Pennsylvania Intergovernmental Cooperation Authority

Staff Report
on the
City of Philadelphia's
Five-Year Financial Plan
for
Fiscal Year 1999 - Fiscal Year 2003

June 9, 1998

PENNSYLVANIA INTERGOVERNMENTAL COOPERATION AUTHORITY

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EXECUTIVE SUMMARY AND STAFF RECOMMENDATION

The City of Philadelphia (The City) submitted its Five-Year Financial Plan, Fiscal Year 1999-Fiscal Year 2003 (including Fiscal Year 1998) (the FY99-FY2003 Plan or the Plan) to the Pennsylvania Intergovernmental Cooperation Authority (PICA, or the Authority) on May 28, 1998. The Plan failed to appropriate funding for the First Judicial District of Pennsylvania (FJDP), funding which PICA Staff believes to be legally mandated. PICA Staff was able to ascertain that funding was available but not specifically allocated for such purpose.

Except for the failure to specifically appropriate required FJDP funding (in both the Plan and the City's FY 1999 budget) the Plan presents a reasonable prospect for balanced budgets in each year of its term. Such prospect however continues to be dependent on a variety of circumstances beyond the City's control.

Annual updating of the Plan and submission of various data to PICA is legally required of the City. PICA Staff then prepares a report on such submission to the Authority Board which includes a recommendation as to whether the Plan, as submitted, should be approved. Non-approval requires that the City submit a revised Plan (and make appropriate budget revisions).

PICA Staff is pleased to acknowledge that the currently submitted Plan deleted two major revenue risks which had been included in the prior year Plan and which were identified by PICA Staff in its report dated May 20, 1997.

The two averted revenue risks not included in the current Plan are:

- The City repeal of the State-authorized Personal Property Tax ($71.5 million risk).

- The City has ceased to anticipate the realization of tax revenues from riverboat gambling, a highly speculative revenue source, previously expected to commence in FY2000 ($88.5 million risk).

Two major appropriation risks to the Plan, also previously identified in the May 20, 1997 Report continue unabated. They are:

- The City's failure to appropriate FJDP funding in accordance with the State Supreme Court appointed Special Master's Plan and the approved Commonwealth budget. Last year's Plan methodology of appropriating only six months of FJDP funding was deemed viable in as much as it conformed to the existing circumstances. The decision by the City to take a "no-appropriation" stance for FY99 and thereafter jeopardizes the continuance of a vital governmental function.

- The City's continuing inclusion of unidentified "Future Target Spending Reductions" as a component of if obligations/appropriations in each of the final four years of the Plan ($50 million risk).

Additionally, the Plan's success will depend greatly on improving economic trends. PICA Staff continues to believe that the City's projections of these trends are optimistic.

The City's Future Ability to Weather Risks is Unknown

Even though many of the Plan's assumptions have a high degree of uncertainty, the Rendell Administration has repeatedly shown a willingness and ability both to control expenditures throughout the fiscal year and impose extraordinary measures when necessary to balance the budget. PICA Staff has no reason to believe that the current administration will not do so again if such actions are required.

However, nearly three quarters of the time period covered by the current Plan will occur under the watch of a successor administration. Of the $50 million in risk in "Future Target Spending Reductions" noted above, at least $47 million (95% of the total) will not affect the City until after Mayor Rendell leaves office.

PICA Staff is increasingly wary of the Plan's reliance on unspecified expenditure reductions. Given the timing of the current Plan, the current administration has a limited amount of time to affect the need to continue to rely on such uncertain elements in order to project balanced budgets into the next decade.

The current administration will need to leave its successor with a reasonable prospect for balanced budgets in the future. Accordingly, PICA Staff will be far more skeptical next year about underlying assumptions in the City's next Five-Year Plan, as nearly 90% of that Plan's time frame will be during the tenure of a new administration(s).

Report Summary

Similar to the May 20, 1997 PICA Staff Report on the prior Five-Year Plan, this report focuses primarily on significant risks to the Plan and does not review department-specific issues beyond those that could have a severely adverse impact on the General Fund. A Chart of Quantifiable Risks to the Five-Year Plan appears at the end of this executive summary.

New in this year's report is the inclusion of a Chart of Averted Quantifiable Risks to the Five-Year Plan, which also appears at the end of this executive summary. While the Chart of Quantifiable risks is intended to illustrate PICA Staff's ongoing concerns and the identified potential risks in the current Plan, the new chart is intended to illustrate the City's progress with regard to mitigating prior year identified risks and concerns.

PICA Staff continues to track departmental progress in numerous areas and will report on those areas as significant issues arise.

