institutionalization of change, and the required reformation of City management systems to do so, presents a considerable risk to the Plan, and the sections below explore the issues in greater detail.

## **Principal Operating Departments**

Fire Department -- The absence of an arbitration award adds a great deal of uncertainty to Fire Department obligation projections.

Department of Human Services -- During the years covered by the Plan, DHS is projected to become the department for which the City incurs the highest level of obligations. The increased costs are predominantly in the area of purchased services provided to children. These costs are projected to grow at an 18.3% compounded average annual rate, which actually requires a decline from the compounded average annual growth rate of 20.9% over the last several years. The Plan presents some ideas for restructuring service in ways that might reduce those costs, but presents no clearly articulated comprehensive strategy for improving the manner in which DHS does business. The City has hired a nationally recognized consultant and formed a task force to devise strategies for DHS. Inefficient operations may heighten the possibility that other levels of government, whose support is projected to increase almost as quickly as DHS's costs, will consider reducing the rate of growth for funding for the Department.

Department of Public Health -- Two of the Department of Public Health's key original initiatives appear to be falling short of their goals. The initiative to increase Medicaid billing and eligibility is falling short of expectations because a smaller percentage of patients than anticipated are eligible for Medicaid, and because the Department has not been able to secure State cooperation on facets of the initiative. The Philadelphia Nursing Home initiative has been stalled while the City determines the appropriate strategy for reducing Nursing Home costs. The future course of the City's system of district health centers is not clear.

Department of Public Property -- The City has successfully initiated a number of its Department of Public Property initiatives, including privatizing custodial services at City Hall and the establishment of a fleet manager's unit. Perhaps the Department's largest challenge during the life of the Plan will be space planning, which becomes crucial as the Criminal Justice Center and the work at the Municipal Service Building are projected to be complete in 1995.

Streets Department -- The largest new initiative for the Streets Department is the shifting of Special Gas Tax funds from street resurfacing to personnel costs. This initiative's success is dependent on the City's ability to borrow for resurfacing costs. If this is not done, the City will be forced to delay and increase its street resurfacing costs in the operating budget.

The Department's ability to meet its Plan projections depend in large part on its waste disposal contracts being implemented as scheduled. The Department indicates that the implementation of those contracts is on schedule.

In its December 1992 Staff Report, PICA Staff wrote, "Streets Department non-labor items in the Plan -- discontinuance of alley lights, charging non-City agencies for trash pickup and a reduction in signalized intersections -- all require the Administration to exercise political will and perhaps make decisions which may require re-examination of the Plan."

Departments of Revenue and Law -- PICA Staff's greatest concern with the Revenue and Law initiatives is the continued delay in the implementation of computerization. The project has experienced delays for a number of reasons, but Staff is concerned about the timing of the generation of substantial receipts. Additionally, PICA Staff is concerned that as computerization lags, the City will become more dependent on the success of suburban wage tax withholding legislation, which faces substantial uncertainties.

Prisons -- PICA Staff is concerned that any delays in the construction of the new 2,000 bed facility will require the City to continue operating Holmesburg (and thus increase costs from those projected in the Plan). While the Plan indicates that PICA assistance will be sought for the second 1,000 bed phase of the project, the Authority has not received any detailed information on it.

Philadelphia Parking Authority -- The City's reduction of staffing at the Parking Authority and implementation of a series of other initiatives proposed by the Mayor's Private Sector Task Force could significantly increase revenues received by the City from the Parking Authority.

#### **Other Areas of Concern**

Indemnities -- The Plan identifies a \$24.5 million funding gap for indemnities, caused in large part by the Court of Common Pleas Day Backward/Day Forward Program (which is intended to reduce the Court's backlog). While the Court's program presents the City with an opportunity to better organize and manage its indemnities program, it also is likely to cause a one-time spike in the City's costs. Funding that cost out of operating revenues could cause long-term disruptions to cover a short term cost, which is not managerially prudent. As a result, the City has asked PICA to provide financial assistance to fund costs of the program.

Other Funds -- In its December 9, 1992 Staff Report, PICA Staff wrote, "PICA staff continues to be disappointed with the level of detail provided for the Water and Aviation Funds." The Plan did nothing to ease PICA Staff's disappointment, although additional Aviation Fund material was provided during a Plan review meeting.

Capital Program -- While administration of the capital program continues to improve, PICA Staff is still concerned that, as the December 9, 1992 PICA Staff report

said, "the system as it currently exists falls far short of the standard which should be applied for an entity of the size and complexity of the City."

### **Staff Summary**

The FY93-FY98 Plan includes a method to "cure" the variance found to exist by the PICA Board at its December 9, 1992 meeting and presents balanced budgets (with the exception of the effect of extraordinary indemnity costs) for each year from FY94 through FY98.

The balance is, however, a tenuous one. PICA Staff believes that revenue projections are optimistic and that if the City's economy recovers less rapidly than anticipated, the City will need to make significant adjustments to its Plan. While the City has made great strides towards eradicating the City's deficits, it has yet to institutionalize change. The City has taken important steps, but the City's financial crisis was created over many years and it will require years of effort to correct and years of vigilance to maintain fiscal stability.

### **Staff Recommendations**

PICA Staff recommends that:

1. The PICA Board determine that the City has taken adequate remedial action to cure the "variance" in the Plan declared by the Authority on December 9, 1992.
2. The PICA Board approve the Plan as submitted on March 19, 1993, including supplemental information and technical modifications as of April 12, 1993, inclusive of an agreement in principle to provide financial assistance to the City to cover the costs of the Day Backward/Day Forward program from remaining bond proceeds previously allocated to funding a portion of the City's operating deficit for FY92, but not required to be used for such purpose, but only if the money is segregated into a trust account with provisions for PICA review of disbursement requests, and other provisions which PICA with the advice of counsel deems appropriate.

## Management and Productivity

### Primary Areas of PICA Concern

- o Recognition by the City of the management component of the financial planning process
- o Commitment to fundamental change
- o Management capacity
- o Archaic cost accounting systems limit the ability of managers to have adequate current information
- o Strategic Planning and Institutionalization of change
- o The Plan's Assumption that, unless otherwise specified, all costs other than personal services and debt service will increase at only 1.5 % each year

### Introduction

In its evaluation of the initial Plan, PICA Staff noted that while the document was labeled as a *financial plan*, the greatest challenges to be dealt with by the City were of a managerial nature, which would be judged by financial results. While there were many reasons for the near-total collapse of the City's finances, one of the most obvious was the inability of the City to administer its own affairs efficiently.

Managerial concerns are as significant today as they were last year, and as the City moves beyond the immediacy of a generally-accepted "fiscal crisis", the tasks become more difficult, particularly as they require more complex planning and coordination and become highly detailed in their implementation.

**Recognition by the City of the management component of the financial planning process -- *There is a relationship between management effectiveness and financial performance***

Government, to be effective, requires at least the tacit consent of a large portion of the population -- a degree of support and involvement in the process of management and policy making which is a foreign concept to most corporations. That requirement is fundamental to a system which has been designed to discourage actions which have not earned the requisite critical mass of support. It is, therefore, somewhat naive to believe that government could, or should, "be run like a business" -- although there is ample reason to conclude that the possibilities for government to operate in a more businesslike manner are almost limitless.

The challenge faced by those who seek to re-order the process of government fundamentally is to steer between the requirement for consensus on the one hand and the necessity for leadership on the other. It is an historically rare occurrence when the consensus for basic change runs in the same direction as the political opportunity to accomplish it. The City of Philadelphia, as a result of the continuing general agreement on the severity of its fiscal problems and the necessity to re-order the means by which it manages its affairs, has a momentary opportunity to achieve such a reordering.

The risk is not that political and civic leaders will reach beyond what Philadelphians will accept in an attempt to radically alter City government, but rather that they will not do enough. The greatest threat is that they will fall short of what should be expected of them, and too readily accept the diminished levels of service, efficiency and productivity that those who live and work in Philadelphia have come to expect after years of hard experience and disappointment.

There was no alternative, in 1992, but to make the Administration's first priority the negotiation of a series of labor contracts to stabilize personnel and personnel-related costs (which in FY93 are estimated to make up nearly 57% of the City's total General Fund expenditures). The completion of the AFSCME agreements and the Police arbitration process made a significant contribution towards that goal, and although the still-pending Fire arbitration continues to cause some amount of unpredictability, similar results in that arbitration process would match most of what the City has assumed in the Plan.

If the aim of the Administration's "first stage" was to stabilize the fiscal situation, and generally keep matters from deteriorating further, it has succeeded. What might be seen as the second phase -- the implementation of management and productivity initiatives -- has been somewhat less successful. It is in a "third stage", which has not been articulated by the City in the Plan, where PICA Staff believes there is the greatest opportunity for long-term success.

The City set out a goal in the initial Plan to foster competition as a means to promote the delivery of services more efficiently -- whether by private contractors or City employees making improvements within the existing system. The "competitive contracting" process, after a difficult beginning, has resulted in the award of several contracts to perform work heretofore done by City employees. Security at the Art Museum and custodial services at City Hall have been privatized, as have two Streets Department trash transfer stations, the City warehouse and some Water Department activities. The FY94-FY98 Plan anticipates competitive contracting efforts to be completed for printing, Art Museum custodial services, Prison food services and, probably, the Philadelphia Nursing Home. To date, it is not clear as to whether District Councils 33 and 47 will play an active role in proposing alternatives to privatization by addressing areas where the City claims to be disadvantaged, although

the City indicated that unions presented a serious, but unsuccessful, counter-proposal to the privatization of security at the Art Museum.

***Commitment to Fundamental Change -- To reach beyond the moment, changes must reach into the structure of government***

The PICA Board and Staff long have expressed concerns that changes prompted by a five year financial plan, no matter how successful in their inception, would be only transitory. In order to be effective beyond the moment, the changes suggested in the Plan must be accompanied by an ongoing, aggressive and far-reaching effort to reach into the structure of government and make the fundamental alterations in its operations necessary to institutionalize change. It is only through such a process that the City can expect to recognize the full benefits of what the opportunities at hand promise.

The City has made significant strides in the goal stated in the initial Plan to re-balance the labor-management relationship. It was successful in achieving structural changes in labor contracts with non-uniformed employees to address what the City viewed as undesirable work rules and past practices, many of which have been blamed by municipal managers as a cause of the City's inefficiencies and inability to deliver services to the citizens of Philadelphia effectively and economically. Discussions between City managers and union representatives are ongoing to determine how work rules will be changed. These discussions are an important element in the City's attempt to create change, but will fall short of their potential if not made part of a larger plan.

***Management Capacity -- A structure and culture that continues to operate after current senior managers depart must be established***

In lengthy discussions with City officials, and reviews of the departments and commentaries on their operations, it has become clear to PICA Staff that Philadelphia municipal government has a deep-rooted management problem. While the Administration has understood and accepted the responsibility to assume control of the government and make the critical decisions required to jump-start the process of addressing the underlying issues of governance, there is a difference between the exercise of control over an organization and the management of it. Effective management of large public sector organizations is an elusive goal, and one to which more aspire than achieve, and the degree to which a chief executive establishes a structure and culture that operates effectively after his departure is a major measure of his success.

**Archaic Cost Accounting Systems Limit the Ability of Managers to Have Adequate Current Information -- *The City's system is not an effective tool to monitor or manage activities on the departmental level***

The City's initial Plan, in its attention to the detail of particular financial effects of adjustments in the operation of City government, was an ambitious effort. Its "architecture" depended upon the belief that baseline revenue and expenditure numbers, derived from an analysis of past results and projected short-term performance, when influenced by a list of successfully achieved goals (the management, productivity and revenue initiatives), would change to reach a desired fiscal result over the term of the Plan. From the time of the decision to take that approach, to the development of the Plan for FY94-FY98, the Administration has found quantification of the financial effects of its initiatives to be a daunting task. The same is true in even the most basic of efforts to make City financial reports useful as a management tool. The Plan, in its revised design, represents an acknowledgment that the City's financial and management information system is not either a reliable source of current data or an effective device for management of activities on the departmental level.

The City's current system does not link to a department its costs for items such as benefits, rental costs and indemnities. This makes it difficult to determine what entire departments actually cost the City, much less specific activities undertaken by those departments. By the same token, the City's system to gauge the "output" of departments (in terms of service and productivity) is also flawed and makes the basis of even the determination to undertake particular actions highly suspect. Senior City administrators have indicated that they are making attempts to more closely link departments' indirect costs to their budgets. An example of this type of linkage is the listing of departmental facilities included at the end of departmental budget sections in the FY94 Budget.

As the PICA Staff has noted in earlier reports, the City's system for the reporting and allocation of, and accounting for, revenues and expenditures is inadequate. Philadelphia is not unusual in its use of a line-item budget and fund accounting system, but it seems to be particularly deficient in its capacity to produce useful data on a current basis. In short, managers seem to know -- to the penny -- how much their agency has to spend, but neither know nor care how much anything costs. The City (with estimated total General Fund FY93 revenues and expenditures of \$4.6 billion in all of its divisions) is fortunate only that it did not face financial catastrophe prior to 1991.

The PICA Act-imposed discipline of the Plan, its quarterly reporting requirements and the necessity for post-variance monthly reporting have all been of substantial value in promoting the establishment of the beginnings of a management information system for the City which includes meaningful financial data. As well, the Administration, on its own initiative, since October of 1992 has published Monthly

Managers Reports to detail the status of a wide range of City activities. PICA Staff, in its reviews of City reports required by the PICA Act, has noted problems in the consistent presentation of information and the use of properly explained and applied assumptions and methodology. It should be noted, however, that the City itself developed a fuller awareness of the depths of its problems in financial reporting through the monthly process, and has improved the utility of its documents.

The City's revision of the Plan's structure to devalue the linkage between the achievement of initiatives and departmental financial performance, while understandable in light of administrative reality, represents an admission that there are systemic flaws so far-reaching that it is impossible to rely upon the information concerning the results of initiative implementation for other than the most rudimentary of uses. The problems with the system were highlighted in PICA Staff meetings with departments, where it was apparent that agencies treat initiatives inconsistently in their degree of reliance upon them to achieve budgetary goals. Such a situation makes it difficult for an observer to assess the commitment on a departmental level to the attainment of any particular initiative, and creates problems for senior management in its efforts to make informed decisions and rational comparisons among programs.

In light of the obvious and admitted defects, the City indicates that it has begun to devote greater attention to the reform of its cost accounting system. Changing the Plan's architecture deals with the system's flaws by structuring around them, rather than following a coherent plan to fix the underlying problems. If the City hopes to deal with its problems in a comprehensive manner, such change is critical.

**Strategic Planning and Institutionalization of Change -- *All change is fleeting unless it is institutionalized and integrated into a consensus-based strategic plan***

Both the City and the Mayor's Private Sector Task Force have developed many initiatives to improve City government. The Administration and the departments have embraced some suggestions (such as creation of the Fleet Management Office, although adequacy of its funding for FY94 is still in question) while others have been viewed with misgivings.

As has been noted above, in the 15 months since the Rendell Administration has been in office there have been significant changes for the better in City government, and the initiative process has been of value in focusing attention on crucial issues. On the whole, the results have been most impressive in areas where the tasks have received the full attention of senior City managers, but less successful where detailed planning and interdepartmental and intergovernmental coordination have been required. Unfortunately, it is in those latter areas where the largest long-term risks to the City's fiscal stability may be found.

The popularity of the theme of "reinventing government" in part depends upon the concept meaning different things to different people. In Philadelphia, the management and productivity initiative process is the designated vehicle for "reinvention", but what has been accomplished to date is insufficient as a basis for the amount of optimism expressed about fundamental change. Long-term success -- in the form of eradication of the City's structural deficit -- depends upon the institutionalization of change, and absent major structural and management alterations, the gains achieved to date will be short-lived. The near-balancing of the FY93 budget, and the projected balanced budget for FY94 (exclusive of extraordinary indemnity costs), should not be underestimated in their importance to the City, but neither reflects a vision for the range of services the City should provide for its citizens. Given the substantial changes in the City over the past generation, the formulation and philosophy of the FY94 budget and Plan for FY94-FY98 appear to have been driven in large part by the priority of balancing the budget rather than rationalizing services and rethinking the role and operations of local government.

The "reinvention" of Philadelphia government, if it is to be more than a series of actions to obtain required funding for mandated and entitlement programs from the proceeds of incremental adjustments in other areas, requires more than the implementation of initiatives. Privatization, often part of the "reinvention" process, is also only a means of delivering a service, and does not address which services local government should be delivering -- where, how and to whom. While PICA's role is not to determine which services should be provided, it is part of PICA's role to assess whether a logically constructed strategy has been or can be developed.

The early passage of the FY94 budget and Plan, in conjunction with predictable wage and benefit costs for the majority of its employees through the 1996 fiscal year, have only bought time -- they have given the City a momentary opportunity to assess its priorities and re-examine the most minute aspects of government operations, in the hope of being able to make the fundamental changes required before fiscal pressures once again force it to the edge. The decisions of the Charter Commission will be an important first step in that process, but its work should not be viewed as a substitute for strategic planning. No assumption should avoid analysis, and no priority should be unchallenged. Only with a more rationally organized and managed structure, and agreed-upon priorities supported by all sectors of the community, can the City of Philadelphia survive as a place where people want to live and raise their families.

The future financial and service relationships between the City and other levels of government will be of at least equal importance to restructuring government, but no matter how those relationships are re-organized, the means by which the City administers its affairs will determine its ultimate success. Even with a re-ordered system to deal with financing children and youth services, health services, prisons and the courts, the capacity of Philadelphia to manage its way through the myriad non-fiscal problems it faces will depend directly upon its success in reforming its processes.

In short, the City must, and maintains that it is, both increasing the quality of its management systems and developing a strategic plan for the second half of this decade.

**The Plan's Assumption that, unless otherwise specified, all costs other than personal services and debt service will increase at only 1.5% each year -- *To meet the Plan's projections, City managers will have to keep costs well below the Plan's inflation assumptions***

The Plan assumes that, unless otherwise specified, the costs of purchased services, material, supplies and equipment, payments to other funds, contributions and taxes, and advances and miscellaneous payments increase at 1.5 % a year through FY98. At the same time, the Plan assumes that inflation equals 3.5 % in FY94 and FY95 and 4 % in FY96, FY97 and FY98. That means that costs will grow 2 % slower than inflation in FY94 and FY95 and 2.5 % slower than inflation in FY96, FY97 and FY98. This will require City managers to reduce the real costs of services, which may require reductions in the number of items purchased and improved purchasing procedures. It also implies the continued implementation of new initiatives to reduce the City's costs.

## CAPITAL PROGRAM

### Primary Areas of PICA Concern

- o Inadequate project information and control system to keep departments and senior management apprised of project status
- o Communication problems among inter-administrative and bureaucratic levels
- o Delays in payments to vendors
- o Lack of accountability for projects which rely on multi-agency funding
- o Lack of critical path management and preventive maintenance programs
- o No apparent consistent tie-in of capital budget events to operating budget impacts
- o Future PICA Capital Funding - No PICA Staff recommendation at this time

### Introduction

As part of its FY93 Capital Budget the City anticipated \$176 million in funding from PICA. The bulk of the projects were in the Public Property (Buildings and Transit), Recreation (including Veterans Stadium), and Streets Departments. After analyzing the supporting information on these projects for compliance with the PICA Act, PICA determined that funding would be provided to finance \$121.4 million in projects deemed qualified.

PICA Staff has worked closely with the City Administration and City Controller to initiate comprehensive accounting and reporting procedures to assure proper controls over use of PICA-provided capital funds. The City Controller's Office has been a major contributor to the success of this process.

One of the more disappointing continuing problems discussed later in this report is the delay in payments to vendors. Despite funds being available in the Encumbered Funds Account vendors are not always being paid on a timely basis. In the past this situation may have been understandable due to the City's cash crisis. Now however there should be no delays.

***Inadequate Project Information -- Despite improvements, much work needs to be done.***

PICA Staff in its earlier reports indicated its intention to analyze current and future capital projects, not only for compliance with the PICA Act's requirements, but

also to ascertain the City's ability to implement a sound capital project management and reporting system. We earlier expressed our disappointment with the quality of information the City provided to support the request for initial PICA capital program borrowing. We did so in the anticipation that the City would strive for improvement and eventually provide more thorough information for the PICA funded capital projects and future proposed borrowings.

Reports prepared by the City have been improved since last Fall, but still lack clarity and consistency. In reviewing City reports, PICA continues to find projects with inappropriate or undetermined matching funds, incorrect descriptions of work being performed at some facilities and schedules that incorrectly identify the current stage of the project. These reporting inconsistencies create delays in the project approval and funding process.

While PICA Staff in the main agrees with the Plan's assessment of improved City procedures (in the Capital Budget section) we nonetheless believe much remains to be done.

***Communication Problems -- Within and among City agencies exacerbates the already serious problems of management***

The major problem encountered by PICA Staff in monitoring the City's capital program is the lack of clear communication among the various parts of the bureaucracy involved in the process. There is still a lack of understanding of (and in some cases reluctance to accept) PICA's oversight role.

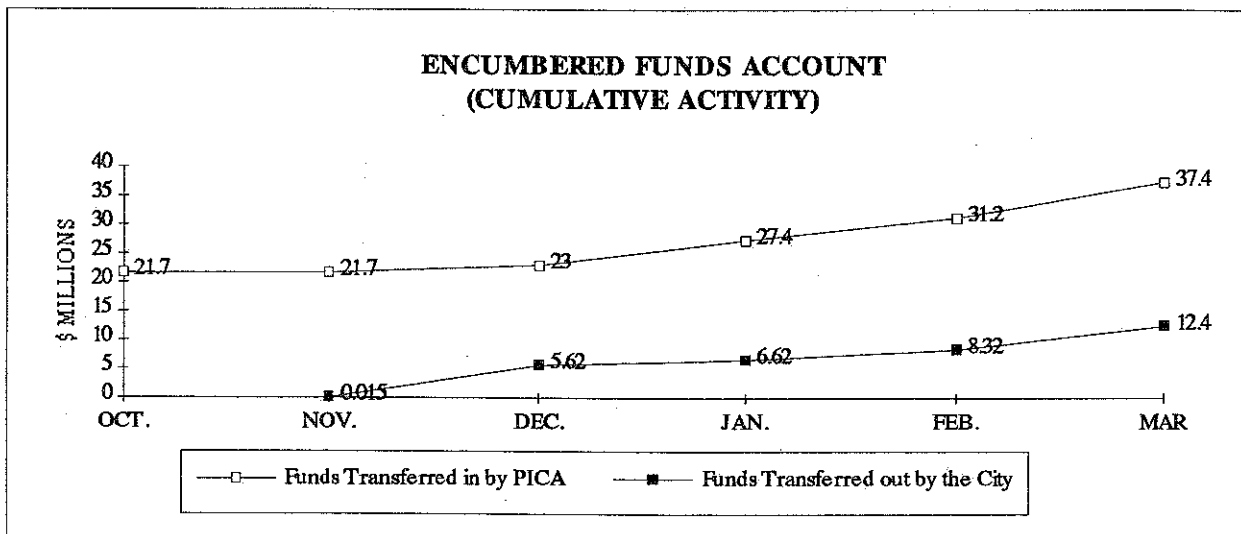
Part of the problem evolves from the "staged" procedure that the City uses to develop the capital budget. The capital budget process begins at the departmental level, where the need for and purpose of each project is developed. Upon completion of this portion of the process requests are submitted to the Capital Program Office and City Planning Commission where further changes are made. When this process is completed the Administration prepares final departmental capital budgets for presentation to City Council. Council reviews the budget on a departmental basis and makes additional revisions prior to approval. Capital budgets submitted by the departments have sometimes been completely revised during the legislative process without any major communication with the initiating department. In the case of the Capital Budget for FY94, however, the Administration indicates that departments were involved with the changes made during Council deliberations.