Mitigated Concerns and Averted Risks Identified in the Prior Five-Year Plan

Last year's Plan relied on continuing revenues from the State-authorized Personal Property Tax which has been challenged in the State Supreme Court on constitutional grounds. The City had attempted to limit its exposure to revenue loss and refunds by enacting a substitute Personal Property Tax that would take effect if, or when the State-authorized tax is found unconstitutional. In the current Plan the City has refrained from its prior reliance on a revenue source (totaling approximately $71.5 million between FY 1999 and FY 2002) with significantly questionable prospects of being able to withstand legal challenge.

PICA Staff is pleased and encouraged by the City's proactive approach of no longer anticipating these revenues. Continued reliance thereon might have undermined future prospects of balanced budgets in this Plan and beyond.

However, the as yet unresolved legal challenge continues to jeopardize the legality of the prior three years collections (totaling approximately $58 million). The City has enacted a "replacement tax" to take effect in the event of a court ordered refund. PICA Staff is concerned about whether the replacement tax, as enacted, could be challenged as unfairly penalizing certain taxpayers.

The Plan no longer includes income from riverboat gambling as a future revenue source. This is in contrast to last year's Plan which recognized revenue from riverboat gambling beginning in FY2000--only one-half of which would be during the tenure of the current administration. In light of current political realities, PICA Staff is encouraged by the City's responsible actions in removing $88.5 million of speculative revenues from the current Plan. Certainly, the inclusion of riverboat gambling tax revenue in this or future Plans without State and City legislation enabling gaming would make it very difficult for PICA Staff to recommend Plan approval.

In previous years, PICA Staff acknowledged the City's improved ability to project overall revenues and expenditures while noting that its methodology for projecting tax revenues and non-personnel, non-debt service expenditures remains imprecise. The City has now taken the commendable step of purchasing and utilizing an acclaimed computerized economic modeling program. It remains to be seen what specific benefits the City's limited application of this model will derive, and PICA Staff intends to closely monitor its use in the months and years ahead.

Major Risks

In the prior year Staff Report, the FJDP was identified as a cost center of significant concern. The State Supreme Court had directed the Commonwealth of

Pennsylvania to assume financial responsibility for the State courts on or before January 1, 1998. PICA Staff was concerned that (as happened) the City would be forced to maintain funding beyond the first six months of FY98. An additional concern was that, if the "zero-growth" budget agreement was not renewed, the City might be required to provide funding to the FJDP above and beyond what the City was known by PICA Staff to be holding in reserve in the Plan.

Subsequent to approval of last year's Plan, the State Supreme Court appointed "Master" issued a four-phase plan, under which the Commonwealth is to gradually assume responsibility for statewide funding of a unified court system. However, Phase I of the Court Master's Plan (spanning FY 1999 through the end of FY 2000) and likewise the Commonwealth's adopted FY 1999 budget provides for only approximately $2.4 million in state court funds for the FJDP.

The President Judge of the FJDP, recognizing that the City did not properly appropriate funding for the FJDP in the FY 1999 budget, has instituted legal action to require the Mayor and City Council to take action to appropriate such funding.

While acknowledging that the City's efforts to speed Commonwealth funding of the courts is justified, PICA Staff could not endorse the City's course of action. Had the FJDP not forced the issue by its legal (mandamus) action PICA Staff would have recommended that the Plan not be approved.

PICA Staff had studied what it considered to be relevant factors, including:

- the Court Master's Phase I funding plan;
- the approved Commonwealth FY99 budget;
- the threat to the City of legal action by the FJDP;
- the City's ability to act in a timely manner to remedy the court funding crisis before the start of FY 1999; and

had initially concluded that such factors placed the City's ability to carry out a vital function of government in dire jeopardy. In accordance with the PICA Act and the PICA Agreement, PICA Staff felt it would have to recommend that the PICA Board not approve the Five-Year Plan until funding was properly in place for the Courts. This unfortunate situation thus jeopardized approval of an otherwise viable Plan.

By instituting legal action, the FJDP alleviated any need for such PICA action. The decision is now in the hands of the Courts for adjudication.

The Five-Year Plan anticipates a total of $50 million in unspecified expenditure reductions over its final four years as a result of the continued use of target budgets. PICA Staff had previously expressed reservations as to the amount of savings that can be anticipated from future use of the target budget process. PICA Staff's concerns about the use of target budgets as a management tool which will continue to result in monetary savings have not been abated.

Significant Risks

The Rendell Administration successfully concluded labor agreements and arbitration negotiations with all four of the City's major collective bargaining units in 1996. Except for the contract with the Fraternal Order of Police, Lodge 5 (FOP), which expires at the end of FY98, the present agreements cover two of the five years in the Plan. Since the Plan's Police Department expenditure projections provide no increase in police personnel costs that may result from the upcoming contract process, the Plan probably underestimates such costs.