Given that PICA, as a provider of funding, was a new player in the capital process, and to insure a universal understanding of requirements for capital projects funded by the Authority, PICA Staff has had meetings with departmental engineers, Capital Program Office personnel, capital projects accounting personnel, and others. Better understandings of problem situations and problem resolution mechanisms, and

corrective procedures evolved from such meetings. The Capital Program Office and PICA have established a project substitution mechanism to assist the operating departments in correcting problems, with the understanding that better planning would be done in the future. The creation of the substitution mechanism in no way reduces departmental responsibility for proper project planning.

**Vendor Relations -- *Slow payments to vendors are still a problem***

The Mayor's Private Sector Task Force, in its Interim Report #2, said "The City is paying an estimated 10%-20% premium for goods and services purchased due to the fact that vendor bills are not paid in a timely manner." While it appears that inordinate delays in paying capital project vendors now occur less frequently, this situation still concerns PICA Staff. There have been several instances where PICA staff has received inquiries from operating departments or others as to the status of funds for a particular contract. In most of those instances PICA funds had been transferred to the Encumbered Funds Account weeks earlier. The chart below illustrates the timing difference between the amount of money transferred into the Encumbered Funds Account and the funds transferred out for payments to vendors.



As of March 31, 1993 PICA, based on certifications from the City, had transferred \$37.4 million (or 30%) of the total amount of approved capital projects into the City's Encumbered Funds Account. Of this figure, \$12.4 million had been disbursed to vendors as of that date. Of the \$12.4 million, \$10.3 million (83%) was for reimbursement to other agencies for contracts not under direct City control (*i.e.*, SEPTA, Veterans Stadium work by the Phillies, and Penns Landing Corporation). Our earlier-expressed apprehensions as to the City's ability to properly manage the spending of the \$121 million provided by PICA for capital projects have not yet been alleviated.

***Lack of Accountability for projects which rely on multi-agency funding -- Budgeted "outside contributions" appear inaccurate***

The City capital planning/spending process has improved, but is in need of continuing improvement. In the Philadelphia City Planning Commission's "Recommended 1994-1999 Capital Program", for example, certain projects seem to overstate Federal and State funding for FY94, and some misstate PICA funding for FY93.

Efficient interdepartmental operation requires that the City automate accounting information by capital project. Departmental submission of PICA Staff requested cash flow or funding schedules for projects with State, Federal or other funding has been an arduous process, with inconsistencies between work products produced by different segments of the Administration. The City presently has substantial difficulty tracking outside funding on an interdepartmental basis.

***Critical Path Method and Preventive Maintenance -- Organized programs are still lacking in the City's capital program, as well as the ability to monitor contracts effectively and integrate preventative maintenance into operating budget requirements***

Much of the capital program management problem appears to result from non-use of state-of-the-art project management skills and techniques by City architects and engineers. Critical Path Method (CPM), a management tool which is common to the construction industry, could forestall many of the recurring problems. Based on The Mayor's Private Sector Task Force's Interim Report #2, if this method were used the City would realize the following positive results:

- o An increase in the number of projects an employee could effectively manage.
- o A reduction in the number of change orders and associated costs.
- o Provide for better management control on status of projects.

If CPM was used by the City's architects and engineers it would make the capital program more efficient. There are several computer software systems that the City could install and utilize at very little cost, which should be eligible for Productivity Bank funding.

Another problem area for the City's capital program is the need to better control capital project administrative costs. Based on the definition of capital expenditures in the City's Home Rule Charter, City staff salaries paid from capital funds must be for employees who have worked "100% of their billed time" on capital projects. While the

City was aware of this requirement, it lacked the ability to independently allocate administrative costs, and the Controller made note of the problem.

***Tie-in of Capital Budget Events to Operating Budget Impacts -- Lack of concerted effort could imperil projects***

The preventive maintenance program for capital facilities being financed by PICA is a major concern. A field study performed by the City Controller's Office as of April 17, 1991 states that of 127 buildings inspected, 32 (25%) were considered to be in poor or hazardous condition. Controlling vandalism, sponsoring ongoing community programs to clean up recreational sites, and the redeployment of the Police to the Fairmount Park area are all positive steps, but much remains to be done.

Prior to its fiscal problems driving it from the bond market, the City had long been criticized for continuing to construct new facilities in the face of an inadequate and deteriorating maintenance effort. While the PICA Act restricts Authority provided funds from being used for totally new or expanded facilities, many of the projects now being done with PICA funding qualify as "emergencies" only because the City too long neglected its responsibility to maintain facilities in favor of new construction. Absent a concerted effort to establish and fund a program to cover the maintenance needs of its physical plant, the City will imperil the very projects now being repaired with PICA funds, and problems as discussed above will continue. PICA will, in the months ahead, devote increased attention to this area.

***Future PICA Capital Funding -- PICA Staff will periodically review the capital program and makes no recommendations as to future borrowings***

Going forward into FY94, PICA Staff plans to increase its oversight of the capital program through periodic reports. The reports will analyze how effectively the City administers capital projects, taking into account overall accountability factors such as preventive maintenance, tying capital projects to operating budget impact (including cost of staffing and maintenance), and maintaining departmental responsibility relationships. We will also review the period of time it takes for vendors to receive payment for services rendered, as well as the types of projects being completed. It is also our intent to present constructive assessments to City management to prevent the recurrence of such items as funding requests for replacement of boilers in buildings scheduled for demolition, or to repair heating and air conditioning systems in buildings which turn out to have had a long standing need for roofing repairs which later are the subject of substitution requests.

## Supplemental Funds

### Primary Areas of PICA Concern

#### **Aviation Fund**

- o Aviation Fund deficits
- o Aviation Fund relationship with Philadelphia Parking Authority

### Primary Areas of PICA Concern

#### **Water Fund**

- o Water Fund "scoop payment"
- o Mismatch between budgeted General Fund payments and Water Fund receipts

## Introduction

PICA Staff's charge in evaluating the Supplemental Funds (the Aviation Fund and the Water Fund) is to determine their potential impact on the General Fund. For the Aviation Fund, the most pressing concern is that continuing Aviation Fund operating deficits will erode its unrestricted cash reserve to a point where it would be required to seek General Fund support. The Plan says, "Once that depletion occurs, the only source of deficit funding of (the Outside Terminals Area) will be the City's General Fund." For the Water Fund, the prime PICA Staff concern is the Fund's ability to make its "scoop" payments (equal to the Fund's operating fund balance at the end of the year, but an amount that cannot exceed the lesser of Sinking Fund Reserve Fund earnings or \$4.1 million) and the projections of payments for services between the Water Fund and the General Fund.

PICA Staff has continuing frustration as to the level of detail provided to support the Supplemental Funds section of the Plan. As with the FY92-FY96 Plan, the FY93-FY98 Plan contains no revenue projections for the Aviation Fund. Moreover, the current Plan does not contain any obligation projections for the Fund. While PICA Staff has received supplemental information detailing Aviation Fund projections, the Plan is a public document, and PICA Staff considers the lack of Aviation Fund supporting information to be a serious shortfall from the required submission. Water Fund projections included in the Plan are out of date. The Plan's calculations were based on a larger customer rate increase than is now being proposed.

## Aviation Fund -- Primary Areas of Concern

**Aviation Fund Deficits -- *If operating deficits continue at the pace of the last two years, the Aviation Fund would be forced to seek General Fund assistance by the end of FY95***

Under their agreement with the Airport, the airlines using the Airport are required to fund 50% of deficits from the Outside Terminals Area (OTA), which are

incurred generally from the cost of operation and maintenance of the land, roads and airport parking facilities around the Airport. The airlines' contributions are capped at the lesser of \$1.1 million or half of a deficit of up to \$2.2 million. Any deficit beyond \$2.2 million is solely the responsibility of the Airport, and generally would be funded from the unrestricted cash reserve established for the Airport. In FY92, the City's share of the OTA deficit was \$1.1 million, and in FY93 the City's share is estimated to be \$1.2 million. The shortfalls, combined with transfers to the Aviation Capital Fund, have reduced the Airport's estimated unrestricted cash reserve at the end of FY93 to \$2.6 million. If the OTA continues to sustain losses at or above its FY92 and FY93 rates, the unrestricted cash reserve will reach zero by the end of FY95. It is highly likely that the General Fund would have to assist the Aviation Fund if its fund balance were completely exhausted. There is no other apparent source for funding.

**Aviation Fund Relationship with the Philadelphia Parking Authority (PPA) --**  
*Airport and City officials indicate that reducing or eliminating PPA functions at the Airport will help eliminate or reduce OTA deficits*

PPA is responsible for the management of parking activities at the Airport and provides revenues (net of costs) to the Airport. That revenue is a key component of OTA revenues. Airport officials maintain that PPA is charging a disproportionate share of its administrative costs to the Airport, and that a truer allocation of those costs would increase net revenues. Those officials also indicate that while the Airport receives PPA payments equaling 65 % of parking revenues, other airports in other jurisdictions receive higher amounts (the officials said the Greater Pittsburgh International Airport receives 85 % of revenues).

As a method of attacking the PPA problem, the Administration is following a Mayor's Private Sector Task Force recommendation to transfer Airport parking garage management to the Airport. The first step in that process was the replacement of PPA security officials with City police already assigned to the Airport. The next step is to eliminate PPA administrative employees at the Airport. The Administration presently is working on a transfer of those duties to Airport officials. The City has indicated that the PPA changes at the Airport will not be completed until FY94. No amounts are included in the Plan for FY93 which are dependent upon any adjustments in the current fiscal year.

An Airport analysis provided to PICA shows that, with the PPA changes, the unrestricted reserve fund balance would remain relatively stable (between \$1.9 million and \$3.5 million) through FY98. The projection is less aggressive in its assumptions about the growth of costs than is the Plan's projection for the General Fund, in that it assumes most costs to grow between 3 % and 5 % a year, as opposed to the General Fund's projection of a 1.5 % annual growth rate.

If PPA is removed from the Airport, with the projected resulting increased annual revenue for OTA, it is unlikely that the Aviation Fund will need General Fund support during the life of the Plan. Only a small cushion remains in place, however, in the form of a fund balance at the Airport.

#### **Water Fund - Primary Areas of Concern**

**Water Fund "Scoop" Payments -- *The Plan assumes that "scoop" payments will be \$4.1 million each year from FY94 through FY98***

The City's General Water and Sewer Revenue Bond Ordinance of 1974 provides that if there is a balance in the Water Department's operating funds, that balance can be transferred to the General Fund, provided the amount to be transferred is not more than the lesser of Sinking Fund Reserve earnings transferred to the Water Operating Funds during the year, the amount of Water Capital Improvement Fund earnings during the year, or \$5 million. The \$5 million limit on Water Fund transfers has since been reduced to \$4.1 million by agreement between the Water Commissioner and the Director of Finance. This Water Fund payment is known as the "scoop". The Water Fund made no scoop payment in FY92, but the Plan estimates it will make a \$3 million payment in FY93.

The calculations in the Plan show sufficient earnings for the Water Fund to make the annual scoop payment. The Plan's Water Fund numbers are, however, out of date. The Plan indicates that it assumes a 20% rate increase and "to the extent this increase is not realized, these projections will require alteration." As a result of a hearing examiner's opinion, the Administration has indicated that it will request a much smaller rate increase. The Water Commissioner has yet to rule on that increase and the Water Department has indicated that it will alter its calculations when that ruling is made.

The proposed rate increase is not the only uncertainty relative to the Water Department's numbers. The Department, after years of discussion, in January of 1993 moved from quarterly to monthly billing (which is projected to increase revenues) and the Department also anticipates benefits from the City's contract with its non-uniformed employees (which also covers the Water Department). The extent of savings from the labor contract will not be known until the Department has completed discussions with union representatives about work rules. Additionally, the Department is anticipating savings from automation, bond refinancings and privatization. The Department has indicated that informal analyses of the changes created by a lower level of rate increase and a number of efficiencies, including the ones discussed above, lead it believe that it will be able to retain the scoop and meet its other requirements. PICA will continue to have some concerns about the scoop until it studies the results of the operational changes anticipated by the Department and the impact of the reduced rate increase.

**Mismatch Between Budgeted General Fund Payments and Water Fund Receipts -- *In FY94, the General Fund budget anticipates more payments to the Water Fund than the Water Fund is budgeting as receipts from the General Fund***

At the end of each fiscal year, the Department of Public Property and the Fire Department reimburse the Water Fund for water used during the year. In FY91, the amount of those payments was \$13 million. The amount paid by the General Fund exceeded the amount the Water Fund budgeted as receipts in FY92, is estimated to exceed Water Fund anticipated receipts in FY93 and is budgeted to exceed Water Fund receipts for FY94. In FY92, the difference was \$2.7 million, in FY93 it is estimated to be \$2.3 million and in FY94 it is budgeted to be \$3 million, with the General Fund projected to pay \$16.9 million to the Water Fund. City officials indicated that the difference between the General Fund obligations and the Water Fund revenues in FY93 and FY94 is caused by the inclusion in the General Fund assumptions of a higher water rate increase than that assumed in the Water Fund revenue projections (which are based on the department's preliminary analysis of a potentially smaller rate increase). The mismatch between the General Fund and Water Fund projections is an example of inconsistencies in calculations that the Plan process is meant to avoid.

## **TAX REVENUES**

### **Primary Areas of PICA Concern**

- o Wage Tax and job growth Projections
- o Real Estate Tax projections, primarily beyond FY94
- o Sales Tax projections

### **Major Plan Assumptions**

- o Job decline will be 1 % in FY94, .5 % in FY95 and 0 % in FY96, FY97 and FY98
- o Wages will grow at about the rate of inflation
- o A series of initiatives will lead to increased Real Estate Tax growth rates

### **Introduction**

The City's projections for overall General Fund revenue growth begin modestly and then accelerate over the life of the Plan, increasing by 3.9% in FY94, 1.4% in FY95, 4.6% in FY96, 4.7% in FY97 and 4.9% in FY98. Revenues are projected to be \$2.367 billion in FY94, \$2.399 billion in FY95, \$2.508 billion in FY96, \$2.627 billion in FY97 and \$2.756 billion in FY98. The bulk of those revenues are tax revenues (about two-thirds of all revenues in each year of the Plan). In analyzing the City's revenue projections, PICA Staff's task was to determine whether the projections were reasonable, not whether they were the most likely of all possible scenarios. As indicated below, PICA Staff has several concerns about specific revenue categories, including the Wage and Real Estate Taxes, the City's two largest sources of tax revenue. Despite misgivings about particular revenue sources, PICA Staff believes that the overall revenue projections are reasonable over the life of the Plan. Nonetheless, there is no guarantee that the projected results will be attained, and optimism about revenues should not be a substitution for expenditure control.

Revenues other than from taxes are discussed in other sections of this report. Revenues from other governments are discussed in the sections pertaining to the Departments of Human Services and Public Health; tax collection initiatives in the Revenue and Law Departments section; and local non-tax revenues in the sections on the department to which such revenue production is ascribed (for example, false burglar alarm fees are discussed in the Police Department section), and revenues from other funds are discussed in the Water and Aviation Funds section.

In reviewing tax revenues, PICA Staff relied upon the Controller's 1993 Mid-Year Economic and Financial Report, advice from the Controller's Office and the Federal Reserve Bank of Philadelphia and supplemental information supplied by the Administration.

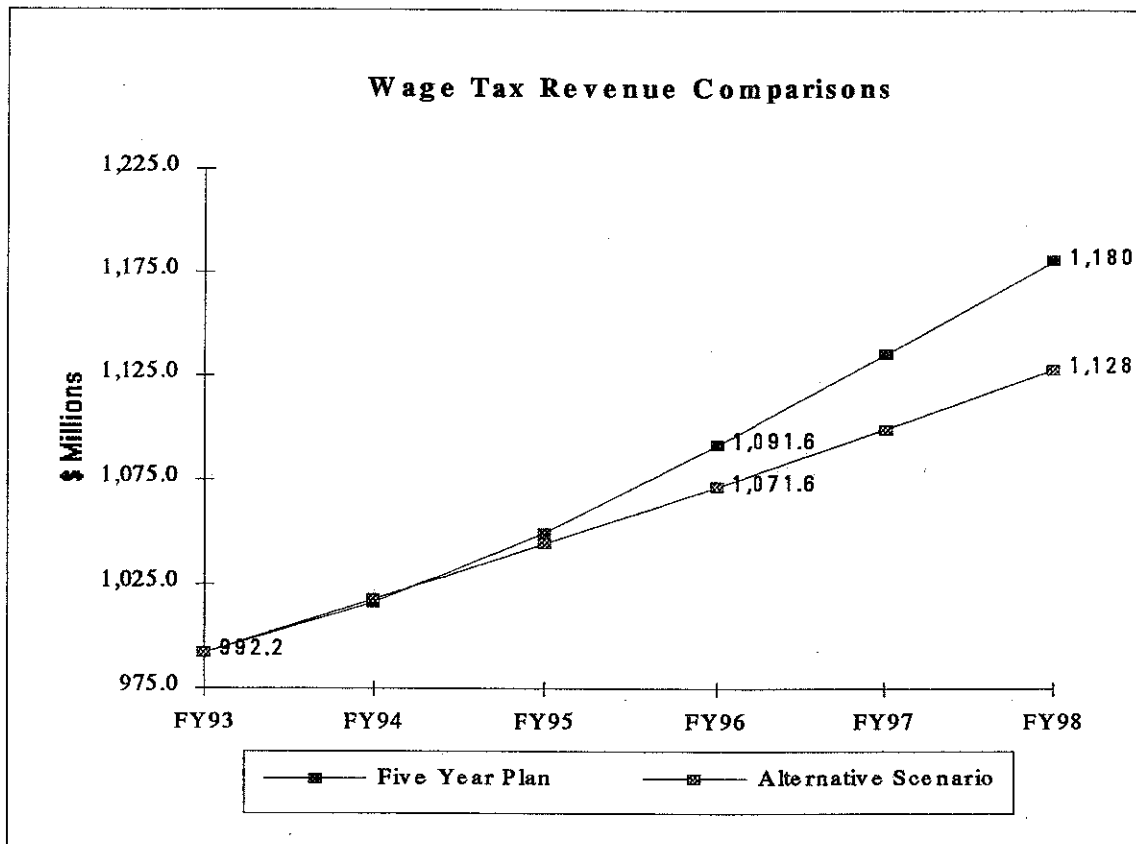
A series of meetings among representatives of the Administration, City Council, the Controller's Office and PICA Staff led the City to reduce revenue estimates for FY93 through FY98 by \$135.4 million (exclusive of PICA deficit financing proceeds), primarily through lowered Wage Tax, PICA Tax and Real Estate Tax projections. This section discusses PICA Staff's remaining concerns. If particular taxes, (as is the case with respect to the Business Privilege Tax) are not addressed in this chapter, it is because PICA Staff is in general agreement with the City's projections for those taxes, and believes them to be reasonably stated.

## **Tax Revenues**

**Wage Tax Projections -- *The Plan assumes at least marginal improvement in the City's economy***

The City Controller's Office's 1993 Mid-Year Economic and Financial Report indicates that the City lost about 9.5 % of its employment base from 1988 to 1993 (the Controller's Mid-Year Report estimated the 1993 employment level to be 706,200 jobs). Wage Tax revenues have increased slightly despite those job losses because of increases in taxpayer wages. Wage Tax revenues have increased between one percent and three percent a year for the last three year fiscal years. The City forecasts a gradual turnaround in the economy leading to a forecast of improved Wage Tax revenues. The job loss is projected to continue at one percent in FY94, slow to .5% in FY95 and go to zero in the FY96-FY98 period. The Plan does not project net gains in jobs in any year. Wages are assumed to grow at the rate of inflation for the life of the Plan, and inflation is projected to be 3.5 % in FY94 and FY95 and 4 % in FY96, FY97 and FY98.

PICA Staff believes that those assumptions may be aggressive, but not unrealistic or unreasonable. PICA Staff conducted a comparative analysis based on a study by the Controller's Office with the help of Temple University (which was used as a basis for the Controller's Mid-Year Report) and on a survey of economists conducted by the Federal Reserve Bank. The Controller's study projected continued job decline of one percent annually and the Federal Reserve survey showed a median inflation projection of 3.6%. Combining those two studies, and accepting the City's assumption that wages will grow at about the rate of inflation, the alternative scenario analysis produces annual growth in Wage Tax revenues of 2.6%. The following graph demonstrates the difference between projections using 2.6% annual growth and those in the Plan. The comparison does not include any benefits from initiatives nor does it reduce receipts from the PICA Tax by the amount of PICA debt service. It compares only the *growth* in base taxes. It also uses the City's estimate for FY93 Wage Taxes.



As the graph shows, the Plan projections are reasonably consistent with the alternative scenario's assumption of 2.6% annual growth through FY95, but become more aggressive for FY96, FY97 and FY98, as the differences increase as a result of the compounding effect. The Plan's projections are lower by \$1.5 million in FY94, higher by \$5.1 million in FY95, \$19.9 million in FY96, \$35.7 million in FY97 and \$52.6 million in FY98. The FY97 and FY98 differences are fairly substantial (1.9% of the City's total revenues projected for FY98) and would force the City to aggressively seek additional expenditure reductions or revenue enhancements were the more pessimistic assumptions to occur.

In evaluating whether the Plan's projections were reasonable, PICA Staff had to weigh a number of factors effecting the local economy. Those factors included:

- o The closing of major military facilities, which by the end of the Plan could cost the City over \$20 million in lost Wage Tax revenues;
- o The impact of the opening of the Pennsylvania Convention Center and the opening of at least one major new hotel;
- o The impact of continued loss of local businesses (such as Mrs. Paul's, Whitman's Candies, Franks Beverages and After Six);

- o The potential boost to the local economy of any federal economic stimulus package; and
- o The likelihood of a broad national economic recovery and its possible impact on Philadelphia.

The Plan contemplates that the impact of all factors influencing Wage Tax revenues will cause a halt in the decline of the size of the Philadelphia workforce, and wages increasing at the rate of inflation. PICA Staff is concerned that the type of jobs being lost at defense/military establishments like the Navy Yard pay much higher salaries than those jobs being created in the hospitality industry; that the economic recovery to date has not produced as rapid an increase in employment as have past recoveries (because businesses are increasing profits by increasing productivity, and increased output is not directly productive of increased employment). As a result, there might not be a direct or substantial link between the recovery and an immediate or substantial increase in employment and wages. Any continued lack of new job creation in the local labor market could depress the growth in salaries. It is also possible that inflation will remain at or below 3 %, which in turn would further reduce anticipated Wage Tax revenues, but would be of assistance to some of the Plan's expenditure projections.

PICA Staff believes there are various scenarios which are more likely to occur than the one the Plan is forecasting. The Plan's revenue scenario is, however, attainable with a recovery in the local economy, and not unreasonable.

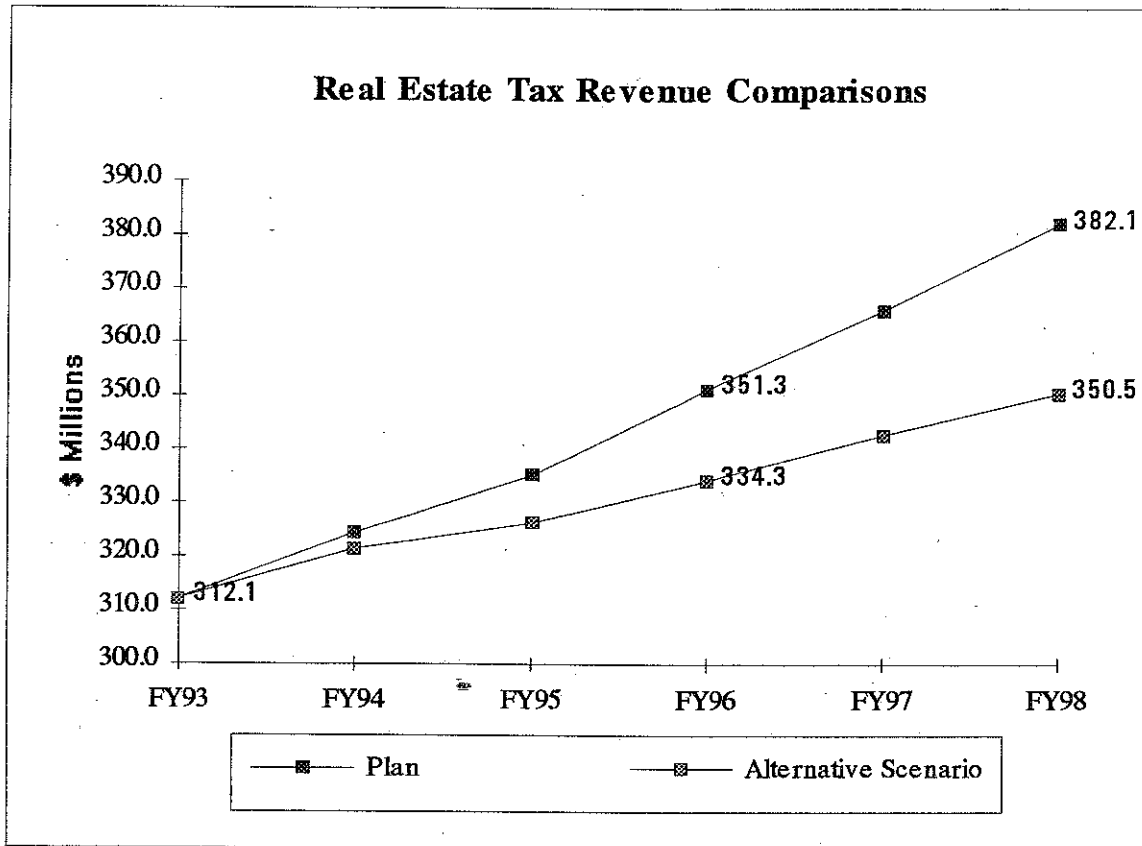
**Real Estate Tax Projections -- *The Plan assumes improved collections, increased success in appeals and recovery in the local economy***

The Real Estate Tax revenue projections are perhaps the most aggressive revenue component of the Plan. The City's ability to meet Plan projections is dependent on a rebound in the real estate market, a slight increase in the success rate in defending assessment appeals of abatements returning to taxable status and improved Real Estate Tax collections. The City has decided against basing a portion of its projection on an aggressive initiative to increase the percentage of market value included in assessments. Instead the City is relying on accelerated growth in the value of taxable real estate. The Plan does, however, say that the Board of Revision of Taxes is applying to the Productivity Bank to finance a computer assisted mass assessment upgrade package. The Plan indicates that the package is designed to improve assessment efficiency and the defense of assessment appeals. While increased efficiency is an important goal, the City should be wary of increased assessments unrelated to changes in market values. This type of change would be viewed by taxpayers as an increase in their tax burden and would likely slow real estate value growth.

The PICA Staff has concerns about each of the factors contributing to the projected growth. Real Estate Tax growth is projected to be over 3% by FY96, reach 4% in FY97 and be 4.4% in FY98 (as contrasted with the 1.7% projected for FY94); taxpayer appeals of returning abatements are anticipated to be successful only 20% of the time (as opposed to the one-third of the time the Board of Revision of Taxes currently estimates); and collection rates are projected to increase from 85% to 89% -- despite a growth in the amount of taxes owed.

The City maintains in the Plan that there is an inverse relationship between the growth in assessed market value and collections. The Plan, however, assumes that both market value and collections increase. Information provided by the City about the historic relationship among the factors contributing to projected Real Estate Tax growth makes it appear very unlikely that the City will achieve each item included in its Real Estate Tax forecasts.

A plausible alternative scenario is one in which the value of taxable real estate in the City grows slightly more slowly than the rates projected in the Plan (reaching 3.5% in FY97 and FY98) and in which collection rates are not improved. The City's contention that higher growth rates have traditionally lowered collection rates makes it probable that increases in growth rates, even the rates included in the alternative scenario projections, would not occur at the same time as improved collections. Additionally, the alternative scenario provides abatements returning at 72% of their pre-appeal value. This 72% abatement returning value figure is about halfway between the City's 80% projection and the Board of Revision of Taxes two-thirds estimate. The following graph shows the difference between the City's assumptions and the alternative scenario.



The alternative scenario produces revenues lower than the Plan's projections by \$3 million in FY94, \$8.9 million in FY95, \$17 million in FY96, \$23.3 million in FY97 and \$31.5 million in FY98. While PICA Staff deems the alternative scenario to be equally as likely as the Plan scenario, it nonetheless believes the City's projections fall within a reasonable range.

In the 1993 Mid-Year Economic and Financial Report, the City Controller projected combined Real and Personal Property Taxes to be \$351.4 million in FY93, \$365.5 million in FY94 and \$371.9 million in FY95. The Plan's forecast is \$352.9 million in FY93, \$365.5 million in FY94 and \$381.7 million in FY95 which is higher than the Controller's projections by \$1.5 million in FY93, \$3.9 million in FY94 and \$9.8 million in FY95. As with the alternative scenario considered by PICA Staff, the Controller's Office has produced projections that are more conservative than the Plan. By FY95, the difference between the Controller's Office and the Plan grows to 2.6% of combined Real Estate and Personal Property Taxes. If the more conservative analyses prove to be more accurate, the City necessarily will have to develop additional cost saving or revenue enhancing measures, particularly in the latter years of the Plan.

***Sales Tax Projections — Collections to date have been uneven and weaker than anticipated***

FY93 is the first full year of City Sales Tax collections (the City Sales Tax added one percent to the State's existing 6% Sales Tax on sales in the City of Philadelphia, beginning in October of 1991). The City, in making its FY93 projection, was thought to have been conservative in forecasting \$80 million in collections. Collections through the first several months were higher than anticipated, making it appear that the City could exceed its initial estimate. An annualization of the City's collections through the first quarter of FY93 would have produced a full-year projection of \$89.4 million. Collections have slowed to the point where an annualization of collections through March (the amount of taxes collected through March divided by nine and multiplied by 12) produces a projection of only \$75.6 million for all of FY93.

While the progress and growth of collections has been discouraging, the final picture is not clear. As with any new tax, the Sales Tax is having start-up problems. An example of the problem is found when taxpayers transfer the entire amount of taxes owed to the State electronically without differentiating between the City Sales Tax and State Sales Tax amounts. Because of misallocations and other such problems, the State occasionally has made high payments in subsequent months to compensate for amounts underpaid in a previous month. In October, for example, the State forwarded \$10.9 million to the City after having provided only \$2.3 million in September. The uncertainty as to whether all reallocations are complete makes an accurate projection based on year-to-date collections difficult. The seasonality impact on the collection process is also not yet determinable. Even if the City attains its current FY93 projections, it will garner revenues below the \$90 million projected for FY93 in the FY92-FY96 Plan. That projection was based on less than one full year's information about a tax which currently has been imposed for less than 18 months. Information now available about the pace of collections makes it clear that the \$90 million projection was overly optimistic, although the lack of other authoritative data makes the development of a reliable alternative scenario difficult. Commonwealth Sales and Use Tax receipts as of February were up by 9.1% over year to date figures last fiscal year, but the partial year history for the local sales tax make it impossible to compare State and City figures.

The possibility that FY93 Sales Tax revenues may be lower than currently projected compounds the impact of the City's aggressive assumption of 5% annual increases in Sales Tax revenues each year from FY94 through FY98. Since the City is assuming inflation between 3.5% and 4% from FY94 through FY98, reaching 5% growth depends either on prices of taxable items rising faster than inflation or growth in overall taxable sales. As with the City's projections for Wage Tax revenues and Real Estate Tax revenues, the Sales Tax revenue projections rely on an improvement in

the City's economy, and particularly on sales to non-wage taxpayers (such as visitor attendees at Convention Center events).

The City's projections for the Sales, Wage and Real Estate Taxes are consistent in their reliance on an upturn in the local economy. That consistency could create problems if the economy fails to rebound. A continuing slow economy will produce tax revenues substantially below those projected in the Plan.

Philadelphia's unwarranted optimism about revenues in the past created an environment which permitted development of the deficit which until recently plagued the budget-making process. While it would be unrealistic to build a budget and Plan on unreasonably optimistic assumptions on the revenue side, it is equally unacceptable to force use of an unreasonably low figure. There should be no doubt, particularly beyond FY95, that the Plan requires several positive events to stay in balance, but revenue projections for FY94 and FY95, taking into account overall revenue projections, are within the bounds of reasonableness. PICA Staff would have a greater sense of comfort with the City's projections had they been supported by the type of analysis and support expected in the PICA Act.

The need for vigilance is great. The City has no realistic alternative but to continue to constantly review each component of its revenue picture over the next fiscal year and thereafter be ready to move swiftly to restrict expenditures to maintain the ongoing balance necessary for the Plan to succeed.

## PERSONNEL

### Primary Areas of PICA Concern

- o Staffing levels/salaries
- o Health/medical benefits
- o Pension payments
- o Other fringe benefits
- o Disability reform
- o Fire arbitration awards

### Major Plan Assumptions

- o Staffing levels will remain unchanged after FY94
- o Health/medical costs increase 12% annually after FY93
- o Non-uniformed employees' contracts' salary provisions will lead to reduced pension obligations
- o Fire arbitration award will approximate non-uniformed settlements and the Police award

### Introduction

The largest unknown variable in the FY93-FY96 Plan was found in the area of personnel costs. The Plan was approved by the PICA Board before the City had completed negotiations with its non-uniformed employees, and before arbitrators had ruled on contracts for uniformed employees. Without labor agreements, the size of City's largest class of expenditures (personnel services are estimated to equal 57% of FY93 obligations) was known only within a large range. There was no way to know with certainty what level of pay employees would receive, what the cost of their benefits would be, whether the City's disability system would be reformed or whether there would be modifications to the City's paid leave policies. Those questions have, to a large extent, be answered for non-uniformed employees and Police, but an arbitration award has yet to be made for Fire employees.

This section discusses significant personnel issues that cut across departments. Departmental sections give more detail on issues such as departmental staffing levels and overtime usage.

### Primary Areas of Concern

**Staffing Levels/Salaries** — *Except for Prisons, no department projects an increase of more than one employee after FY94, and salaries are not projected to increase in FY97 or FY98*

The Plan includes a series of staffing changes from FY93 to FY94 and only one significant staffing increase thereafter through FY98. The Plan projects increases in staffing levels for the Department of Human Services, the Police and Fire Departments, the Department of Licenses and Inspections and City Council from FY93

to FY94. Additionally the Civic Center's 124 employees and 58 of the Water Fund's employees are to be brought into the General Fund. The contemplated staff increases are partially offset by decreases in staffing in other departments, particularly in the Health Department. After FY93, however, the only other staffing change of more than one employee in one year is an increase in Prisons Department employees (from 1,860 in FY94 to 2,050 in FY95) to reflect the impact of the planned opening of a new 1,000 bed facility in September 1994 and a second new 1,000 bed facility in March 1995. The opening of the second facility is expected to be accompanied by the closing of Holmesburg Prison.

PICA Staff believes it unlikely that staffing levels will remain constant over the five years of the Plan. Employee complement control, and reductions in staffing through attrition, historically have been the City's primary methods of reducing expenditures, and have frequently substituted for comprehensive and rational management changes. The number of filled full-time positions in the General Fund has fallen from 26,415 in FY87 to 23,233 at February 28, 1993 (FY93), a 12% decline. Personnel levels have been one of the easiest variables to control and, to the extent that management initiatives fail or revenues lag below projections, the City will be tempted to reduce expenditures again through personnel reductions. Further privatization should also lead to a reduction in personnel levels, but the introduction of privatization will reduce the amount of additional savings the City can achieve through attrition. As the number of employees directly employed by the City shrinks, so too will its ability to save through not filling positions. The projections also do not indicate that the City is basing its Plan on making any basic alterations in its structure or management system, which should be a cause of concern.

The Plan includes the pay raises negotiated in the non-uniformed employees' settlement (2% effective April 1, 1995 and 3% effective April 1, 1996) and assumes that all uniformed employees will receive the increase included in the Police arbitration award (2% at January 1, 1995 and 3% at January 1, 1996). This is a reasonable assumption, but one that will be tested only when the Fire arbitration outcome is known.

The Plan further assumes that in FY97 and FY98, after the expiration of the current contracts (assuming Fire also receives a four-year contract), there will be no additional salary increases. This is an aggressive assumption, particularly given the Plan's projections that by contract expiration, the City will have completed three years without a deficit and employees' salaries will not have kept pace with assumed inflation rates in any year of the Plan.

***Health/Medical Benefits -- The Plan assumes 12% annual increases in the cost of health benefits after FY93***

The City's negotiated settlement with its non-uniformed employees includes an agreement that the City's per employee monthly contribution would be \$360 in FY93, and the Police award included a \$400 per employee monthly contribution beginning April 1, 1993. After FY93, the City's monthly health/medical contribution is to increase by the average rate of increases incurred by the three largest health maintenance organizations (HMO's) in the region. Rather than making the payments directly to recipients, the City makes a payment to a union fund which then administers the program. The City's payment is designed to cover current employees plus retirees for their first four years. The City assumes that Firefighters will get the same base FY93 contribution as Police (\$400) and that the growth of the cost of those benefits will approximate 12% annually through the life of the Plan.

The projected annual growth rate appears reasonable and could exceed actual growth, particularly if the Clinton Administration successfully implements a health care reform package that reduces costs for local government.

***Pensions -- The single largest obligation reduction projection during the time the Plan was being considered by City Council was a \$57.9 million reduction in pension costs from FY94 through FY98***

When the Plan was submitted to City Council, projected total pension contributions for the life of the Plan were \$1,069.8 million. The Plan approved by City Council projects total pension contributions of \$1,011.9 million. The \$57.9 million change (the largest obligation decline in the Plan from the time of submission to Council and its approval) was the City's primary method of compensating for the effect of its reduced revenue forecasts.

The City was able to have a reasonable basis for an alteration in its pension projections based on an analysis performed by a consulting actuary. The analysis took lower salaries and certain disability plan changes into account, but it did not include changes in the number of personnel employed by the City, an assessment of the potential impact of other disability system reforms or any decrease in assumed fund earnings. PICA Staff asked for, but has not yet received, an actuarial analysis taking into account the omitted factors. PICA Staff's concern is that the impact of potentially reduced plan earnings will outweigh other changes, and the City's required pension contribution might not decrease as expected. The City has indicated that it is bound to budget the amount determined by its actuary for FY94.

The results of the partial actuarial analysis indicated that the change in salary assumptions and the disability benefit offset would allow the City to reduce its pension contribution by \$135.3 million over the life of the Plan. The City decreased its

projected total pension contributions by \$67.7 million from FY95 through FY98. The remaining \$67.7 million in pension payments to be provided per the Plan, but not required according to the partial actuarial analysis, are designated to be used as additional amortization of the City's mammoth unfunded pension liability (\$2.4 billion according to the City's 1992 fiscal year actuarial valuation, up \$165 million from the 1991 fiscal year report).

Pending PICA receipt and analysis of a more complete actuarial study, including an evaluation of the existing earnings assumptions as being in line with reasonably anticipated market conditions, PICA Staff continues to have concerns that the City will not fully realize the forecasted pension cost savings. No impact of any required revision would be seen in FY94, inasmuch as the required contribution calculation and City payment amount for FY94 are determined by the results of the FY92 actuarial report.

An additional pension concern is a Commonwealth Auditor General's draft audit finding (subject to revision prior to issuance) that the City owes the State \$18 million as a result of not complying with State law on pension fund contributions. The City has indicated that it will contest the finding and that any additional payments ultimately determined to be required would be amortized over a multi-year period (this type of payment schedule would require the pension fund's agreement). Such amortization would reduce the impact in any one year. It is also possible that the amount of money the draft asserts is owed by the City will be reduced in the final version of the audit or in subsequent discussions between the Commonwealth and the City. PICA Staff, in consideration of the preceding, believes that the City ultimately will incur higher pension obligations than those included in the Plan, and will monitor matters as they develop further.

***Other Fringe Benefits -- The City has achieved most of its disability plan reform goals in its contracts with non-uniformed employees and Police, and must now implement the allowed changes***

For the most part, the City has taken a fairly conservative approach to its "other fringe benefits", assuming that unemployment compensation, employee disability, group life insurance and tool allowance costs will grow at 5% annually. In each of those categories the assumed growth rate appears adequate (with the possible exception of employee disability). Employee disability costs were \$25.6 million in FY91, grew to \$31.9 million in FY92 (up by 24.6%) and are estimated to be \$36.3 million in FY93 (an increase of 13.8%). The City anticipates slowing the rate of growth of disability payments through its disability reform program (discussed below).

In the non-uniformed labor settlement, legal plan payments were reduced to \$10 a month per employee with a return to the pre-FY93 monthly contribution of \$12 at the beginning of FY95. The fringe projections reflect this 20% increase and then show no

change for the life of the Plan. The Police arbitration award maintained the City contribution rate at \$20 per month per police officer. The Plan assumes Firefighters will continue to receive their current contribution rate of \$16 per month.

Employer FICA and Medicare taxes (Social Security payments) which are a set percentage of salary, are estimated at \$44.8 million in FY93 and are projected to grow at between 1% and 2.5% per year in accordance with wage growth. The Plan initially submitted to Council showed Social Security payments increasing 5% annually. The change in assumed growth rates reduces obligations over the life of the Plan by \$33 million, and appears consistent with salary projections.

Flex cash payments (made to non union-represented employees to provide choice in benefit selection) are projected to decline rapidly from \$3.2 million in FY93 to \$1.7 million in FY95, before increasing by over 10% per year to \$2.3 million in FY98. The projected costs are scheduled to decrease through FY95 because of a restructuring of the Plan and then to grow because of increasing health care costs.

***Disability Reform -- The City achieved almost all of its goals for disability reform in its negotiations and in the arbitration award with Police, but must now implement the changes***

The City's contract with non-uniformed employees and the Police arbitration award made the following changes to the City's disability system:

- o It prohibited the practice of "double-dipping" under which an employee could receive two City-funded pensions for the same injury;
- o It reduced tax-free temporary disability pay to 75% of an employee's full salary (from 100%); and
- o It established "two for one" offsets for outside income earned while receiving City disability payments.

The City has projected \$8.6 million in savings from this initiative. The two remaining variables are the Firefighters' arbitration award and the City's ability to manage the new disability system in a way to achieve projected savings.

The City is presently revising its pension ordinance and civil service regulations to conform with the newly negotiated provisions. Additionally, the City is establishing a Risk Management Division in the Finance Department. That unit is projected to be in place at the beginning of FY94; its function will be to "control and manage the City's exposure to risk and to develop and implement appropriate strategies to ensure against and reduce the magnitude of potential losses." The unit's responsibilities will include indemnity claim and subrogation management, self-insurance and/or purchased

insurance decisions, employee injury and disability programs and work safety/injury prevention and loss prevention programs. The Risk Management Division is viewed by the City as a key component of its cost containment efforts. If it is appropriately staffed and allowed to work effectively (and if the disability provisions of an eventual Fire award are similar to those negotiated with non-uniformed employees and obtained in the Police arbitration proceeding), the Risk Management Division could save more than the \$8.6 million assumed in the Plan.

***Fire Arbitration Award -- The absence of a Fire arbitration award adds some uncertainty to the City's projections of both salaries and benefits for Firefighters. In the past, however, Fire arbitration awards have been similar to Police awards***

Arbitrators have yet to make their Fire award rulings. This leaves a degree of uncertainty in the Plan, although Fire awards traditionally have been reasonably similar to Police awards. While preparing the Plan, the City received a draft of the Police arbitration award and used that draft as the basis for its Plan projections for both Police and Fire costs. The City has indicated that the final version of the Police arbitration award appears to be substantially the same as the utilized draft, and we have therefore preliminary concluded that the FY93 Plan's estimates are a reasonable base for the FY93-FY98 period. PICA Staff is continuing to study the award, and has yet to see its appendices, so that it is possible there are facets of the award that may alter Staff's conclusions.

## Debt

### Primary Areas of PICA Concern

- o Structure of FY93 short term loans
- o New issues
- o Refundings
- o City debt limit
- o Additional PICA borrowings

### Major Plan Assumptions

- o PICA will issue bonds in FY94 to cover both \$125 million in general capital costs and \$54.5 million for prison construction
- o The City will issue approximately \$250 million to \$300 million in short term notes early in FY94
- o The City will issue general obligation bonds in FY95 and FY97
- o The City will pursue refunding possibilities

## Introduction

The City's debt service and long term lease payments are projected to be \$173.7 million in FY94, \$167.5 million in FY95 and between \$179 million and \$180 million for each of the remaining years of the Plan. While the City's projected long term lease payments did not change from the Plan as submitted to City Council to the version approved by Council, the City's debt service payment projections changed dramatically. The Plan as originally proposed by the Mayor projected FY94 through FY98 debt service payments of \$757.7 million, but the Plan as approved by Council was for \$682 million, a decrease of \$75.7 million. The decrease was the result of a combination of a reallocation of costs and reductions in projections.

The Plan as initially submitted included payments for PICA debt service on a new issue as a City obligation, but by law those payments are made by PICA and offset against the PICA Tax. PICA debt service on a new issue is projected to be \$61.9 million, so that the difference between the change in PICA debt service and the change in total debt service was \$13.8 million. An additional change must be factored into the calculation: the Plan revision process added a \$6.5 million loan to the Spectrum II project to debt service obligations (the funds for the loan emanate from asset sales made by the Philadelphia Authority for Industrial Development). If that \$6.5 million is subtracted from the City's debt service obligations, the net difference between the debt service amount in the Plan as initially submitted to City Council and the Plan approved by Council is a decrease of \$20.3 million. That \$20.3 million, combined with \$76.5 million in projected employee benefit reductions, constituted the largest portion of expenditure reductions made to compensate for its \$135 million in decreased revenue projections over the life of the Plan.

**Structure of FY93 Short Term Loans -- *The FY93 notes were not structured to provide the City the maximum hedge it historically has required in its traditional low cash periods***

Short term loans are normally made to give the City maximum protection against cash shortages in its traditionally illiquid periods. The FY93 loans were not structured to do this. The PICA-purchased notes were structured so that \$95 million was repaid by December 30, 1992. The City is traditionally at a low cash point from the end of December until the end of February (when most Real Estate Taxes are collected). While there were other considerations involved in the City's public loan note issue, having the bulk of the PICA notes repaid before January made a second issue much more necessary (the City also wanted the PICA notes to mature early enough so that PICA funds would be available for capital projects).

The City again faces a cash crunch before the Business Privilege Tax receipts come in at the end of April, as a result of the two FY93 note issues being structured so that the City had to make principal repayments in early and mid-April (\$60 million to PICA on April 1 and \$65 million for public noteholders on April 15) before the bulk of the Business Privilege Tax revenues are usually received. These two loan repayments, combined with a scheduled \$30 million pension payment, mean the City will make \$155 million in extraordinary payments in April. At March 26, 1993, the City had \$179 million in available cash. That balance, combined with Wage Tax revenues, other miscellaneous revenues and the City's ability to delay the pension payment into May will probably allow it to maintain its "minimum threshold" cushion of at least \$50 million through April. Note issues, however, should be designed to avoid continuing concerns about the size of the City's cash cushion. The City would be better served by note issues that have repayments scheduled after the end of April and the City has indicated that will seek that type of repayment schedule in the future. To the extent that note holders require earlier payments (PICA did not make such a request), the City should negotiate pre-May repayments to be as low as possible.

**New Issues -- *The Plan anticipates new City general obligation issues in FY95 and FY97.***

The City's long term debt expenditure projections contemplate an issuance program that should be seen as somewhat aggressive given the City's current below investment grade ratings and limited remaining tax supported debt capacity. The Plan assumes, in addition to issuance of PICA bonds in FY94, that the City will issue its own bonds in FY95 and in FY97. Over the life of the Plan, these latter two bond issues are projected to require \$46.6 million in total debt service payments. In order to enter the market for large scale long term general obligation issues, the City will either have to regain its investment grade credit rating or be able to obtain credit

enhancement. Additionally, it will need to have sufficient bond issuance capacity (see the section below concerning debt limits). It may be aggressive to assume that the City will be able to reenter the market within two years, but if it is able to meet its budgetary goals in FY93 and FY94 and to pass a legitimately balanced budget for FY95, the City may have an opportunity to regain its investment grade rating. It is wise policy for the City to provide sufficient debt service appropriation power in the event that it is able to issue bonds, since the Plan assumptions in this regard can be altered as matters evolve.

***Refundings -- The Plan does not assume any savings from refundings of existing debt***

Despite a recent modest upturn in interest rates, the bond market is still at a level which presents the City with opportunities to refund bonds that were issued at much higher rates. The Plan points to several types of outstanding City bonds that lend themselves to refundings -- bonds that have no remaining call premiums; insured bonds and high yield bonds. The insured bonds seem to offer the best immediate refunding possibilities because they do not require the City to regain independent market access. The creditworthiness of the insurer would be enough to allow the bonds to be refunded through a public offering, and insurers should be receptive to reissuing otherwise non-cancelable policies if the City requests them to do so. The high yield bonds and callable bonds would be likely candidates for refundings when the City regains an investment grade credit rating. The Plan's projections are that the City will be able to reenter the market by FY95, which means that it might be able to refund some bonds then, although it is impossible to predict whether interest rates would be low enough to make refundings attractive at that time. The City has also suggested the possibility of asking PICA to refund some of the City's outstanding bonds. A PICA refunding could save the City money, and while the City has at various times discussed the possibility of approaching PICA about refundings of non-insured City bonds, it has to date not yet requested such assistance.

The uncertainties surrounding the City's ability to refund existing bond issues make it prudent for the City not to assume any refunding-generated savings during the life of the Plan.

***Debt Limits -- The City may be restrained from the issuance of new bonds by its General Obligation debt limit***

The City's Constitutional limit on the amount of principal outstanding for tax supported debt is the equivalent of 13 1/2 percent of the preceding ten-year average of the assessed value of taxable real property. The City's Comprehensive Annual Financial Report for the fiscal year ended June 30, 1992 shows that the City's remaining tax supported debt incurring capacity was \$116.5 million. That limit does not give the City much room for new issues and does not give it the ability to refund

the PICA bonds. The City is likely to have additional borrowing capacity by the time its credit is strong enough for it to enter the market on its own since it retires debt each year and presently does not have market access to issue its own new long term general purpose debt.

The use of the Real Estate Tax as the base for calculating borrowing capacity is an anachronism for a City that is primarily dependent on the Wage Tax for its revenues. It is equally unrealistic, however, for the City not to be required to consider debt service of entities like PICA and the Philadelphia Municipal Authority in its debt issuance calculations. The City pays the debt service on debt issued by those entities and its ability to pay debt service cannot be fully judged without including those payments. The City should devise an internal procedure to measure general purpose debt incurring capacity based on overall tax revenues and existing debt service requirements for all long term debt for which it makes payments; and also plan for altering its statutory debt limit to a level which approximates that of other counties in the Commonwealth and for the time when PICA will no longer issue for the City.

**Additional PICA Borrowings -- *The Plan assumes one new PICA borrowing***

The Plan assumes a new PICA borrowing with debt service payments beginning in FY95. The issue would be for capital projects, possibly including a new prison facility (the Plan shows \$125 million for general capital projects and \$54 million as the total size of a required financing for Phase II of the prisons project as noted in the Prisons portion of the Other Significant Plan Concerns section below). It is reasonable for the City to include debt service payments on that projected issue in its Plan, but bond payments included in the Plan are only estimates. The City and PICA have not yet had any discussions about specific projects to be included in a potential PICA capital bond issue. The Plan states "nothing in the current Plan should be deemed to constitute an official request to PICA for funding," and PICA Staff is at this time not prepared to recommend any action by the Authority in that area.

Even if the City makes requests for projects equaling the amount underlying its debt service assumptions, it is possible that PICA will borrow for fewer projects than the City's request. Last year, PICA funded only about two-thirds of the projects proposed by the City. PICA will carefully review any proposed project to determine whether it qualifies for funding under the requirements of the PICA Act.

## Indemnities

### Primary Areas of PICA Concern

- o Handling of ongoing cases
- o Day Backward/Day Forward program
- o Financing Day Backward/Day Forward program

### Major Plan Assumptions

- o Financial assistance from PICA will close a funding gap
- o Day Backward/Day Forward costs can be pushed beyond FY94

## Introduction

The Plan as submitted to City Council did not comply with the PICA Act's requirements of projecting balanced budgets in each year. The Plan indicated there were unfunded indemnity costs of \$31.1 million through FY98, including a \$20.8 million gap in FY94 alone. The initially submitted Plan said "the City has not yet determined how it will bridge this financing gap."

This Plan-identified funding gap specified as its primary cause the "Day Backward/Day Forward" program developed by the Court of Common Pleas to reduce its case backlog. That program, together with the City's determination to more efficiently handle its ongoing inventory of litigation and required payments of large settlements to District Council 33 as a result of the new labor contract, are projected to swell indemnity costs from \$39 million in FY92 to \$46.5 million in FY93 and \$49.9 million in FY94 before they decline to \$38.8 million in FY95, \$25.3 million in FY96, \$29.2 million in FY97 and \$26 million in FY98. While the Day Backward/Day Forward program is the reason the indemnity issue is now being brought to the fore, the City's long-standing and growing crisis in the administration of its indemnities program is the true "cause" of the problem.

The Plan as approved by City Council shows a \$12.7 million gap in FY94, a \$12.5 million gap in FY95, a \$1.4 million surplus in FY96, then a \$2 million gap in FY97 and a \$1.5 million surplus in FY98. This section analyzes the City's projections underlying the gap and its plans for financing the gap.

### **Handling of Ongoing Cases — *The City has traditionally delayed settling cases***

The City's financial crisis led it to delay settling litigation for budgetary rather than legal reasons. Additionally, underfunding the indemnity account has led to years in which the account ran out of money in the second half of a fiscal year and the City thereafter stopped paying out on settlements. This impediment to the City's ability to settle cases led to both increased interest costs on some cases and an increased backlog on top of the already growing problem in the courts involving non-City litigation. The

amount not settled in one year would then be pushed into the following year. The additional burden of settling cases from a prior year added to difficulty in making the succeeding year's payments and the City would again delay payments. This will again largely be the case in FY93, and it is imperative that the spiral be broken and that the City come to terms with the problem. Both the City and the courts should be complimented for taking steps to do so.

The Rendell Administration's stated policy is to settle cases more quickly. This is shown in the Plan's projection that the City will settle 682 cases a year from FY94 through FY98, which is more cases than have been settled in all but one of the last five years (in FY92 1,019 cases were settled). The City also assumes that the cases will settle at an average cost of \$25,000, which is less than the \$50,000 average estimated for FY93, the \$25,500 average in FY91 and the \$27,192 average of FY90, but higher than the average case settlement costs for FY92, FY89 and FY88. The City's projected average cost per case for FY94 through FY98 is therefore lower than the average costs for three of the last four years, which may mean the average cost of settlement could well be higher than the City's estimates. If the average cost per settled case is the higher than the City's projections, the City may have to reduce the number of cases it settles annually to hold to the Plan's projected \$17.1 million annual costs, or find other financial resources to pay for the costs of the settlements. By the same token, making settlements on a more timely basis, with the prospects for having the agreed-upon amounts actually paid, could have a very beneficial effect on City finances.

The City's estimates include the costs during the Plan period for all currently known extraordinary settlements, including \$15 million in FY93, \$18.4 million in FY94 and \$4.4 million in FY95 for D.C. 33 and provision for other appeal losses that reach \$10.5 million in FY97 and FY98. The City has indicated that those appeal losses are tied to existing cases. That leaves some exposure if other large settlements or appeal losses requiring large payments occur in the Plan period, but also offers some potential for lower than anticipated awards.

**Day Backward/Day Forward Program --*The Court of Common Pleas'* program will increase City costs in the short term, but should stabilize them over the long term with better case management**

The Day Backward program, begun by the Court of Common Pleas in December 1992, is designed to eliminate all major pre-October 1989 Court of Common Pleas cases by December 1993. After completing Day Backward, the Court plans to implement a Day Forward program for cases filed after October 1989 that will reduce the Court's backlog to one year by October, 1995 and permit all but extraordinary cases to move through the system in no more than two years.

The Plan indicates that the programs will force the City to settle cases more quickly than previously anticipated. The Plan projects that there are 1,050 City cases in the two programs, of which 66% will be settled, and that of the settled cases the ratio of General Fund to Water Fund cases will be 4.7 to 1, which the Plan indicates has been its historic rate. The City's other key assumption is that 34% of its program payments will be made in FY94, 47% in FY95, 16% in FY96 and 3% in FY97.

This set of assumptions produces projected Day Backward/Day Forward costs of \$10.1 million in FY94, \$13.8 million in FY95, \$4.7 million in FY96 and \$1 million in FY97, the last year of costs for the program. The total four-year cost of this effort is projected to be \$29.6 million, but the Plan provides funding for only \$5.1 million, leaving a possible gap of \$24.5 million.

The City will likely need the cooperation of the Court and the parties with which it reaches settlements to arrange payments so that only about a third of costs incurred are recognized in FY94. This seems to be an attainable goal.

The \$29 million in accelerated costs buys the City projected ongoing costs that stabilize over the life of the Plan at \$17.1 million annually, significantly below the \$23.2 million estimate for FY93 and the \$21.8 million recorded in FY92. Additionally, the program presents the City with an opportunity to restructure its indemnities through the establishment of a Risk Management Division. The Risk Management Division, projected to be fully in place for the start of FY94, will be responsible for managing all claims against the City.

While those benefits are clear, the City still has a funding gap which must be met.

***Financing Day Backward/Day Forward -- The City proposes to close its indemnities financing gap with financial assistance to be requested from PICA***

Unlike the Plan submitted to City Council, the approved Plan proposes a method for financing the indemnities gap. The City currently proposes to finance the gap with a request for an additional grant from remaining PICA deficit financing bond proceeds for FY92. (In 1992 PICA issued bonds to cover a projected \$94.9 million deficit in FY92, but the City's actual FY92 deficit was \$71.4 million. The difference between the deficit financing amount and the actual FY92 deficit was \$23.5 million, about \$1 million less than the amount of unfunded indemnities projected by the City.)

The City's justification for the requested use of PICA deficit proceeds to finance its extraordinary indemnities costs is that the primary cause of the gap is the Day Backward/Day Forward program which will produce "a one-time 'spike' in the City's indemnity costs." The City wants to avoid making service cuts with long term implications to pay for what most likely will be a short term program. Just as it is

unsound financial policy to make long term commitments to pay for short term benefits, so too is it undesirable policy to make long term cuts and severe disruptions to pay for short term costs.

Actively participating in the Day Backward/Day Forward program will give the City an opportunity, if pursued properly, to restructure its indemnity payments and resolve a long-standing problem. PICA Staff believes that using Authority financial assistance to fund a portion of the indemnities gap is appropriate, assuming that appropriate controls are in place to ensure that the Authority's funds are directed to anticipated uses. PICA Staff also believes, however, that the City has a rare opportunity upon which it must capitalize. If after the Day Backward/Day Forward program has been financed, the City reverts to a policy of delaying settlements, it will have paid a high cost for a minimal net benefit. As well, the City has a more difficult challenge to deal with, in the form of reducing the City's liability exposure at the departmental level. Better performance in the operations of City government could limit the number of cases filed and ultimately reduce indemnity losses even more.

## Fire Department

### Primary Areas of PICA Concern

- o Arbitration awards
- o Overtime

### Major Plan Initiatives

- o Ladder company restaffing
- o Reorganize deployment

## Introduction

FY93 operating costs for the Fire Department are estimated to be \$114.9 million. The Plan projects a 2.8% decrease in spending for FY94, with costs growing only slightly throughout the remainder of the Plan. The Plan projects the Fire Department's obligations will total \$117.1 million by FY98, for only .37% compounded average annual growth over the life of the Plan. This low growth rate results from projected lower uniformed personnel starting salaries, successful implementation of departmental initiatives, and arbitration results similar to the Police Department's arbitration award. In a department where personnel costs average 90% of total Department costs, assumptions as to the employee complement and labor contract provisions are the key elements of obligation projections.

### *Arbitration Still Outstanding -- This effects Class 100 Spending in Several Ways*

The lack of an arbitration award adds uncertainty to projections of Fire Department obligations in the Plan. Until the Administration knows the costs of starting salaries, the required health and welfare contribution, and the number of paid holidays, any projection of cost is speculative. In the Plan, the City has projected arbitration award results substantially similar to those of the Police arbitration ruling, which seems reasonable given the history of the award process.

At a March 1993 meeting with PICA Staff Department officials indicated tentative plans to start a new class in mid-April, but in the absence of an arbitration award allowing lower starting salaries and to assist in budget balancing the Plan indicates a five week delay.

### *Overtime -- The Department anticipates decreasing overtime throughout the life of the Plan*

The Department historically has had difficulty containing the cost of overtime. In FY92, overtime was more than double that of the preceding year, reaching \$6.4 million. FY93 regular overtime has been estimated to be \$5.7 million, \$1.3 million over budget. This trend in overtime has been attributed to staffing shortages, and the City in FY93 made the decision to incur overtime costs in lieu of increasing personnel. The Fire Department intends to increase its staffing level by one hundred employees in

FY94 and to keep constant at the increased level throughout the life of the Plan. The Department's statements in meetings with PICA Staff to the effect that the large increase in FY93 overtime costs was inevitable in light of staffing levels and deployment practices was troubling. Through the preparation of the initial Plan and the current fiscal year, repeated representations were made to PICA to the effect that Fire Department overtime would be dealt with, when it appears that the City was not prepared to make the required changes pending the outcome of labor arbitration. The City has the right to make its own policy decisions, but it should come to terms with the impact of such policy on its finances. It should be noted that the FY93 overtime estimates anticipate the Department successfully implementing its initiatives.

The possibility of delay in implementation of departmental initiatives adds uncertainty to the Fire Department obligations in the Plan. A recent analysis prepared by the City's Budget Bureau indicates that in the absence of achievement of initiatives like ladder restaffing and reorganized deployment, the Fire Department's overtime costs in FY93 would increase by \$2 million over the Plan's projections.

**Ladder Company Restaffing -- *Reduction in crew size should help control overtime***

One of the major initiatives of the Fire Department is the restaffing of ladder companies. Currently, Fire Department ladder companies have a running strength of one officer and four firefighters. The Plan's initiative is to decrease the running strength to one officer and three firefighters. The Department estimates this will produce savings of \$2.1 million in FY93, growing to \$5 million each year for the remainder of the Plan. The City Controller's Office estimated yearly savings for this initiative to be \$3.9 million in its 1992 audit. While PICA Staff feels comfortable with the projected savings from this initiative, based on the Department's "Management and Productivity Initiatives Monthly Status Report: Project Overview" dated January 31, 1993, and the Monthly City Managers Report for the month ending February 28, 1993, implementation requires further discussions with the union. If the Department is not successful in achieving this change, it would have to make other adjustments to control overtime.

**Reorganize Deployment -- *If completed, it should cut overtime***

With this initiative, the Department plans to reduce its overall staffing requirement by six positions. This will be done by running two stations as task forces (which means one battalion will be eliminated from the Department). The estimated savings for this initiative is \$172,000 in overtime in FY93, growing to \$800,000 annually for FY94 and thereafter. The projection appears reasonable and the Department has indicated that it believes it has the right to implement the initiative without arbitration.

## Department of Human Services

### Primary Areas of PICA Concern

- o Growth in number and cost of cases
- o Reliance on increases in  
intergovernmental revenues
- o Lack of a comprehensive service  
improvement plan
- o Staffing levels

### Major Plan Initiatives

- o Needs based budget
- o Title IV-E
- o Caseload diversion
- o In-Home treatment
- o Funding determination
- o Regulation 3130.32 (social worker  
ratio)

### Introduction

The Department of Human Services' (DHS) FY93 operating costs are estimated to be \$247.2 million, second only to the Police Department. The Plan projects rapid growth in DHS expenses (a 14 % compounded average annual growth) which will make it the City's most costly operating department by FY95. The Plan projects that DHS obligations will total \$476.4 million by FY98, a 93 % increase over FY93. An indicator of the manner in which DHS costs growth will impact Philadelphia government is that, in FY93, DHS obligations are estimated to be \$62 million lower than those of the Police Department; in FY98 DHS obligations are projected to be \$166 million *higher* than those of the Police Department. DHS expenditures are projected to increase from 10.9% of FY93 General Fund revenues to 17.3 % in FY98. More important than DHS's gross costs, however, are its "net costs" after departmental service-related intergovernmental and local non-tax revenues. Net costs (DHS obligations minus intergovernmental revenue and local non-tax revenue generated by DHS activities) are projected to grow more quickly than gross costs. Net costs are estimated to more than double, from \$70.5 million in FY93 to \$144.8 million in FY98 (a 15.5 % compounded average annual growth rate). While cost-related intergovernmental revenues also are projected to grow rapidly during that period (at a 13.8% compounded average annual growth rate), gross costs grow more quickly.

The FY94 Budget and the Plan mark a significant shift in the manner in which the City budgets for the Department of Human Services. In past years, underbudgeting for projected DHS obligations led to the need for annual transfers to the Department in order to meet its obligations. In FY94, the City appears to have provided funding that more closely approximates the Department's probable FY94 obligations. In FY93, for example, DHS obligations initially were budgeted at \$233 million (an 8.4 % increase over actual FY92 obligations), but FY93 obligations are now estimated to be \$247.2 million, a 15 % increase over FY92. The FY94 budget increases to \$279.4 million, a 13 % increase, which more realistically approximates annual increases in DHS costs. While there are still threats to the Department's ability to meet its budget (as described

below) it logically can be assumed that if a FY94 DHS budget variance were to occur, it should be much smaller on a percentage basis than those of previous years.

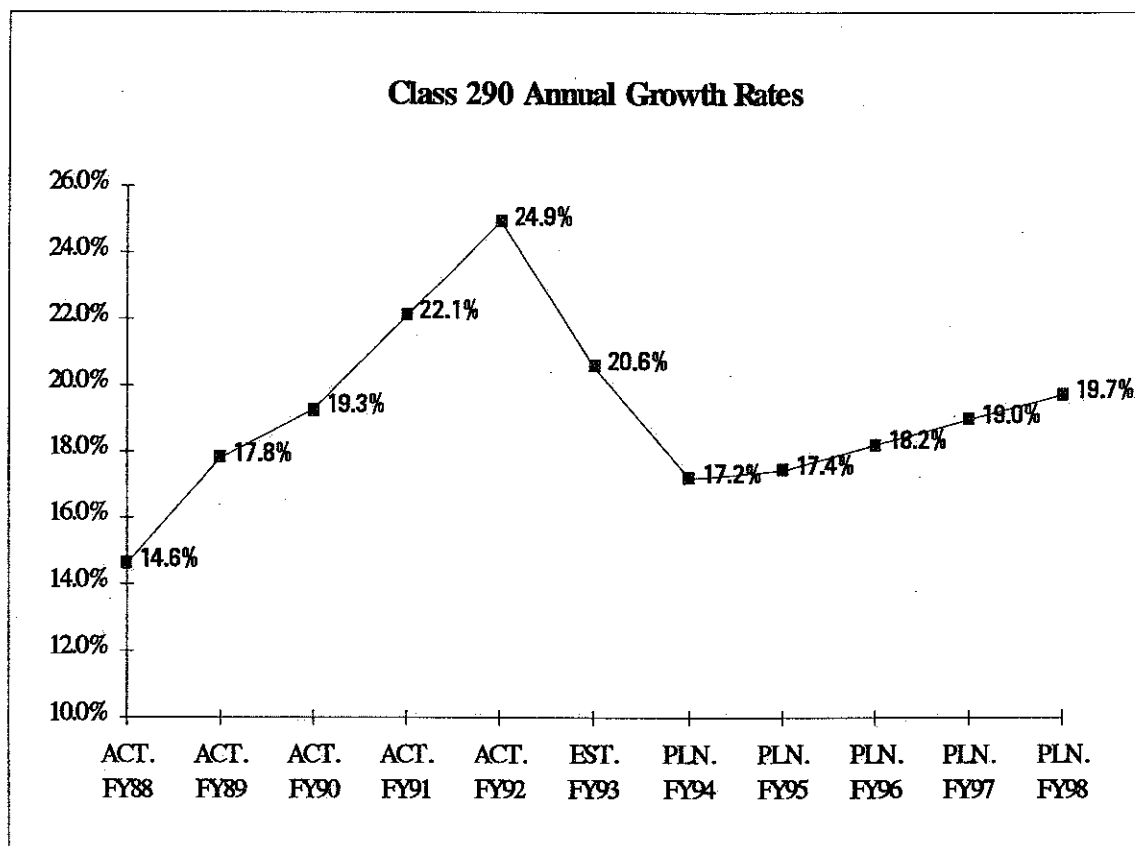
The primary projected increase in DHS costs is found in Class 290 (purchased services for care of individuals) in the Children and Youth Division. Such costs are projected to grow from \$161.1 million in FY93 to \$373.1 million in FY98. The causes of that increase, the steps the City plans to take to control that increase and PICA Staff's concerns are addressed below.

***Growth in Number and Cost of Cases -- Growth has been dramatic and the Plan assumes continued increases (131.7% from FY93 through FY98)***

The single largest financial challenge to the Department (and perhaps the City) is the explosion of mental health/mental retardation costs in the Children and Youth Division. In FY87, DHS purchased \$3.1 million in services for care of children with mental health/mental retardation problems. In FY93, MH/MR costs are projected to be \$43.2 million. The Plan projects that those costs will continue to grow rapidly -- at a compounded average annual rate of 30% during the life of the Plan. While that growth is dramatic, it actually requires a material *decline* from recent MH/MR growth rates, which were 70% compounded annually for the FY88 through FY93 period.

MH/MR is not alone as a rapidly growing cost area for DHS. Care for physically impaired children has jumped from \$2.3 million in FY87 to \$20.1 million in FY93. The Plan projects continued rapid growth (24.8% compounded annually) to \$61 million in FY98. As with MH/MR, this projected growth rate is actually a decline from the compounded average rate of 36.5% for the period from FY88 through FY93.

While MH/MR and service to the physically impaired have been the most dramatic examples of growth in costs, there are many other rapid growth areas in DHS purchased service costs. For all of Class 290 in the Children and Youth Division, compounded average annual growth is projected to be 18.3% over the life of the Plan, a slight decline from the 20.9% compounded average growth rate over the FY88-FY93 period, but which nonetheless produces an FY98 expenditure which is 2.8 times greater than the City's FY92 expenditures in the same area. The projected decline in growth rate assumes that the drop from 24.9% in FY92 to an estimated 20.8% in FY93 is the beginning of a trend that will lead to a decline in growth rates to 17.2% in FY94. PICA Staff has some concerns about this assumption because, as the following graph shows, FY93 was a break in a five year upward trend. It is possible that FY93 could be simply a one year deviation from a trend of accelerating growth rates for Class 290 costs. If this is the case, Class 290 expenditures would grow much more quickly than the Plan projects, and accordingly dramatically widen the gap in the City's budget.



The rapid growth appears to result from a combination of factors, many of which are beyond the control of DHS. Certain DHS procedures, however, contribute to the increase in costs. One is "overplacement" (placing children in a higher level of service than their needs require, or retaining children in higher levels of care after their condition would require less intrusive assistance). The Controller's Annual Audit of DHS for FY92 said that 40% of the foster care cases examined by auditors were overplaced. The Controller's audit indicated that overplacement can happen when social workers are under pressure to place a child and are not inclined to "haggle over price." The report said that placement pressure, coupled with difficulty in monitoring or controlling social workers' placements and low base service payment rates (which can preclude immediate placement at a base service level) combine to create "overplacement". The audit suggested that increasing the base foster care rate from \$23 to \$30 might save \$3 million a year by promoting greater availability of beds at a lower service level. The audit also suggested the existence of "overplacement" in other areas, particularly for medical services. In its response to the Controller's audit, DHS disagreed with the premise that there are a large number of overplacements. It did say that there are children who, after a course of treatment, should be moved to a lower level of service. DHS indicated it is developing a computer tracking program to monitor such cases. If properly designed and implemented, the tracking system should help DHS reduce costs and improve service.

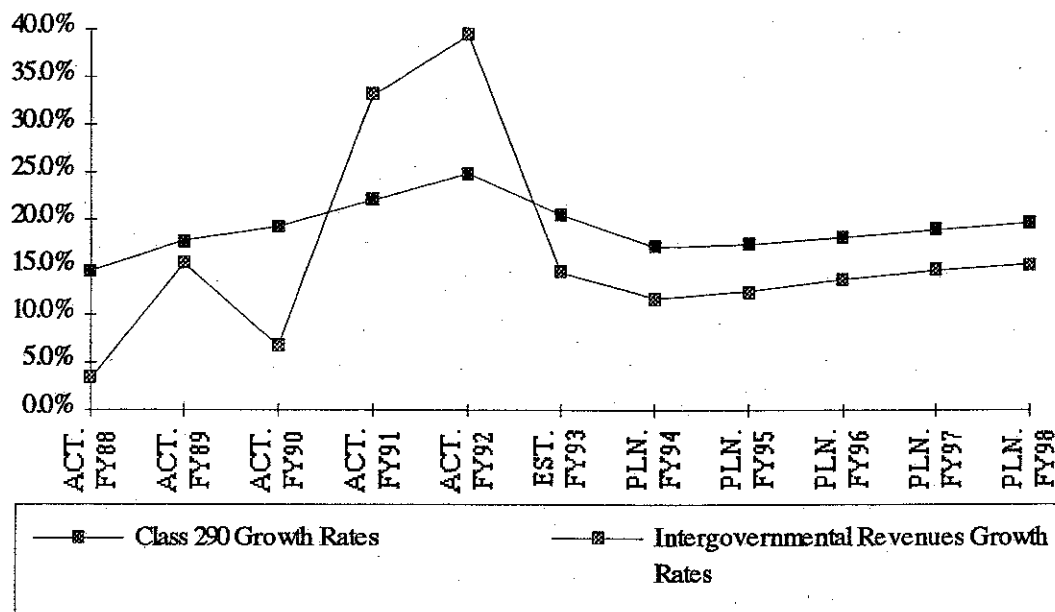
Failing to move children through to adoption expeditiously may also increase DHS costs. In testimony before City Council, a State official was very critical of DHS adoption procedures, a criticism which echoed those made in other years. The Commonwealth has asserted that DHS leaves children in too restrictive placements and moves them through the system too slowly.

**Reliance on Increases In Intergovernmental Revenues -- *DHS has been successful in increasing intergovernmental revenues, but other governments may seek to cut costs***

To date, the primary thrust of the City's response to escalating DHS costs has been to seek compensatory increases in intergovernmental revenues. This quest for additional revenues has taken the form of initiatives for federal money (Title IV-E), State money (needs based budget) and increased funding from State/Federal programs (funding stream determination, caseload diversion and reductions in in-home treatment costs).

The initiatives, combined with the growth in costs (intergovernmental revenues are typically reimbursements for costs incurred) have helped to increase compensatory revenues dramatically. In FY92, intergovernmental revenues were \$151.2 million and in FY93 they are projected to be \$173.1 million, a 14.5% increase. The increase results primarily from more federal revenues, as Title IV-E reimbursements increased from \$63.6 million in FY92 to \$77.5 million in FY93, and a retroactive reimbursement for Title IV-E eligible costs produced an additional \$7.9 million in FY93. In FY95 through FY98 the projected growth in revenues appears to be tied to growth in expenditures (they are projected to grow at similar rates). As the following chart demonstrates, growth rates for intergovernmental revenues have not followed a consistent pattern. While growth rates for intergovernmental revenues lagged behind Class 290 growth rates in each year from FY88 through FY90, the growth rate of intergovernmental assistance exceeded Class 290 expenditures in FY91 and FY92 before again lagging Class 290 expenditures in FY93. The growth rate has been influenced by a number of factors, including settlement of litigation and new legislation. The number of outside factors that can influence intergovernmental revenues, and recent history, make the City's approach of assuming that they grow on a par with costs reasonable.

### Growth Rates -- Class 290 Vs. Intergovernmental Revenues



The Plan makes an argument to support the City's case that it should receive more State funding and sets out a detailed strategy, including possible litigation, for obtaining such additional funding. The goal of the needs based budget initiative, the cornerstone of the City's reimbursement strategy, is to limit unreimbursed expenditures by the City to 32% of total costs (the Plan indicates that in FY92, unreimbursed obligations were 31.4% of total obligations). PICA Staff is not in a position to comment on the merits of the City's reimbursement arguments in this report. There is some reason to believe, however, that the City will receive intergovernmental revenues in FY94 in excess of those anticipated in the Plan. Preliminary legislative analysis of the Governor's FY94 budget indicates that the City will receive as much as \$116 million in Act 148 funding in FY94, a \$15 million increase over the City's budgeted amount for FY94. The Plan contemplates the City's receiving \$112.8 million in FY95 (less than the amount that it now appears the City will receive in FY94) \$128 million in FY96, \$148.2 million in FY97 and \$170 million in FY98. While the preliminary analysis gives reason for optimism on State funding in both the next fiscal year and in future years, there has been no official notification to the City of the amount of FY94 Act 148 funding and it is possible that the actual amount will be lower than \$116 million. The uncertainty as to the final amount of Act 148 funding for FY94 makes it unreasonable for the City to build a Plan and FY94 budget on optimistic assessments. The City should be complimented for not succumbing to the urge to inflate revenues on the basis of optimistic projections of State actions.

Total intergovernmental revenues for DHS activities are projected to grow from \$173.1 million in FY93 to \$327.4 million in FY98. Projected increases in revenues are only a part of the City's projected increased success in obtaining support for DHS from other levels of government. The Plan also relies on obtaining \$3.8 million annually from Medicaid through an initiative entitled "reduce in-home treatment costs." Under this initiative, DHS and the Pennsylvania Department of Public Welfare (DPW) are performing a case-by-case review of all DHS cases in which medical services are included in the cost of care. DPW will attempt to determine whether the cases are eligible for Medicaid reimbursement. If the cases are eligible, and the providers are Medicaid qualified, then the medical costs involved in those cases will be assumed by Medicaid. DHS will not know how many cases and providers are qualified until the review process is completed.

The Plan does not include any benefit from Early and Periodic Screening, Diagnosis and Treatment (EPSDT), a federal program that will increase the number of children eligible for Medicaid (although the Plan section on staffing levels explains that DHS uses the likely implementation of EPSDT as one justification for its assumption that staffing levels will remain flat). Once children are Medicaid eligible, their medical costs are borne by the Federal and State governments, with no required City contribution. The State is obligated by Federal law to implement EPSDT, but that implementation process may be lengthy. The State indicates a desire to ensure that switching children to EPSDT will not have an overall negative impact on the City by reducing reimbursements from other revenue streams (like Title IV-E). Large scale benefits from this program are unlikely to be attained in FY94 and may not be attained until FY96. Once fully implemented, EPSDT could play a major role in diverting DHS costs to other levels of government.

Over the last year, DHS has made significant improvements in its ability to obtain intergovernmental revenues (particularly Title IV-E revenues), and its initiative to develop a funding stream determination unit is expected to further enhance those efforts. There is an inherent risk in relying on continually increasing revenues from other governments (particularly when the fiscal stability of the City to a large extent depends on those revenues). If those governments come to believe that the costs of DHS programs are too large a drain on their resources, they may seek ways of cutting reimbursements. The projected \$90 million in increases in Act 148 funding over the life of the Plan could cause concern in Harrisburg and, if the increases in Philadelphia are typical of increases in other cities, the Federal government also could become concerned with funding projected increased costs. The City and other advocates would likely fight attempts to limit funding, but the City's past battles over Act 148 funding show how protracted that type of dispute can become.

Alternatively, there are possibilities that actions by the Federal government could change the nature of the City's responsibilities in a positive way. Federal government success in attempts to limit increases in health care costs, depending on the scope of such actions, could reduce the City's costs of providing services.

DHS revenue projections, consistent with its obligation projections, include no discernible assumption of fundamental change in the way DHS does business or in moderating continuing growth patterns. If the assumptions of continued unchecked growth prove true, it is highly probable that both the State and Federal governments will take actions to limit their expenditures. This risk makes it essential that DHS take all appropriate actions to make the changes in its management structure necessary to limit the rate of growth in the number and cost of its cases to the greatest degree possible, and PICA Staff continues to question whether the DHS has the commitment and management capacity necessary to do so.

**Lack of a Comprehensive Service Improvement Plan -- *The City has acknowledged the need for change and the Plan offers some ideas***

The City has acknowledged that major change is needed at DHS. The need for change has been asserted in the Mayor's FY94 Budget address, in City Council testimony and in the Plan itself, and they join literally dozens of other reports, audits and evaluations of the Department. The Plan includes a laundry list of proposals (and some actions already taken) for service delivery system restructuring, improving family preservation efforts, altering MH/MR services and funding, improving permanency planning and speeding adoptions. There is still absent, however, any discernible and rational management plan to reach clearly articulated goals. The City is attempting to develop a comprehensive DHS strategy, in part, through a contract with the Child Welfare League of America to study DHS and make recommendations (the Child Welfare League's study is being jointly funded by the City and the Commonwealth) and through the City's formation of a Children and Families Task Force.

One of the ways in which the City can increase State funding is to increase the extent to which it complies with the State's policy objectives, such as by placing children in the least restrictive type of appropriate service, which the City asserts is a problem in light of the extreme disfunctionality of many families in the City. However, if the City does not change its service delivery system to more closely match the State's children and youth goals, recurring funding disputes with the State are likely.

DHS cannot by itself halt the dramatic increase in the number of children in need. It should, however, take every step possible to improve the service it provides to them. The list of activities presented in the Plan is a good beginning. The test will come in implementing the recommended changes. The contemplated actions, in addition to improving services, would also help curtail increases in costs, but DHS needs basic structural change and management reform.

DHS has taken a significant step towards improving services by seeking funding from the Productivity Bank for the purchase of hardware, software, training and initial technical support for a child placement management information system. If used as intended, the system will allow DHS to track the appropriateness of placements and to assess data for contract negotiations with providers. Such a system, if appropriately implemented and staffed, could prove invaluable in reducing the potential for placement of children in overly restrictive environments. The Plan does not rely upon obtaining monetary benefit from this system, which is prudent in light of previous reform efforts.

**Staffing Levels -- *The Plan appears to provide insufficient staffing for the Children and Youth Division, but DHS indicated that it has alternate funding ideas***

It is probable that the proposed Children and Youth Division staffing level is insufficient for each year of the Plan. In FY94, the number of employees in the division is budgeted at 574 (it was at 569 at January 31, 1993). The Plan assumes no increase in the number of overall DHS positions for the life of the Plan (which would mean no increases in Children and Youth Division staff unless compensating reductions were made in other divisions).

PICA Staff is very skeptical that employment will remain flat in the Children and Youth Division. DHS is required to maintain a set ratio of caseworkers to cases by State regulation 3130.32. Currently, that ratio is 30-to-1, regardless of the type of case. The Plan projects an increase of 5,807 children to be serviced from FY93 to FY98. At a ratio of 30 to 1, this increase would require 194 additional employees, 34 of whom would have to be hired in FY94.

The City has proposed several methods of dealing with the ratio requirement. It has commissioned a study by the Child Welfare League of America to, among other things, study appropriate caseload ratios (the study is due for release in May and was originally scheduled for release in January). The City has a Plan initiative to change the ratio of cases to DHS social workers to 75 to 1 for cases contracted by DHS to private providers. Even at a ratio of 75 to 1 (the attempt to change this coverage ratio is the initiative labeled Regulation 3130.32), however, the City would need to hire 78 additional social workers over the life of the Plan, including 13 in FY94 alone. Notwithstanding the alternatives noted below, the Plan should reflect probable results and actions not a situation that is unlikely to occur.

The City has said that it will fund any personnel shortfall in required personnel in DHS. DHS has indicated that two potential areas of any such additional funding would be to divert some portion of planned personnel increases from the Administration and Management and Juvenile Justice Services Divisions. While this approach might alleviate the FY94 problem, those divisions are not projected to have

personnel increases in future years, and therefore could not be used to provide staff positions to be transferred for future social worker hirings. The required increased staffing level for the Children and Youth Division could also be achieved through diverting children out of the dependency stream to the Department of Public Health for treatment (and possibly to EPSDT funding) or through culling out low- or no-risk cases. In essence, the City is using the successful implementation of EPSDT as one of its fallbacks for any inability to maintain flat personnel levels in the Children and Youth Division. Successful implementation of EPSDT would also reduce purchase of service costs, which could free additional funding for personnel. Lack of successful EPSDT implementation would make it more difficult for DHS to hold personnel costs to the levels projected in the Plan.

## Police Department

### Primary Areas of PICA Concern

- o Overtime
- o Further civilianization
- o False burglar alarm fees
- o Injured off payroll

### Major Plan Initiatives

- o Further civilianization
- o Overtime cap
- o False burglar alarm fees

### Introduction

On March 31, 1993 the details of the Act 111 interest arbitration between the City and Fraternal Order of Police Lodge No. 5 were made public. The major provisions of the award, in effect through June 30, 1996, are as follows:

- a wage freeze through January 1, 1995 when a 2% increase is granted, followed by a 3% increase effective January 1, 1996;
- a monthly cap on the health benefits contribution from the City of \$400 a month per employee as of April 1, 1993, subject to annual adjustment;
- a reduction of paid holidays from 14 to 10;
- civilianization of specified off-street positions (discussed below); and
- a reduction in entry level pay (\$29,750 to \$23,750).

While civilianization is subject to further discussions between the City and the F.O.P. and the F.O.P. has indicated an intention to contest the award in court, PICA Staff is of the opinion that the award shows no major differences with the Plan.

The Police Department has projected its overall FY93 costs to be \$309.2 million. The Plan projects a 2.2% decrease for FY94, with growth rates fluctuating over the remainder of the Plan. The compound average annual growth for this Department (through FY98) is .05%. The projected growth rate is low because salaries make up roughly 96% of the Department's overall costs, and the four year growth rate for total Departmental salaries is low -- FY94 (-1.63%), FY95 (-1.04%), FY96 (1.56%) and FY97 (2.4%). The City has been allowed, through arbitration, to institute lower starting salaries (by \$6,000) for entry level officers.

***Overtime -- The Police Department has historically found it difficult to manage overtime***

One of the more difficult cost control elements for the Police Department has been overtime. In FY92 the Department was \$2 million over budget in overtime and the February Monthly Managers Report projects overtime to be over budget by \$1.6 million for FY93 (although \$ 2.7 million lower than actual FY92 overtime). The Department is attributing half of the FY93 overage to the one-day municipal strike, with no explanation as to the remaining excess cost. Overtime spending probably will have increased in March because of the blizzard that hit the City. The Police Department is projecting overtime reductions for FY94. The projected overtime cost for FY94 in this department is \$18.2 million (down from the \$19.7 million estimated for FY93). Due to lower starting salaries, and minimal salary growth, PICA Staff sees the saving projections as being reasonable, and notes that the projected FY93 overtime levels are surprisingly low in light of there being 140 fewer uniformed officers in the Department as of March 21, 1993 than on June 28, 1992.

***Increased Use of Civilians -- Further civilianization of work now performed by uniformed personnel will help control overtime and increase on-street Police presence***

One of the tools that the City intends to use to decrease overtime and increase the effectiveness of its uniformed complement is the initiative for further civilianization. The 179 additional civilianized positions awarded through the recent arbitration, if the changes are implemented by the City, will yield positive financial results. The initiative's goal is to make more officers available for street duty by reassigning them from certain off-street positions and replacing them with lower paid non-uniformed personnel. The Administration is projecting \$11.6 million in savings over the life of the Plan from this initiative. PICA Staff does not believe this projection is unreasonable, but recognizes the prospect for retirements of Police officers not willing to return to street duties. This could increase unbudgeted costs in other areas, such as overtime and pension costs.

***False Burglar Alarm Fees -- Charging for registration of burglar alarms and false alarms is the Department's only revenue initiative***

The Department's only revenue initiative is charging registration fees for all burglar alarms and fines for false alarms. Based on statements in the Monthly Managers Reports and the Plan, this initiative has been successfully implemented. FY93 revenues are projected to be \$700,000 (based on alarm registration) and growing to \$1.7 million in each year thereafter (based on revenues from both fees and fines). Despite the optimism in the Plan, PICA Staff remains somewhat skeptical of overall

success. City preparations to implement this initiative pointed out a potential inability to operate it efficiently. In the Monthly Status Report for the month ending January 31, 1993, the Police Department questioned the financing and staffing necessary to the success of this initiative, as well as raising questions as to managing the communication with alarm customers. In light of those concerns involving the Police and Licenses and Inspection Departments, and the Bureau of Administrative Adjudication, we believe this communication problem could adversely impact the timing for, and eventual success of, this initiative.

***Injured Off Payroll -- Initiative to encourage transfers to the disability program is lagging for FY93 and has been sharply reduced for the term of the Plan***

The Police Department is anticipating savings resulting from the injured off payroll initiative. The goal of this initiative is to reduce the lag time between medical diagnosis of long-term disability and the removal of the officer from the payroll from six months to thirty days. While the processing time for the Department has been decreased to thirty-nine days, the savings are far below expectations. Current projected savings from this initiative is \$605,000, down \$3 million from original projections. The Department anticipates a \$545,000 yearly savings for the life of the Plan. This seems to be a reasonable assumption, and it will be monitored closely by PICA Staff.

## Department of Public Health

### Primary Areas of PICA Concern

- o Timing of Nursing Home changes
- o EPSDT
- o Medicaid billing and eligibility
- o Prison pharmacy costs
- o Impact of initiatives on revenues

### Major Plan Initiatives

- o Nursing Home privatization
- o Budget balancing measures
- o General obligation reductions
- o EPSDT expansion
- o Improve medicaid billing

## Introduction

The Department of Public Health (DPH) has the largest budgeted reduction in expenditures from FY93 to FY94 of any operating department. DPH's FY94 budget is \$187.9 million, a \$17.7 million (8.6%) reduction from FY93 estimates. DPH's budget is projected to decline again (to \$186.5 million) in FY95, and then to grow gradually in FY96, FY97 and FY98 to a total of \$195.1 million. The two largest reductions in DPH's FY94 General Fund budget result from moving \$6.2 million of the costs related to the Community Health Services division to the Grants Revenue Fund and a \$8.7 million anticipated reduction in expenditures resulting from privatizing the Philadelphia Nursing Home (Nursing Home privatization also results in a \$9 million reduction in annual revenues from fees and other governments and benefits savings -- the February Monthly Managers Report estimates benefits for PNH employees to be \$3.5 million -- with smaller savings for other indirect costs). DPH also projects various other general budget reductions, including a transfer of employees from the Employees' Service Division to the Risk Management Division and several other transfers to the Grants Revenue Fund (DPH receives a large amount of Grants Fund revenues; it estimates \$107.6 million in FY93 obligations will be paid through the Grants Revenue Fund, and it has considerable discretion as to fund designation of obligations). DPH projects General Fund obligation declines for each of its divisions in the FY94 budget in comparison to the FY93 obligations estimate.

Aside from privatization of the Nursing Home, most of the DPH FY94 Budget reduction projections are different from those in other departments. Instead of being tied to initiatives related to a service, they are shown in the budget as "general reductions". This format will make it difficult to monitor progress through the year other than through personnel levels and year-to-date spending, and the fluidity of DPH initiatives suggests either a lack of commitment to the process of planning or problems of management capacity.

The impact of DPH on the City's General Fund is best measured by the net costs remaining after consideration of revenues generated from the Department's activities. The net cost impact is projected to decline from \$63.2 million in FY93 to

\$61.6 million in FY94 before gradually increasing to \$70.7 million in FY98. The compounded average annual growth from FY93 through FY98 is 2.3%, which is below the Plan's projected rate of inflation (adding back to FY98 the \$6.5 million transferred to the Grants Revenue Fund for consistency of analysis, increases the compounded average annual growth to 4.1% -- which is marginally above the City's assumed inflation rate).

One initiative removed from the Plan, an initiative to reduce district health center pharmaceutical costs (projected to save \$400,000 in FY93 and \$700,000 annually) points to a continuing revenue problem at the district health centers. The initiative would have required patients with insurance to obtain pharmaceuticals from a drug store instead of a health center so that insurance would cover most of the cost, with the patient required to pay whatever co-pay amount was necessary. Instead, the patients will continue to be serviced at the health centers and the City will incur not only the costs of the co-pay, but in some cases the entire cost. The City may incur the entire cost because it has not always been able to determine when patients have insurance or to effectively bill third-party providers. Department managers, however, report that recent staff changes make it more likely that collections will be made.

***Timing of Nursing Home Privatization -- DPH has indicated that the Nursing Home must be privatized by October 1, 1993 for the budgeted savings to be achieved***

The privatization of the Nursing Home was originally scheduled for July 1, 1993. At the time of DPH's Plan review meeting with PICA Staff (February 25, 1993), DPH was estimating that it would be unable to privatize the facility before September 1, 1993. The City Administration and City Council have now budgeted as though privatization will not occur before October 1, 1993, but the City continues to anticipate completing privatization of the Nursing Home on September 1, 1993. Council, recognizing the impact of delaying the start of privatization, restored \$3.79 million to DPH's FY94 budget. \$1.66 million was also restored to the budgets of other departments and \$3.2 million in revenues were added to the General Fund. DPH indicated that the adjustment was based on the assumption that the Nursing Home would have a staffing level of 376 and a patient population of 306. The February Monthly Managers Report, however, indicated that at February 28, 1993, the number of employees at the Nursing Home was 364 and that by the end of the year the number of employees was projected to be 341, a 9.3% decrease from the staffing level DPH indicated it had used in calculating costs and reimbursements for the first quarter of FY94. Staffing levels are only tied to reimbursements if they have an impact on the Nursing Home's patient population. DPH indicated, however, that even at the reduced number of employees it was sufficiently staffed to house 306 patients. If the decreased staffing level does not lead to a requirement to reduce the number of patients at the facility, it could lead to a reduction in costs without a reduction in reimbursements.

DPH indicated that its timeline for privatization (if the City were to contract out management of the facility beginning October 1, 1993) requires issuance of a request for proposals by May 1, 1993. The Department indicated a possibility that an RFP will not have been prepared by that date. DPH indicated that its next step in the process is to consider an expected union proposal to match or better the \$3 million projected annual subsidy included in the Plan after PNH privatization. The April 1, 1993 Monthly Mangers Report indicated a four month schedule from the drafting and release of an RFP to the commencement of a new contract. If DPH held to that schedule, it could have until late May to release an RFP if it were to meet the budget's anticipated October 1, 1993 privatization date. An analysis prepared by the Finance Department to demonstrate the impact of delaying privatization of PNH until October 1, 1993 showed that the City projected the three month delay to increase net costs by approximately \$1.5 million, assuming that it saves \$750,000 a quarter by reducing the estimated \$3 million subsidy. It is probable that a delay in the privatization schedule would cost about \$1.5 million each calendar quarter.

PICA will monitor DPH progress toward meeting its timetable. The reform of PNH has been presented to PICA Staff as a core concern of the Administration from the time it took office. PICA Staff is concerned that after more than a year, the City has yet to decide what course of action it will take with the Philadelphia Nursing Home, and the variances among data reported by DPH in different places at essentially the same time (as to staffing levels for example) heightens that concern.

***EPSDT -- The City has yet to document the State's acceptance of any of its EPSDT cases***

DPH has reduced its Mental Health/Mental Retardation Division expenditures by \$2.1 million in each year of the Plan, beginning in FY93, in line with its projection that such amount will be covered by Medicaid under the Early and Periodic Screening, Diagnosis and Treatment program. If the cases qualify for EPSDT, and are Medicaid eligible, their costs will be divided between the State and the Federal government. The City has been told by providers that the providers have received reimbursements from the State which lowers PICA Staff's concerns as to DPH's ability to achieve this initiative.

***Medicaid Billing and Eligibility -- DPH has reduced its estimates of anticipated revenues from this initiative because year-to-date FY93 revenues are below projections***

The Medicaid Billing and Eligibility initiative is a combination of revenues enhancing initiatives, which include:

- o Attaining Federally Qualified Health Center status for district health centers -- This status has been achieved and it allows the health centers to seek reimbursements at higher rates.
- o Eligibility verification system and management information system -- These are computer based initiatives which are designed to improve the City's ability to seek reimbursement for eligible patients and to better prioritize the City's billing system. The systems are in place and began generating revenues in December.
- o Medicaid program computer tapes -- DPH is attempting to obtain State permission to access the State's Medicaid computer tapes. DPH would then be able to determine which of its Medicaid eligible patients have not been generating reimbursements for the City. PICA Staff has concerns that the number of patients found to be eligible will be lower than anticipated by DPH thus reducing the revenues generated by this initiative below the \$150,000 projected. Negotiations with the State have stalled.
- o The stationing of DPH or State employees in the City's district health centers to ensure that all patients are placed in the appropriate billing category -- this initiative is not projected to produce revenues until the later years of the Plan.

In the Plan as submitted to City Council, the above initiative package was projected to produce \$3.6 million in FY93 and \$3.4 million in each fiscal year from 1994 through 1998. Revenues received through January 1993, however, caused DPH to lower its projections to \$1.95 million in FY93 and \$2 million in each succeeding year of the Plan (the text of the Plan still shows the value of the initiative as being \$3.4 million annually beginning in FY94 and that is the Department's goal for revenue generation from this initiative. The FY94 Budget and projections for the remaining years of the Plan, however, rely on \$2 million annually from this initiative). The prime contributor to the shortfall from this initiative's projections was the eligibility verification system component, which in October 1992 had been projected to provide \$1.9 million annually. The original projection was based on an anticipated 25% Medicaid eligibility rate for health center patients. To date, the actual eligibility rate has ranged from 10% to 15%, and the lag time for completed forms has been longer than originally anticipated. The projected annual income from this initiative component has been decreased to \$650,000. In previous reports, PICA Staff expressed its concern that, while this initiative was certain to generate some revenue, projections as to the amount of revenues to be generated by it would be speculative until the Department's assumptions as to the percentage of patients qualified for Medicaid were tested.

DPH officials indicated that they would require analysis of another month of revenue receipts before making a final projection as to the initiative's revenues for the Plan period.

***Prison Health Cost Projections -- DPH projects slower growth during the life of the Plan than has been the case in the recent past***

DPH projects no growth in prison health costs from FY93 to FY94 (the FY94 Budget estimates that the contract for correctional and related forensic health care will cost \$7.6 million in FY93) and then 1.5% growth for the life of the Plan. DPH acknowledged that achieving the projection requires a reduction in growth from recent rates. To limit growth, DPH plans to rebid and reorganize its prison health contract, and plans to have a new agreement in place by July 1, 1993.

***Impact of Initiatives on Revenues -- PICA Staff has continuing concerns that DPH's budget reductions will have an adverse impact on reimbursements***

DPH's budget reductions include cuts in many areas that trigger reimbursements (for example, the Nursing Home). These cuts can lead to a reduction in service and resulting decreases in reimbursements for those services. DPH indicated that previous budget cuts have led to such revenue reductions. For some of the cuts included in the FY94 budget which will lead to budget reductions, the City has clearly foreseen the probable impact and reduced revenue (as in the case of the privatization of the nursing home). PICA Staff is concerned, however, that the series of general budget cuts drawn together under the initiatives labeled "budget balancing measures" and "general obligation reductions" will also lead to revenue reductions. DPH has indicated that the impact of lost revenues from each of its initiatives is included in its net projections. PICA Staff plans to monitor DPH generated reimbursements to determine whether obligation reductions might be having a revenue impact beyond that projected in the Plan. It is critical that departments are aware of the consequences of their action away from their budget (revenues, benefits, and indirect costs).

## Department of Public Property

### Primary Areas of PICA Concern

- o SEPTA contribution
- o Space planning
- o Utility costs

### Major Plan Initiatives

- o Cap SEPTA contribution
- o 911 user fee
- o Lease savings
- o Custodial services

### **Introduction**

The Department of Public Property (DPP) administers many of the City's central support functions including space rental, telephone and utility payments and custodial services. After a 1.4% increase in costs to a budgeted \$169.2 million in FY94, DPP is projected to experience declines in obligations for each year of the Plan, based largely on projected decreases in lease costs.

While this section primarily focuses on a handful of areas of major concern, the City has implemented several important DPP initiatives and has others in progress. The 911 Users Fee (a per line fee to reimburse the City for the capital and operating costs of its 911 system) has been implemented and is beginning to generate revenues at a pace (over \$800,000 monthly) that makes the projected \$10.2 million annual return seem reasonable; newly privatized City Hall custodial services are projected to reduce expenditures by \$733,000 annually; the April 5, 1993 privatization and June 30, 1993 phase-out of the City warehouse are estimated to save \$1.2 million annually and \$262,838 in FY93; the projected June 30, 1993 closing of the City print shop and contracting out of its work are projected to save \$206,000 annually (and \$15,000 in FY93); the City has begun to reduce lease costs and has named a manager to centrally administer the City's automotive fleet.

The steps above are important organizational and cost cutting measures, but there are still large questions remaining in DPP. DPP carries the cost burden of inefficiencies in other departments with little authority to force change. The City's use of a line item budget, and the absence of an effective cost accounting system to permit departments to be charged back and made responsible for their indirect costs, makes DPP management a great challenge.

## Primary Areas of PICA Concern

**SEPTA Contribution — *The City's projections assume a reallocation of subsidy responsibilities between the City and surrounding Pennsylvania counties***

The largest portion of the City's annual payment to SEPTA (which is estimated to be \$50.7 million in FY93) is a subsidy based on local operating matches of State grants to the transit agency made by Philadelphia and its surrounding Pennsylvania counties. Under current formulas for regional transportation services, Philadelphia pays 70% of the local match and the counties collectively pay 30%. Thus, if the total required local match were \$50 million, the City would pay \$35 million. The Plan assumes that the City will be able to reduce its contribution to 60% of the required match over the life of the Plan so that by FY98 a \$50 million local match would require only \$30 million from the City. The Plan reflects this change by reducing the subsidy payment \$548,000 each year from FY94 through FY97, and by \$348,000 in FY98. As of mid-March, the City had not begun what it expected to be the hard negotiations over changing percentage allocations. If the allocation formula is not changed, the City is likely to be required to pay higher amounts to SEPTA than are included in the Plan. The other factor which impacts any SEPTA subsidy projection is the amount of State aid (which the City estimates will grow between 2% and 4% for the life of the Plan). State aid increases in excess of the rates projected could adversely impact the City's projected payments by driving up the City's required contribution. The City indicated that FY93 and FY94 SEPTA funding were based on the State's FY93 Budget and the Governor's proposed FY94 Budget.

**Space Planning — *The Plan relies upon the completion of several projects to allow the City to save \$11 million annually by the final years of the Plan***

The City's building rental costs, after increasing in FY91 and FY92, are estimated to decline in FY93, and the Plan anticipates that cost reductions will continue, accelerating once the Criminal Justice Center is opened and Municipal Services Building renovations are completed.

In FY92, Public Property's building rental costs were \$34.8 million. Those costs are estimated to be \$30.1 million in FY93 and are budgeted to drop to \$28.9 million in FY94. The reductions emanate from a number of leases. Examples of budgeted reductions from FY93 to FY94 include: the City's 34 South 11th Street lease is budgeted as being reduced from \$1.8 million to \$1 million, the 1321 Arch Street lease is budgeted to go from \$742,500 to \$435,500 and the 1600 Arch Street lease is budgeted to be reduced from \$12.4 million to \$12.1 million.

The changes to date have come from both realignments of space use and renegotiations of lease costs. The largest lease savings in the Plan are projected for FY96 (\$7.7 million), FY97 (\$11.3 million) and FY98 (\$11.3 million). By that time,

DPP estimates, the Criminal Justice Center (projected to be complete in January 1995) and work at the Municipal Services Building will have been completed. DPP also indicated that the City is considering purchasing or leasing space to allow it to realign its usage in ways that are not only less expensive, but that also increase efficiency. A key part of the planning process will be deciding what to do with City Hall space vacated by court operations which move to the Criminal Justice Center in 1995. DPP indicated that several plans are under consideration for space realignment, and that a City Hall master plan is being developed. Space planning is a component of critical importance over the life of the Plan, particularly as the City considers its purchase and long-term lease options. Were the City to have a strategic plan for its delivery of services the prospects for development of an effective space management program would be brighter.

Real estate management steps, recommended by the Mayor's Private Sector Task Force and being now implemented, include:

- o A preliminary inventory of City-owned property
- o Implementing a preliminary contract for a consultant to develop a long-term space plan
- o Requiring that all real estate transactions be centrally reviewed.

Each of the Task Force's recommended actions is important to the City's continuing efforts to limit lease rental costs. PICA will continue to monitor the City's progress in utilizing these real estate management tools.

***Utility Costs -- DPP projects that electrical, gas and steam costs will each increase at 2% per year for the life of the Plan***

DPP's budget shows electrical, gas and steam costs of \$28 million in FY93 and \$31.5 million in FY94, a 12.7% increase. The primary reason for that increase was a 13.7% jump in budgeted electrical costs from \$21.2 million to \$24.1 million. For the remaining years of the Plan, DPP projections include 2% annual increases for electrical, gas and steam costs.

PICA Staff is concerned that in addition to normal increases in energy costs, there will added upward cost pressure from the energy tax proposed by the Clinton Administration. It seems unlikely that, without countervailing downward pressures on energy usage, 2% projected increases will be sufficient to cover the City's actual needs. The City's FY92-FY96 Plan, for example, projected utility cost increases of 6.5% annually.

The City indicates that a portion of its attempt to slow the growth rate of energy costs includes establishing an Energy Office. The Mayor's Private Sector Task Force and the City have developed a series of ideas for reducing energy costs, and the first

initiative that has been reported to PICA is the purchase, through a Productivity Bank loan, of energy efficient lamps. PICA will follow closely the extent to which the City proceeds forward with energy savings initiatives and with the establishment of the Energy Office. If timely taken and aggressively pursued, such ideas and initiatives could allow the City to meet its aggressive energy cost assumptions.

## DEPARTMENTS OF REVENUE AND LAW

### Major Areas of PICA Concern

- o Additional tax collections -  
likelihood of diminishing  
returns
- o Computerized collections - pace  
of implementation schedule
- o Suburban withholding -  
legislative approval and  
backup plan
- o Network compatibility between  
Law and Revenue  
Departments

### Major Plan Initiatives

#### **Revenue**

- o Computerized collections
- o Suburban withholding collections
- o Additional collections through  
discovery program

#### **Law**

- o Improved tax collections
- o Tax recovery through enforcement  
program

### **Introduction**

As with previous PICA Staff reports the Revenue and Law Departments are discussed together because of their jointly managed initiatives.

### **Revenue Department**

The Revenue Department has three major revenue initiatives that focus on increased tax collections: computerized collections, additional tax collections, and suburban Wage Tax withholding.

The Productivity Bank has approved the Revenue Department's application for \$5 million for funding to implement a computerized collection system. Based on the implementation schedule provided with the Productivity Bank application, the system was to take eighteen months to complete, with installation to begin on or around February 1, 1993. Recent reports from the Department indicate the project to be behind schedule.

The Department indicated that the additional tax collection initiative has been very successful in FY93. The goal of this initiative is to collect tax revenues through intensified enforcement and research. The Department indicated this initiative has generated more than \$10 million in additional collections.

The goal of the suburban withholding initiative is to recover Wage Taxes from City residents who work in the surrounding Pennsylvania suburbs. This initiative requires approval by the General Assembly and Governor before suburban employers

can be required to withhold. If legislation for this initiative is not passed, the Department believes it can achieve comparable results through computerization and use of tax data from other sources.

In the FY94 Budget, a dollar value is not ascribed to individual initiatives, rather additional revenues to be collected through the initiatives are grouped by the type of the tax they impact. Thus, while the Revenue Department is projecting additional Wage Tax collections of \$10.1 million in FY94, there is no allocation of the amount of the increase expected to be generated by each initiative. For FY94 the Department projects a combined increase in tax collections through its initiatives of \$13.2 million, and total increases of \$74.5 million for the life of the Plan.

### Law Department

The two major revenue initiatives in the Law Department are improved tax collections and enhanced enforcement. The improved tax collections initiative is based on increased collections through automation, while the enhanced enforcement initiative is based largely on hiring of additional enforcement attorneys and a more focused tax recovery plan.

Consistent with the Revenue Department's presentation, the FY94 Law Department Budget does not disaggregate revenues by initiative. For FY94, the Law Department is projecting a \$6.8 million increase generated from initiatives and \$31 million in such increases for the life of the Plan.

The initiative revenues shown in the Plan for both of these departments are designed to illustrate the potential total impact of the initiatives, as goals which the Departments are to strive to attain. In preparing the FY94 budget the Administration seems to be taking a more conservative approach by including less anticipated revenue from initiatives, which is a prudent action given the uncertainties surrounding them.

**Additional Tax Collections -- While currently strong, the rate of increase may decrease in the future because of diminishing returns**

Based on the Monthly Managers Report for the month ending February 28, 1993 the Additional Collections (Enhanced Enforcement) initiative will generate \$10 million in FY93, \$8 million more than originally projected (\$2 million). While the budget for FY94 does not disaggregate revenues by initiative, the Department's FY93 projection (\$10 million) makes the City's FY94 projection (\$6.8 million) seem reasonable. It is probable that a portion of the revenues from this initiative has now been included in the Plan in total base tax collections -- this would partially explain the difference between departmental initiative projections and the amount included in the budget. PICA Staff is, however, cautious about this initiative in the out years of the Plan. While the Revenue Department believes there will always be a strong "on-going"

base for the collection of overdue taxes and the identification of non-filers, PICA Staff is concerned that the supply at some point will begin to diminish and accordingly depress the rate of growth from this initiative.

**Computerized Collections -- PICA Staff is concerned with the implementation schedule for this initiative**

While PICA Staff believes that Revenue Department's projections for the Computerized Collections initiative are generally reasonable (once on-line and running smoothly), we are very concerned about its implementation schedule. Due to recent delays, the revenue projections for this initiative have been revised downward. The Five Year Plan projects no revenue from this initiative in FY93. The projections have also been reduced for the periods of FY94-FY96. Despite these delays, and based on better collections in other initiatives, the Revenue Department's overall projected increase in additional tax collections seems reasonable.

"The implementation schedule for the integrated tax administration is based upon a phased process to ensure incremental successes and accomplishments."<sup>1</sup> The February 1, 1993 proposed starting date seems to have been missed. The projected full integration with tax types was to have been achieved in eighteen months in the following sequence:

- Use and Occupancy Tax
- Self-Assessed Taxes
- School Income Tax
- Real Estate Tax
- Earnings Tax
- Personal Property Tax
- Water and Sewer Charges

The Use and Occupancy Tax module was to be integrated with the main system on or around September 1993, with the remaining modules being brought on line in the following nine months.

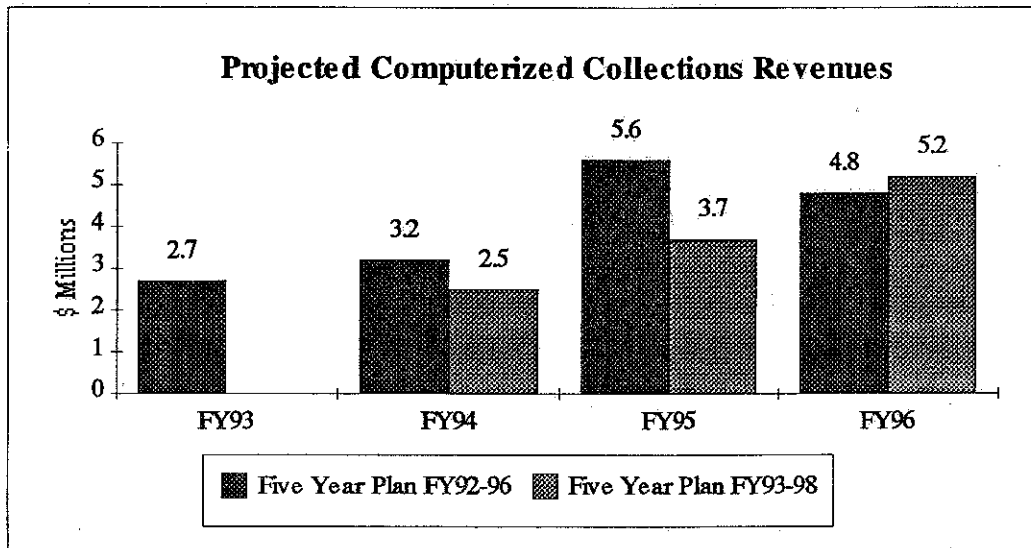
Simultaneous with the implementation of the Integrated tax system is the implementation of the individual modules. The first two modules projected to be brought on-line were Earnings ( April 15, 1993) and Audit ( May 1, 1993). As previously stated these two modules were initially projected to generate income in FY93 and no such revenue is now anticipated. PICA Staff can only assume the implementation schedule also has been revised or delayed.

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<sup>1</sup>Application to the Productivity Bank - Revenue Department pg. 22

With this initial delay and the "phased process" needed to implement this system, there is a potential future deadlines will not be met and revenue projections will fall short of expectations throughout the Plan.

The Chart below illustrates the effect that these delays have had on revenue projections from this initiative. The initial Five Year Plan projections (FY92-96 ) are directly from the revenue initiative (after discount) projections. The current Five Year Plan projections (FY94-FY98) are from the Productivity Bank section in the Plan.



In the initial Plan projected revenues totaled \$16.3 million (after discount) while in the current Plan projected revenues from this initiative for the same period (FY93-96) total \$11.4 million, a reduction of \$4.9 million.

**Suburban Withholding – *Still is speculative and dependent on State legislation***

The progress of the suburban withholding initiative is dependent upon events outside of the City's control. Last year, the Revenue Department indicated it hoped for passage of suburban withholding legislation by the end of the 1991-92 legislative session, and absent such results would seek to implement an automated approach in order to achieve the projected increase in revenues. Currently this legislation is still under review in the General Assembly. The City needs to reevaluate the status of this initiative and begin to set dates as to when it will implement the automation phase of this initiative or adjust the FY94 revenue projection. PICA Staff has concerns as to the City's ability to generate revenues from this initiative if an alternative plan is not quickly put into place.

***Computerization -- The network capabilities between the Law and Revenue Departments may be inefficient***

While the Law Department is making significant efforts to fully computerize operations a potential problem is the networking of computers between the Revenue and Law Departments. During FY92 the Law Department purchased new Macintosh computers, while the Revenue Department uses the DOS environment. This is very disturbing since a major part of the Tax Enforcement and Computerized Collections initiatives are dependent on cross-linking between these two departments. The Revenue Department has indicated that in order to make the system usable by both departments some inefficiencies will have to be tolerated.

## Streets Department

### Primary Areas of PICA Concern

- o Use of Special Gas Tax Funds for personnel costs
- o Alley lighting and signalized intersection initiatives
- o Waste disposal contracts
- o Charging PHA and School District for refuse removal services
- o Costs of March 1993 storm

### Major Plan Initiatives

- o Waste disposal contracts
- o Elimination of City-provided transfer services
- o Charge PHA and School District for refuse removal services
- o Restructuring street resurfacing obligations as capital items

### Introduction

Streets Department obligations are projected to be \$6.9 million lower in FY98 than in FY93. The major factors reducing those costs are new waste disposal contracts (along with the transfer station shutdowns they make possible), a shift of personnel to the Office of the Fleet Manager (\$9 million in FY94) and the shifting of street resurfacing costs to the City's capital budget. If those changes are all successful, the Department's obligations will be reduced from \$157.3 million in FY93 to \$135.9 million in FY95 before beginning to increase by between 2.9% and 3.8% a year to \$150.4 million in FY98. The increases in obligations from FY96 through FY98 assume 5% annual increases in trash disposal costs.

In FY93, the Streets Department had mixed success with its initiatives, but the Plan estimates the Department's obligations to be \$5.7 million below budget for the current fiscal year. Unlike several other departments, the Streets Department appears to have integrated its initiatives into its budget and management systems. The largest contributors to the success of performance against budget are lower staffing levels and lower than anticipated trash tonnage removal. The Department's filled employee complement at March 21, 1993 was 2,446, which is 80 positions below the number of positions the Department projected having at the end of the fiscal year (continued attrition may push the number of employees even lower by the end of FY93). A decline from estimates in the tonnage of trash collected allowed the Department to decrease its landfill payment costs by \$1.1 million. Landfill costs are projected to reach their low point in FY95 when the Department's purchases of services are projected to total \$75.2 million, \$11.4 million below FY94's budget.

The Department has successfully implemented initiatives to close two transfer stations (projected to save \$1.1 million annually), charge the School District of Philadelphia for refuse removal services (estimated to produce from \$1.4 to \$1.6

million annually in revenues), and reduce recycling collections from every week to every other week (projected savings of \$575,000 in FY94, declining to \$245,000 in FY95 and growing to \$374,001 in FY98).

***Uses of Special Gas Tax Funds for Personnel Costs -- Special Gas Tax funds had heretofore been used for street resurfacing and reconstruction***

Special Gas Tax funds (State motor fuel tax allocations) historically have been used for reconstruction and resurfacing of streets, but the Plan calls for the transfer of that money to cover Departmental personnel costs, reducing Special Gasoline Tax resurfacing and repaving of streets expenditures from FY93's budgeted amount of \$6 million to estimated FY93 expenditures and budgeted FY94 expenditures of \$221,900. The Plan assumes that resurfacing costs in the General Fund will be reduced by \$5.8 million in each year of the Plan. The Plan and the City's Capital Budget for FY94 show an increase of \$8 million in the Department's capital request for resurfacing, although the request for added resurfacing funds is not included in the Capital Budget for any other year of the Plan. The Department has indicated, however, that if the General Fund operating reductions are made in future years, the Capital Fund request will also be made. To be consistent and to be a useful planning tool, the Plan should have included increased capital requests for each year for which it shows decreased operating budget resurfacing obligations.

There is also a question as to whether resurfacing is an appropriate capital item. The Streets Department estimates that the useful life of a resurfaced street is seven years, which exceeds the five year minimum life required for capital funding in the City Charter. The City would, however, be borrowing on a long term basis for a relatively short term benefit if it paid debt service on 30 year bonds that included funding for the Street resurfacing. The project would have to be grouped with other projects that had longer lives to produce an average life equivalent to the life of the bonds to be issued.

***Alley Lighting and Signalized Intersection Initiatives -- These initiatives have been delayed and have an uncertain future***

In the Plan as submitted to Council, the City projected saving \$1 million annually by discontinuing private alley lighting, but in the Plan as approved by City Council, no alley lighting savings were assumed from FY94 through FY98. The City has also indicated plans to convert selected intersections' traffic signals to four-way stop signs, and the Plan projects \$400,000 in electrical cost savings from this initiative (the savings are shown in the Department of Public Property's budget). Each of these initiatives has been stalled after facing Councilmanic opposition.

The FY94 budget as submitted to City Council indicated that about \$600,000 had been eliminated from the budget for the alley lighting initiative (\$386,260 for

electrical costs and the remainder for repair and maintenance charges). The FY93 budget for Streets Department electrical costs was reduced by \$613,740 to reflect the projected effect of discontinuing alley lighting. The reduction in alley lighting costs helped reduce the FY93 budget for electricity to \$15.1 million. The City did not discontinue alley lighting in FY93, and accordingly it will not attain all of the \$613,740 in FY93 savings. In a March 3, 1993 written response to PICA Staff questions, the Department indicated that there were several ways in which it could compensate for the lost alley lighting savings, including the Department's projections that it would have lower than budgeted costs for refuse removal and snow removal costs -- the adverse impact of the March 13, 1993 blizzard will be discussed below.

The Administration agreed in its negotiations with City Council to hold a series of community meetings to discuss the traffic signal conversion initiative. The Department anticipates converting 680 signals in several phases stretching into this Summer and this process has begun. The Department has contended that the initiative will result in reduced costs and increased safety. It is the type of initiative that PICA Staff has continually viewed as a measure of the City's ability to bring about change in the way it does business. According to the Department, this initiative would change delivery of a service to make it both better and cheaper.

The private alley lighting initiative is being studied by a task force, but at this point PICA Staff does not anticipate any additional savings. The City had discontinued all maintenance of private alley lights, but has restored a maintenance contract which will pay for maintenance to alley lights for which the City still provides service.

**Waste Disposal Contracts -- *The Streets Department has indicated to PICA that construction of the facilities upon which the Plan's projections depend is on schedule***

The Plan projects waste disposal contract savings of \$18.8 million in FY95, \$20.9 million in FY96, \$23.2 million in FY97 and \$25 million in FY98. The contracts are for four years beginning not later than July 1, 1994, and call for two contractors to dispose of City trash using a combination of landfilling and incineration (trash to energy). The Department indicates that the initiative is on schedule.

Aside from producing savings by reducing trash disposal costs (the costs are based on projected tonnage and the fees in the contract and appear to be reasonable), the contracts allow the City to close three transfer stations. Two of those stations have been closed in FY93 and the Plan anticipates closing the third station in FY95, at a Plan projected savings of \$4.1 million.

***Charge Philadelphia Housing Authority (PHA) and Schools -- The City has reached agreement with the School District of Philadelphia on refuse disposal payments, but has a continuing dispute with PHA***

The FY92-FY96 Plan projected \$5 million in revenues from charging PHA and the School District of Philadelphia for trash collection services. An agreement on payments has been reached with the School District and the City is projecting \$1.4 million in revenues in FY93 from the School District increasing to \$1.6 million in FY98. Talks with PHA have stalled and the Plan indicates that litigation will be instituted. The Department has projected that the PHA payments would be \$3.4 million annually. Until there is a change in PHA's position or a court decision, any projection of revenues from PHA under this initiative would be speculative, and the estimates underlying the FY93-FY98 Plan do not include the PHA revenues. If such revenues are obtained, they could be used as an offset against other potential shortfalls in the Plan.

***Cost of the March 13, 1993 Blizzard -- The Department's FY93 Budget did not contain provisions for a storm of the size of the March blizzard***

In supporting material prepared for its FY94 budget testimony before City Council, the Department indicated that for snow removal "allocated resources and budgeted amounts are for the lower limits of most recent seasons. A severe winter season would strain the limited resource capacity and would require emergency funding." In early March, the Department anticipated avoiding high snow removal costs for FY93 and wrote in response to a PICA Staff question that a potential underfunding for alley lights would be funded through available balances in the Streets Department's budget. The March 13 storm forced the Department to incur higher FY93 snow removal costs than had been budgeted, and also added additional costs such as unplanned overtime for trash pickup delayed by the snow. The Department is preparing an analysis of all costs associated with the storm, and the City is likely to seek Federal disaster relief funds in conjunction with the State, but in possible competition with other municipalities. In addition to adding costs above budget, the storm leaves the Department less margin to fund other potential FY93 overruns. If the City is able to obtain substantial Federal emergency funds, some of PICA Staff's concerns about the financial effects of the storm would be alleviated.

While the Streets Department must face problems in FY93 resulting from under budgeting snow removal costs, its budgeted amount appeared reasonable in light of the prior history of storms in Philadelphia. No City should plan its expenditures based upon speculation as to the occurrence of events beyond the range of those which are normal. Although no particular event can be anticipated, prudent management and experience requires that the City administer its financial affairs in the expectation that unanticipated events which require extraordinary actions will have to be dealt with from time to time. Such circumstances point to the still-delicate balance of Philadelphia's

fiscal affairs -- no Mayor should have to face the choice of providing adequate emergency assistance or stripping services from normal operations.

## Other Significant Plan Concerns

### Primary Areas of PICA Concern

- o Commerce -- Convention Center payments
- o Prisons -- Budget process
- o Prisons -- New facilities
- o First Judicial District -- FY95-FY98 payments
- o First Judicial District -- Fee collections
- o State Reimbursement for court costs
- o Productivity Bank -- Repayment structure
- o Philadelphia Parking Authority -- Workforce reductions are only a first step
- o Fleet Management-- Impact of cuts
- o Extraordinary Contracts -- City compliance

**Commerce - Convention Center Payments -- *The required FY94 payment to the Pennsylvania Convention Center Authority (PCCA) appears to be understated***

The City has covenanted, in accordance with the bond indenture for PCCA's December 20, 1989 bond issue, to make annual payments to PCCA that would cover debt service on PCCA's bonds, net of interest earnings and PCCA's portion of Hotel Tax revenues. Additionally, the City agreed to fund operating deficits and make payments for any reserve fund deficiency. In the years covered by the Plan, the City has projected funding that appears to be at least sufficient to cover PCCA's needs in each year other than in FY94. In FY94, PCCA has indicated that it needs \$1.5 million to restore the reserve fund to the level required by its indenture. The City has eliminated that reserve fund payment from its FY94 budget and moved it to FY96. The City's Finance Director has indicated that the City intends to address any potential shortfall in the PCCA subsidy through a transfer ordinance. If the City does not meet any potential shortfall through a transfer ordinance, PCCA's likely recourse will be to reduce the service fee offset it provides the City. The offset is budgeted to be \$5.8 million, but PCCA would likely reduce its payment to \$4.3 million to compensate for the elimination of the reserve payment, thus reducing the amount of local non-tax revenues the City will receive in FY94. The City would then need to compensate for the shortfall in some other area of its FY94 Budget.

The City, however, appears to have budgeted more than PCCA has indicated it requires for the later years of the Plan. Only in FY95 does the City's projected service fee minus the offset PCCA is projected to provide the City, approximately equal the net service fee PCCA indicates it requires (the City provided PICA with a PCCA calculation of the required service fee for each year of the Plan). In FY94, the net fee is about \$1.3 million *less* than PCCA indicates it requires and in each of FY96, FY97, and FY98 the net service fee totals at least \$2 million *more* than PCCA indicates it

requires. The FY96 amount is likely to be reduced if an alteration is made to the FY94 net fee to include the \$1.5 million reserve payment the City is now projecting for FY96. The FY97 and FY98 projections appear, however, to include a cushion, but given the uncertainty of Hotel Tax revenue projections based on activity stemming from a convention center that has yet to open (although it has generated bookings) conservative estimates for PCCA subsidies appear to be prudent.

**Prisons - Budget Process -- *The budget process left the Prisons Department with a FY94 budget that will be far different from its actual distribution of obligations***

The Plan as approved by Council and submitted to PICA contained \$4.5 million less for the Prisons Department's FY94 Budget than did the Plan as originally submitted by the Mayor, including almost \$3 million less in employee compensation appropriations. In written material presented to PICA on March 11, 1993, the Administration indicated that \$3.5 million of the reduction in the Prisons budget was a result of the delay in the scheduled opening of the new 1,000 bed facility. In a April 12, 1993 memo, the Administration indicated that it had also based the \$3.5 million reduction on the assumption of privatization of food service and civilianization. The Prisons Department, however, indicated that the change presents a problem because the delay already had been factored into their FY94 budget (although the Administration contends that the delay was not built into the department's original budget). The Department indicated that it would balance its budget through the initiative to contract out food services (which the Plan estimates could save \$2.6 million), privatizing the prisons' commissaries -- which the Department indicates would save \$350,000; civilianizing certain functions to increase the number of uniformed personnel available for more appropriate assignments; and adding clerical staff to reduce overtime costs, which the Department estimates could save \$650,000. These initiatives, if implemented, should allow the Department to balance its budget, but not in the ways the Plan, as currently constructed, anticipates. The Department would have higher personnel costs than budgeted and lower food costs. While departmental managers in this case seem to have both the capacity and the desire to make the changes necessary to meet their budget and Plan goals, there is an obvious need for better communication between departments and central administrators during the budget alteration process. The Administration has indicated that after the FY94 budget was adopted by City Council, the Administration notified departments of changes to their FY94 budgets and met with departmental officials to discuss concerns about FY94 budgets.

The Prisons Department may also have another problem, in that it projected a \$1.7 million reduction in overtime costs from FY93 estimates to FY94 Budget for the Prison Operations Division. The Department has an excellent track record in reducing overtime (FY93 costs are estimated to be \$2.2 million lower than FY92 costs and \$6.1 million lower than FY91 costs), but the FY94 reduction is partially based on the closing of Laurel Hall and the redeployment of its workforce to other facilities. The

redeployment was assumed because the Department did not plan to open a replacement facility when it closed Laurel Hall. A Federal Court judge now has required, however, that Laurel Hall be replaced, thereby eliminating one avenue for overtime reduction. Prisons Department officials remain confident, however, that through stringent oversight they can reduce overtime to the budgeted level. PICA Staff will monitor the Department's overtime expenditures and its implementation of the initiatives it says are necessary to balance its budget.

The Prisons Department appears to be one area of City government where managers have an appreciation for stringent cost containment. While the City has been pushed relentlessly by the Federal Court on prison matters in recent years, the Department seems to have better control of its operations than many other City agencies.

**Prisons - New Facilities -- *The City plans to complete a 2,000 bed facility in two phases, demolish Holmesburg Prison and demolish and replace Laurel Hall***

The City has plans for the construction of a 2,000 bed prison facility in two 1,000 bed stages, the demolition of the existing Holmesburg Prison and the demolition and replacement of Laurel Hall, an alternative placement facility. The first phase of the Prison project (1,000 new beds) is slated to be completed on September 1, 1994 and completion of the second phase (also 1,000 new beds) is scheduled for March 1, 1995. Laurel Hall is scheduled to be demolished and replaced by May of 1993.

The Prisons Department has indicated that the costs of operating the new facilities are included in its budgets and the Plan, based on the schedule noted above, although a preliminary Prisons Department analysis showed that the Department would need 2,050 employees if Laurel Hall were not replaced. Laurel Hall is to be replaced as discussed above, and maintaining a total of 2,043 employees per the Plan's projections could result in the need for a marginal increase in the Department's use of overtime.

There are two primary areas of concern relative to the construction projects. One relates to the reliance on Phase II to reduce expenditures by producing a more efficient facility than antiquated Holmesburg, which it will replace. Any project delay would, therefore, increase the Department's costs and force it to make cuts elsewhere to meet its targeted spending levels. The Plan assumes a savings of 250 staff positions through the replacement of Holmesburg with the addition of 1,000 beds in the new facility.

A second concern relates to the City's reliance on State funding assistance to complete a portion of the capital project. PICA has been advised that the receipt of State money is contingent on the demolition of both Holmesburg and Laurel Hall. If

for any reason either of those facilities is not demolished, the City could have to seek other funding sources, which in time could cause delays in completion and thereby delay the City's achieving savings from utilizing more efficient facilities.

The Plan also indicates that the City will request PICA funding for Phase II of the project. PICA has yet to receive a formal request for funding or supporting detail for costs of the project, and therefore PICA funding should be viewed as speculative at this time.

**First Judicial District (FJD) - FY95-FY98 Payments -- *The City and FJD are not in agreement on the amount to be included in FJD's FY95 and FY96 budgets***

The City has been operating under an agreement with the FJD under which the FJD agrees to accept a "zero growth budget," with certain adjustments. The Plan's projections for FY95 do not agree with FJD's projections of those adjustment items. In the Plan as submitted to City Council, FJD was projected to spend \$96 million in FY95. In a written analysis provided to PICA, however, FJD projected its FY95 expenditures at \$98.9 million. FJD indicated that the difference was in the City's calculation of FJD's promised savings in conjunction with FJD assuming responsibility for leases previously paid through the Department of Public Property. FJD indicated that it was responsible for reducing lease costs by \$1 million and the City has reduced its budget by \$1 million per year. The City has advised PICA Staff that FJD is adding items to its budget (such as a pay increase) in variance with its agreement and that the Plan's FY95 amount (revised to \$95.9 million in the Plan as approved by City Council) is accurate. FJD also indicated that there is no agreement beyond FY95, while the City has indicated that the agreement includes FY96 and FY97. An April 7, 1993 Directive of the Supreme Court of Pennsylvania also indicates that the zero based budget agreement has been extended through FY97. The directive includes budget amounts it characterizes as agreed to with City officials for each year from FY94 through FY97, but the budget amounts the Supreme Court describes as agreed to are higher than the amounts included in the Plan by \$3.4 million in FY95 (the amount in the Supreme Court's directive is \$400,000 higher than the amount FJD has indicated it anticipates requesting for FY95) and \$1.8 million in FY96. In FY97 the amount included in the Supreme Court's directive is \$200,000 lower than the amount included in the Plan. This is a disagreement that it unlikely to be resolved at least until the FY95 budget process. Until it is resolved, there remains a risk that in FY95 and FY96 FJD costs will be higher than projected in the Plan, and this is an area which will require some additional attention.

**First Judicial District Fee Collections -- *Fee receipts are below estimates***

FJD indicated that revenues from Traffic Court fees and from newly increased Prothonotary fees are coming in more slowly than initially anticipated. FJD is

developing projections to determine whether fees will be below budget for FY93 and, if so, by how much. FJD indicated that more stringent enforcement measures such as decreasing the number of tickets allowed to accumulate before a car can be "booted" may yet increase Traffic Court revenues, and that initial receipts of the new fees may be low because people may have made more filings than usual before the fee increase was implemented (in an effort to avoid the higher amounts). PICA will review FJD projections to determine the severity of any threat to Plan revenues. The new fee schedule was projected to produce \$4 million in FY93, and \$8.8 million annually beginning in FY94, and Traffic Court revenues are projected to produce \$2.5 million in revenues in FY93 with increased fines projected to produce an additional \$4 million annually beginning in FY94.

***State Reimbursements for Court Costs -- The General Assembly has yet to pass supplemental appropriations restoring court cost funding including \$9.75 million for Philadelphia***

The City's revenue projections have consistently assumed that the State will restore funds to its budget for county courts. The City now estimates that the restoration of these funds would provide \$9.8 million to the City in FY93. The General Assembly has yet to agree on legislation including the restoration of those funds leaving a degree of doubt as to whether the City will receive its estimated \$9.8 million in FY93.

***Productivity Bank Repayment Structure -- The City has implemented a Productivity Bank repayment structure for loans designed to reduce obligations, but not for those designed to produce revenues***

The Productivity Bank was established with a grant from PICA to provide funding for loans for projects designed to improve the efficiency of City government. The City has established a review process and, to date, has made \$2.2 million in loans that appear to fit within the Bank's intended mission. Among those approved were loans to the Department of Public Property to purchase more energy efficient lights, to the Department of Human Services (DHS) to implement a computer system that would allow DHS to more effectively place and monitor children, and to the Revenue Department to improve collections.

The City has also set up a Productivity Bank loan repayment procedure reflected in budgeted payments in FY94, which in itself is encouraging and generally conforms with the previously stated goals of the program. The one area in which no repayment system has been implemented is for the loans for Revenue Department initiatives to generate increased revenues. Where initiatives increase revenues rather than decrease a Department's obligations, any requirement to repay such a loan would mean a net reduction in its ability to incur obligations without a related increase in operational efficiency, which would create a disincentive for any department to seek funding for a

revenue generating concept. This change is a deviation from the initial Plan's concept of how the Productivity Bank would work, although it may be a deviation necessary for the Bank to fulfill its mission. While it may be prudent to avoid reducing a department's obligations to compensate for a revenue generating initiative, the City should transfer an amount equal to the required loan repayment from General Fund revenues to the Productivity Bank. The decision not to repay the Productivity Bank for loans to the Revenue Department heightens PICA Staff's concern expressed in its June 4, 1992 report on the FY92-FY96 Plan about the City's ability and commitment to capture departmental savings, and thereby institutionalize the revolving nature of the Productivity Bank. While some savings are being recaptured, there is a gap in the City's recapture mechanism.

***Philadelphia Parking Authority -- The reduction in the number of employees is a first step toward decreasing PPA costs and increasing its remittances to the General Fund***

The Plan indicates that a \$4 million increase in revenue for FY94 will be the result of a reduction in the number of employees at the Philadelphia Parking Authority (PPA), increases in parking ticket revenue resulting from other initiatives (including a fee increase projected to increase revenues by \$2 million) and related operating and administrative improvements.

One step taken towards reducing PPA costs was the reduction of its staff by 123, a reduction which included projected early retirements and 57 layoffs. If PPA's number of employees is actually reduced by 123 at the start of FY94, it is likely that savings would exceed \$4 million.

The workforce restructuring is just one step toward increasing PPA efficiency. The April Monthly Managers Report listed a number of Mayor's Private Sector Task Force initiatives for the Parking Authority which were in various stages of implementation, and some others not supported by PPA and the City. None of the initiatives had an accompanying City estimate of savings. At the end of the PPA section of the Monthly Managers Report, however, there is an "adjusting entry" which shows a City projection of \$4.7 million in savings from all Task Force PPA initiatives that are projected to be implemented. The entry says the City's projections are lower than the Task Force's projection of savings of between \$20.2 million and \$24.3 million because the City contemplates implementation delays, has more conservative estimates of savings on labor-related initiatives and includes the loss of revenues from the Spectrum II project and the transfer of Airport parking facilities to the Airport. If any of the initiatives are successful, however, the City is likely to receive more PPA revenues than projected. A reformed PPA is potentially an important source of increased revenues for the City.

Increased revenues to the General Fund from PPA may be somewhat lower than the total amount of PPA savings because PPA already has attributed over half of its year to date FY93 expenses (PPA's fiscal year begins in April) to the Airport. If projected PPA savings are a deduction in expenses formerly charged to the Aviation Fund, the General Fund will not receive a benefit. As a result, the employee reductions may provide less than \$4 million to the General Fund. This division of savings between the General and Aviation Funds makes further reforms at PPA even more essential for the General Fund to obtain significant benefits.

***Fleet Management - Impact of Budget Reductions -- There is a possibility that adjustments in the City's FY94 budget will reduce the new unit's effectiveness***

One of the significant managerial accomplishments of the first year of the Rendell Administration was the establishment of an Office of Fleet Management within the Managing Director's Office. The City plans to consolidate all of its vehicle purchasing and maintenance in that Office. In addition to prioritizing needs across departments and improving maintenance practices, the Office is to accomplish new efficiencies such as receiving manufacturer warranty payments on vehicle repair where appropriate. The restructuring appears to be a basic alteration in the way the City does business rather than just a reshuffling of people and responsibilities (the Office will have employees from a number of departments, including Streets, Police and Public Property). The Office, however, also became a target for budget reductions in the final stages of Council deliberations on the FY94 Budget and FY93 Budget transfer ordinances: \$3.5 million was removed from FY93 appropriations for purchases, \$6 million was removed from the FY94 budget for purchases and \$125,000 was removed from its personnel budget.

The cuts may create problems. As noted in the Mayor's Private Sector Task Force study, a well planned and managed program is an element of an integrated effort to reduce maintenance costs, reduce fuel consumption and improve vehicle reliability. There was no offsetting adjustment to other areas of the budget to compensate for any impact of not having the planned number of new vehicles. While savings from reductions in fleet size are achievable, increased costs for maintenance and operation can also be expected when vehicle replacements and related operational changes are delayed for more than a year. The City should publish a synopsis of how it intends to meet its goals in the Plan with the reduced resources now found in the FY94 budget. Of all the Task Force suggestions, the Office of Fleet Management was the most warmly embraced by the Administration, and good management requires an evaluation and explanation of the impact of the FY94 changes.

***Extraordinary Contracts -- PICA has yet to receive an Extraordinary Contract that was found not to be compliance with the Plan, despite clear evidence of non-compliance***

In its December 9, 1992 report on the City's Quarterly Report for the First Quarter of FY93, PICA Staff expressed concern about the City's compliance with the Extraordinary Contract provisions of the Cooperation Agreement. Those provisions require the City to provide PICA with a summary of terms, and a certification from the Director of Finance as to Plan compliance, for all contracts valued at more than \$1 million in a single year or \$5 million over the life of the Plan. The Extraordinary Contract provisions were designed to provide the City with an early warning if contracts were costing more than had been anticipated.

As of the end of the first quarter of FY93, PICA Staff had not received any Extraordinary Contract that was not certified as being in compliance with the Plan. This caused PICA concern as to the City's compliance with the Cooperation Agreement's provisions and fiscal controls, particularly since the City was forecasting substantial variances from its FY93 Budget in purchased services. The City has certified that each contract it executed for FY93 was in compliance with the FY92-FY96 Plan, despite (for example) DHS' current purchase service obligations estimate now being \$12 million above those included in the FY92-FY96 Plan's projections. As a result, PICA Staff remains concerned about the City's Extraordinary Contract compliance.

The City will soon be entering into the bulk of its contracts for FY94, and PICA Staff hopes that the Extraordinary Contract provision will be used by the Administration as a more useful planning tool than it was for FY93. For example, PICA Staff anticipates that the Administration will pay closer attention to whether contracts comply with the Plan. This can provide an early indication as to departmental budget compliance.

## **Appendix A**

### **Statutory Background and Chronology**

#### **Overview**

The General Assembly created PICA in June of 1991 by its approval of The Pennsylvania Intergovernmental Cooperation Authority Act for Cities of the First Class (Act of June 5, 1991, P.L. 9, No. 6), and critical events have occurred since that action which are of value to interested parties in assessing the efforts of both the Authority and the City to meet their respective responsibilities. Rather than re-state in the body of the Report the principal provisions of the PICA Act and the Authority's history, PICA Staff has included such information in this Appendix.

#### **Statutory Basis -- The PICA Act**

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

**Policy.**--It is hereby declared to be a public policy of the Commonwealth to exercise its retained sovereign powers with regard to taxation, debt issuance and matters of Statewide concern in a manner calculated to foster the fiscal integrity of cities of the first class to assure that these cities provide for the health, safety and welfare of their citizens; pay principal and interest owed on their debt obligations when due; meet financial obligations to their employees, vendors and suppliers; and provide for proper financial planning procedures and budgeting practices. The inability of a city of the first class to provide essential services to its citizens as a result of a fiscal emergency is hereby determined to affect adversely the health, safety and welfare not only of the citizens of that municipality but also of other citizens in this Commonwealth.

**Legislative intent.**--

(1) It is the intent of the General Assembly to:

(i) provide cities of the first class with the legal tools with which such cities can eliminate budget deficits that render them unable to perform essential municipal services;

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

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

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

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

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

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

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

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

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

(2) Plan components that will:

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

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

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

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

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

(c) Standards for formulation of plan:

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

(2) All revenue and appropriation estimates shall be on a modified accrual basis in accordance with generally accepted standards. Revenue estimates shall recognize revenues in the accounting period in which they become both measurable and available. Estimates of city-generated revenues shall be based on current or proposed tax rates, historical collection patterns, and generally recognized econometric models. Estimates of revenues to be received from the state government shall be based on historical patterns, currently available levels, or on levels proposed in a budget by the governor. Estimates of revenues to be received from the federal government shall be based on historical patterns, currently available levels, or on levels proposed in a budget by the president or in a congressional budget resolution. Non-tax revenues shall be based on current or proposed rates, charges or fees, historical patterns and generally recognized econometric models. Appropriation estimates shall include, at a minimum, all obligations incurred during the fiscal years and estimated to be payable during the fiscal year or in the 24-month period following the close of the current fiscal year, and all obligations of prior fiscal years not covered by encumbered funds from prior fiscal years. Any deviations from these standards of estimating revenues and appropriations proposed to be used by a city shall be specifically disclosed and shall be approved by a qualified majority of the board.

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

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

(1) be in such form and shall contain:

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

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

(2) include projections of all revenues and expenditures for five fiscal years, including, but not limited to, projected capital expenditures and short-term and long-term debt incurrence and cash flow forecasts by fund for the first year of the financial plan;

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

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

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

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

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

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

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

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

(i) are consistent with the Financial Plan;

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

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

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

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

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

appropriate in light of the City's current and forecast financial condition. The parties agree to cooperate such that the form of the report required under this paragraph (h), and the subjects covered, are reasonably satisfactory to the Authority.

### **City Reporting and Variances**

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

- (i) a net adverse change in the fund balance of a Covered Fund of more than one percent (1 %) of the revenues budgeted for such Covered Fund for that fiscal year is reasonably projected to occur, such projection to be calculated from the beginning of the fiscal year for the entire fiscal year, or
- (ii) the actual net cash flows of the City for a Covered Fund are reasonably projected to be less than ninety-five percent (95 %) of the net cash flows of the City for such Covered Fund for that fiscal year originally forecast at the time of adoption of the budget, such projection to be calculated from the beginning of the fiscal year for the entire fiscal year.

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

The statute mandates the submission of monthly reports to PICA by the City after determination by the Authority of the occurrence of a variance, and the City submitted its first post-variance monthly report to the Authority, on November 16, 1992 and has filed monthly reports since then.

As provided in Section 210(e) of the PICA Act, there are legal consequences flowing from a determination by the Authority that a variance exists, and in addition to the City's additional reporting responsibilities, it also is required to develop revisions to the Plan necessary to cure the variance. The remedies which PICA has available to it to deal with a continuing uncorrected variance are to direct the withholding of both

specific Commonwealth funds due the City, and that portion of the 1.50% tax levied on the wages and income of residents of the City in excess of the amounts necessary to pay debt service on PICA's bonds. Any amounts withheld would be paid over to the City after correction of the variance. PICA has not taken any action with respect to fund withholding as a result of the declaration of the variance in the current Plan, and the City has submitted proposed corrective actions for FY93 in conjunction with its submission to the Authority of the Plan which has been proposed by the City for the FY94-FY98 period.

### **Major PICA Events**

PICA's creation was an action taken by the Commonwealth in direct reaction to Philadelphia's fiscal crisis, and its work during its first year of existence was to assist the City to avoid insolvency and in its efforts to lay the foundation for its return to fiscal stability. The negotiation of an Intergovernmental Cooperation Agreement to set out the basic terms of the City-PICA relationship, review of an initial Five Year Financial Plan and the issuance of bonds to provide funding to permit the City to stabilize its budget and cash needs were the most critical tasks at hand. Since the issuance of its bonds in June of 1992, following successfully defended challenges to the constitutionality of the PICA Act, PICA has devoted its primary attention to the assessment of Plan progress, evaluation of City reporting, analysis of City practices and programs and oversight of the capital projects for which PICA borrowed \$120 million for use by the City. the following notes in summary form the major events since the Authority's creation:

- |                          |  |
|--------------------------|--|
| <b>June 5, 1991</b>      | Act 6 of 1991 approved by Governor Robert P. Casey.  |
| <b>June 25, 1991</b>     | Initial organizational meeting of the Authority.   |
| <b>January 3, 1992</b>   | Approval by Council and Mayor W. Wilson Goode of the Cooperation Agreement ordinance.  |
| <b>January 8, 1992</b>   | Execution of the Cooperation Agreement by PICA and Mayor Edward G. Rendell.  |
| <b>February 20, 1992</b> | Submission by Mayor Rendell of proposed Plan to City Council.  |
|                          | Public employee labor unions file legal action with the Pennsylvania Supreme Court alleging unconstitutionality of PICA Act. |
| <b>April 7, 1992</b>     | Arguments before the Supreme Court concerning PICA   |

challenge.

**March 5, 1992**

Approval of Plan by City Council and submission to PICA.

**March 6, 1992**

Submission by Mayor Rendell of proposed fiscal year 1993 operating and capital budgets to City Council.

**March 29, 1992**

Approval of FY1993 capital and operating budgets by City Council.

**April 6, 1992**

PICA approval of Initial Plan.

**April 13, 1992**

Supreme Court declares the PICA Act to be constitutional.

**April 21, 1992**

Submission to PICA by Mayor Rendell of amendments to The Initial Plan.

**April 27, 1992**

Public employee labor unions file for reconsideration of Supreme Court decision.

**May 18, 1992**

Submission to PICA by Mayor Rendell of further amendments to the Plan.

PICA approval of amended Plan.

Authorization by PICA Board of distribution of a preliminary Official Statement with respect to first issue of PICA bonds.

**May 29, 1992**

Supreme Court issues written opinion supporting the constitutionality of the PICA Act, and denying unions' request for reconsideration.

**June 1, 1992**

PICA bonds offered.

**June 4, 1992**

PICA approves execution of bond purchase contract for issuance and sale of \$474,555,000 in Special Tax Revenue Bonds (City of Philadelphia Funding Program), Series of 1992.

**June 16, 1992**

Bond settlement.

<b>August 16, 1992</b>	PICA receives first City quarterly Plan report (for fourth quarter of FY92).
<b>October 19, 1992</b>	PICA authorizes initial transfer of Authority bond proceeds for capital projects (\$21.7 million).
<b>October 15, 1992</b>	City completes negotiation of labor agreements with District Councils 33 and 47 of the American Federation of State, County and Municipal Employees.
<b>November 16, 1992</b>	PICA receives City quarterly Plan report for first quarter of FY93, projecting a variance in the Plan through June 30, 1993 of \$57 million (2.5 %) of budgeted revenues of the General Fund.
<b>December 9, 1992</b>	PICA Board declares existence of "Variance" in Plan, requiring monthly City reporting.
<b>January 21, 1993</b>	Mayor Rendell proposes FY93 variance correction measures, FY94-FY98 revised five year financial plan and FY94 capital budget to Philadelphia City Council.
<b>March 18, 1993</b>	City Council completes action on FY93 variance correction measures, FY94-FY98 revised five year financial plan and FY94 capital budget.
<b>March 19, 1993</b>	Mayor Rendell submits the City's "Five-Year Financial Plan, Fiscal Year 1994 - Fiscal Year 1998 (including Fiscal Year 1993)" to Authority in compliance with PICA Act requirement for annual Plan revision, and to propose measures to correct variance declared by PICA on December 9, 1992.
<b>March 31, 1993</b>	Act 111 Police arbitration panel issues its award concerning the City and F.O.P. Lodge No. 5.

## **Future City Reporting to PICA**

As discussed in the section of this Report entitled "Executive Summary and Staff Recommendations", absent the occurrence of a variance, receipt of an arbitration award which is at variance with the Plan or a determination by the City that further revisions to the Plan are necessary, the City will not submit a revised Plan until March of 1994. During the future months, assuming that the PICA Board accepts the recommendation of PICA Staff that the City's proposed corrective action with respect to the variance declared to exist by the Authority on December 9, 1992, the Authority will receive quarterly reports on the City's performance under the Plan, together with other data.

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

Quarterly Plan reports. The Authority receives reports from the City on a quarterly basis (45 days after the end of each fiscal quarter) concerning the status of compliance with the Plan and associated achievement of initiatives. The remaining quarterly reporting deadlines for FY93 are May 17, 1993 and August 16, 1993. Quarterly reporting deadlines for FY94 are November 17, 1993, February 14, 1994, May 17, 1994 and August 13, 1994. The Cooperation Agreement also requires that the City provide reports to PICA concerning Supplemental Funds (*i.e.*, the Water and Aviation Funds) on a quarterly basis.

Grants Revenue Fund Contingency Account Report. The Cooperation Agreement provides that a report on the Grants Revenue Fund Contingency Account be prepared and submitted, by department, not later than 20 days after the close of each fiscal quarter, and those to be received relating to FY93 are: April 20, 1993 and July 20, 1993. For FY94 the reporting dates are October 20, 1993, January 20, 1994, April 20, 1994 and July 20, 1994. This report details the receipt and use of Federal and Commonwealth Funds by the City, as well as the eligibility for fund withholding by the Commonwealth at PICA's direction in the event the City cannot balance the Plan after an extended period of intensive reporting and PICA review of proposed corrective efforts.

Prospective Debt Service Requirements Report. The Cooperation Agreement requires submission of a report detailing prospective debt service payments by the City, as well as lease payments, 60 days prior to the beginning of a fiscal quarter. The remaining report in this category for FY93 is to occur on April 30, 1993. The dates for submission of future such reports for FY94 are August 2, 1993, November 2, 1993, January 28, 1994 and May 2, 1994.

## **PERSONAL VIEWS OF PICA MEMBERS**

### **BERNARD E. ANDERSON**

The City of Philadelphia's second Five Year Financial Plan is another major step toward the return to fiscal stability. The process through which the Plan was developed by the Mayor and approved by City Council demonstrates the value of cooperation, mutual respect, and common interest among the public officials who are the stewards of the public trust, and in whose hands the City's future rests.

The first Five Year Financial Plan, for fiscal year 1993 through 1996, was born in a crisis atmosphere, when the City faced an imminent threat of bankruptcy. The Plan necessarily focused on restructuring costs and reducing spending. The strategy pursued by City officials included the renegotiation of labor agreements to control personnel cost increases, and the introduction of management and productivity initiatives to permit the delivery of public services at lower cost. The successful attainment of these goals was not easy. In fact, to paraphrase an oft-repeated statement, "there is nothing so difficult to accomplish, nor uncertain of success than to introduce a new order of things".

But the City achieved a major part of the cost reduction program last year. As a result, the framework for responsible fiscal management is now in place, and ready to be implemented fully in the months and years ahead. Old assumptions and common understandings about spending and budget management have been challenged at every turn; many sacred cows have been slaughtered on the altar of fiscal solvency.

But as the PICA Staff Report observes, much remains to be done to assure the successful transformation to a new, more fiscally responsible way of conducting public business. Fiscal controls, consistent reporting, effective monitoring, and the continued search for economies in the delivery of public services must become part of the culture of public management. The crisis will not be over until crisis conditions are no longer the incentive for better, more effective public management.

The new Five Year Financial Plan justifiably moves beyond the crisis atmosphere of last year toward a focus on the fundamentals of the City's fiscal prospects for the future. On that score, my interpretation of the Plan suggests that the picture is not as bright as one would like it to be. Revenue growth prospects are exceedingly modest for the next five years -- even assuming a marked improvement in the national economy.

According to the regional office of the U.S. Bureau of Labor Statistics, Philadelphia lost about 18,000 jobs last year alone. Further job losses are expected over the next two years. Part of the job loss will result from military facility closings, such as the Naval Base, Naval Air Supply Office and Defense Personnel Support

Center, that together might reduce employment by more than 20,000 workers during the next three years. These prospective job losses are exacerbated by the continued competitive disadvantage in operating cost of businesses in the City compared with the surrounding suburban counties that will undoubtedly reinforce the trend of more rapid private employment growth outside rather than within the City limits.

Much hope for the future is invested in major economic development projects, such as the Convention Center and the Avenue of the Arts. There is little doubt that these, and other, big-ticket economic development projects will help, but they will not be a panacea for the City's fiscal salvation. The number of new jobs created by such projects is almost always less than projected, and in this case, most of the newly created jobs will likely pay lower wages than the jobs Philadelphia will lose during the next three years.

When stripped to the bare essentials, the issues surrounding the City's fiscal condition revolve around the people who live and work in Philadelphia. The people of Philadelphia have borne the heaviest burden of the City's fiscal crisis, and they will be the major beneficiaries of the emerging era of fiscal stability and responsible management. But if the crisis has forced the people to step back and re-examine the role and responsibility of government, and the obligation of personal responsibility, then the difficulties of the past five years have had a positive impact.

The City government cannot, and should not, meet all the public demands placed on it during the halcyon days of generous federal grants and local deficit spending. The public interest is best served when government provides basic public services, and leaves to the private sector, with public funding when necessary, those things that are not the legitimate function of government.

The quality of life in the City also requires a healthy dose of personal responsibility. Homeowners and landlords have the responsibility to maintain their properties; youth have a responsibility to attend school and focus on getting a good education; the unemployed have a responsibility to seek and obtain job training and other assistance to prepare for jobs; all of us have a responsibility to take preventive measures to protect our health and to avoid personal and socially destructive behavior. These are the requirements for "the good society", which if met, will greatly ease the burden of government.

PICA will continue to be vigilant in fulfilling its responsibility to monitor the City's fiscal management. As during the first year of PICA, this responsibility will be carried out in a spirit of cooperation with City officials. As the process in approving the second Five Year Financial Plan demonstrates, PICA provides the framework for the exercise of fiscal responsibility. The future well-being of the people of Philadelphia depends on PICA's continued performance of its task. But the true victory will not be won until PICA is no longer necessary.

## **CHARLES L. ANDES**

I would like to thank the PICA Staff and Executive Director Henry for the outstanding job they have done working with the City over the past weeks, and for their thorough and perceptive analysis of the Five-Year Financial Plan, which I found to be so helpful to my own understanding of this complex plan.

I would also like to express my gratitude to Mayor Rendell, his cabinet and staff, and to President Street and City Council and their fine staff for their leadership.

The City had indeed come a long way in the last 16 months. In that period, the Mayor and the President of City Council, with, I like to think, the help of PICA, have brought the City back from the brink of bankruptcy; have reduced operating costs substantially, partly through an extraordinary accomplishment of negotiations and arbitration, and have initiated a series of management and private sector initiatives.

They have given the City a new "can-do" image. We have gone from being a nationwide example of ineptitude to being a nationally-recognized symbol of an old city on the way back.

But the job isn't over. Let's not delude ourselves. And let's not lose the sense of urgency which made possible much of what was accomplished so far.

The basic problems -- the root causes -- still remain. Businesses are still leaving the City. And jobs. In the five years between 1987 and 1991, the City lost 10% of its jobs, a loss of about 75,000 jobs. The hope was that the rate had slowed to 1% last year. But in the final tally, job loss was 17,000, or about 2.4% of the base.

Why? Well, consider this. The costs to a business of the wage tax (assuming it has to make up the tax in higher wages) and the extra business taxes can be as much as all the profits of that business. And the difference that businesses pay in taxes between Philadelphia and suburban Pennsylvania locations can be dramatic. Some retailers can pay up to 9 times as much in taxes in Philadelphia as they would pay in Montgomery County, and a law firm in Philadelphia pays 350% more in taxes than one in Upper Merion.

The only way to stop the outflow of jobs is to make the entire region a level playing field for wage and business taxes. And even that will probably not attract many businesses back. That will take a Federal Enterprise Zone to make it more desirable to be in the City.

City real estate taxes are higher too. Only the higher initial cost of suburban real estate keeps the move-out rate down.

The City's public schools offer little to parents who are concerned with the quality of their children's education. The enormity of this problem boggles the mind, but should not hamper active thought to solve it.

Add crime to high taxes and inadequate schools, and you have three basic reasons why people want out.

These all must be addressed, and progress made towards a solution in order for the City to regain its vitality.

The Five-Year Financial Plan doesn't address these problems. It is a collection of cost saving ideas, mixed in with some revenue enhancing projects, blended with initiatives from management and the private sector. The cuts, adds, and initiatives are arrived at independently, do not necessarily relate to each other, and do not seem to relate to a master plan.

A Five-Year Financial Plan is like a sailboat's bilge pump. It's nice to have it go on when the boat leaks, and it will keep the boat afloat as long as it pumps at least as fast as the water pours in. But the bilge pump doesn't fix leaks or re-step the mast or sew torn sails. Nor does the Five-Year Financial Plan fix the City's basic problems. That's the job of a Strategic Plan.

That's why I am glad to hear that the Mayor is considering a Five Year Strategic Plan for the City, to go along with the Five-Year Financial Plan.

What is in a Strategic Plan, and how is it different from a financial plan?

A Strategic Plan can be developed in many different ways, but I would hope the Mayor would consider the format that allows him, as the leader of the City, to state his "vision" of the City in a given future year (say five years from now, or ten at most).

The Mayor's vision should not only be general, such as "the leading city on the east coast," but include specifics such as the number of new jobs, the reduction in crime rate, the tax level, the state of the school system, etc.

The Strategic Plan should also define the mission of City Government. What is the job of government? It is to provide public jobs for as many citizens as possible?. Is it to provide services to its citizens? What services? And what services should it not try to provide? What should be provided by other governments?

The plan should also list the obstacles to be removed and the objectives to be achieved in order to fulfill the vision.

Specific goals are then set to reach each objective. These specific goals often give ordinary politicians a bad case of nerves. Because it is here that the public gets wind of the cost of the goals.

Fortunately, Ed Rendell is not an ordinary politician. He has proven to be an unusually effective leader. He has a reputation for telling it like it is. He is a believable leader, and now he should be encouraged to lead.

But we shouldn't let him lead the charge alone. Philadelphia needs some help. Mayor Rendell has been painstaking in insisting that Philadelphia get its own house in order before asking for help, and that was right. And Philadelphia still has a lot it can do:

It must implement the initiatives that are in its financial plan. Getting these private sector task forces organized and their recommendations completed is only half the job. Getting the initiatives implemented is just as big a job, or bigger. The normal bureaucratic forces tend to work against change of any kind. Most initiative programs die right here. It will be challenging to the Rendell Administration not to let this fall through. A big challenge.

It must push for City Charter changes and Civil Service changes that will let it get management control of the City's work force, to set goals for workers, and to reward them when they succeed and discharge them if necessary when they don't do the job.

Finally, it must re-engineer city government so that it can no longer hide ineptitude behind monopoly. So that each department of City government is challenged to deliver the best possible service at the lowest possible cost.

All of this must still be done by the City. If it is done properly, I believe the City can improve the quality of its services and reduce its costs substantially.

But it is also time for others to step up and help. It is only by a 19th century political accident that Philadelphia's problems are not Montgomery and Delaware and Bucks County problems. That accident merged Philadelphia's city and county lines together. In most other American cities, the county boundaries stretch out to include affluent suburbs, and thus the city's tax base is augmented for the normal "county costs" of health care, aid to children and youth, and criminal justice.

But not in Philadelphia. Like most American cities, we incur most of our county costs inside the city limits. But the iron curtain that is the Philadelphia County line keeps 80% of the region's wealth outside the county walls.

And these county costs are substantial, now accounting for about 40% of the City's general fund costs, and growing far more rapidly than other costs. It is these county costs that are breaking the City. It is these county costs that should be shared by other governments.

Some have said the state government should bear the costs. Perhaps. It is also a regional responsibility, in my view.

Those of us who live in one of the suburban counties must now be aware that the City, which the repository for most of the region's needy citizens, cannot carry the load alone. (The reverse of the affluent ratio is also true: 88% of the region's population below the poverty line lives in the City.) We have to carry part of the load, if not for humanitarian reasons, then out of enlightened self-interest. The suburban counties need the City as a strong center in order for the region to prosper and grow, perhaps even for it to survive. What will happen to the region, to the suburbs, if the City deteriorates as much in the next 20 years as in the past 20?

So, I would hope that the Mayor, when he begins a Strategic Plan for the City, will be able to call on other regional leaders to develop a joint plan to solve our mutual problems.

Now, I'm a practical person. I realize many may not believe that regional cooperation is possible. But we have to make a start. After all, only sixteen months ago, many did not believe that City could make the progress it has now made.