Last year, both the State and Federal governments enacted dramatic welfare reform legislation that has already altered the eligibility and the level of support provided to those in need. The enacted changes will continue to be phased in over the next few years. These reforms will likely lead to increases in demands for City services, most particularly emergency shelter, homeless prevention, child welfare, and primary health care.

PICA Staff continues to stress the importance of improving the underlying economic trends in Philadelphia. If the City's economy does not grow, the City will be unable to handle an increasing demand for public services. PICA Staff recognizes that much of what dictates the fate of the City's long-term economic health and its ability to address structural deficiencies lies outside of the City's jurisdiction. However, PICA Staff strongly encourages the City to intensively address the economic state of the City, primarily by continuing to reduce the costs of living and doing business in Philadelphia.

The tax reduction program and the economic development activities of the City and its affiliated agencies are excellent steps in this endeavor. However, the City continues to lack a satisfactorily comprehensive approach to economic development and, in spite of major gains--such as the Kvaerner ASA shipbuilding agreement--and improved efforts to bridge formal barriers to coordination, its efforts remain largely reactive.

Other General Fund Concerns

The City remains burdened by a $2.6 billion unfunded pension liability. The payment schedule for eliminating the liability requires annual General Fund payments, gradually increasing to more than $250 million in FY2003--the final year of the Plan, and more than double that in FY2019, the last year of the liability reduction schedule. The City has proposed instituting a ten-year rolling amortization program once the Pension Fund reaches a 70% funded level, projected to be in the year 2012, in effect stretching out payments beyond 2019.

PICA Staff is pleased that the City is pursuing potential solutions to a problem that threatens to be a budget crisis early in the next millennium. However, PICA Staff strongly urges that the City also seriously consider other viable solutions to fully eliminate the current unfunded Pension Fund liability.

PICA Staff does not believe that the Plan's indemnity projections are reliable. Estimates in previous Plans have consistently been lower than actual final costs. The City's past inability to project indemnity costs results in obvious concerns about the projections in this year's Plan. PICA Staff believes that the City should increase the indemnities budget, improve its methodology for estimating and budgeting for indemnities, and align its indemnities budget with its CAFR[1]-projected aggregate loss deemed "probable" and "reasonably possible."

The City of Philadelphia issued a citywide strategic plan in 1995 as an appendix to that year's Plan. Since that time, several departments have provided PICA Staff with copies of their departmental strategic plans. With the exception of those put forth by the Mayor's Office of Information Services (MOIS) and the Water Department, the strategic plans provided to date have not been particularly impressive. However, they do provide some focus to the City's broad range of activities and a guide for how to proceed with improvements.

Based on the actions of the Rendell Administration to date, PICA Staff can only conclude that the City is not utilizing the strategic planning process to its full potential and is setting a poor internal planning precedent for future administrations.

PICA Staff is encouraged by the improvement shown by the City's Capital Program Office (CPO). In the past PICA Staff had urged that the Capital Program Office receive more attention from the City Administration. Serious steps have been taken to address PICA's concerns, resulting in a more professional and institutionalized CPO operation focused on maximizing the positive economic impact of the expenditure of capital project dollars.

With the reorganization of the capital program structure and the hiring of a Capital Program Director, PICA Staff now believes that the City will be able to achieve its stated aim "...to manage and complete capital projects with the ultimate goal of carrying out our responsibilities faster, cheaper, and with greater quality." This will be an area of PICA Staff attention for years to come.

[1] City of Philadelphia, Pennsylvania Comprehensive Annual Financial Report, Fiscal Year Ended June 30, 1997

Non-General Fund Concerns

The Philadelphia Gas Works (PGW) has an important place in the City's economic future. The most significant challenge confronting PGW is preparing for private market competition. The debt-laden municipal utility faces the unsavory prospect of being outmaneuvered in a free market. Although the current management is confident that they can operate effectively in a private market, PICA Staff is not convinced that the net impact of deregulation will benefit the City or otherwise hold the General Fund and taxpayers harmless. PGW is subject to political pressure, union challenges, a high debt load, and significant numbers of delinquent accounts. As a publicly owned utility, PGW does not have the flexibility that its private market competitors have.

Staff Recommendation

Notwithstanding identified potential risks to the General Fund and PICA Staff concerns expressed on such matters in this report and, only because the FJDP has instituted legal action which should timely resolve the matter of appropriating moneys known to be available to fund the Courts, the FY99-FY2003 Plan presents a reasonable prospect for balanced budgets in each year of its term.

PICA Staff recommends that the Pennsylvania Intergovernmental Cooperation Authority approve the Plan as submitted to the Authority on May 28, 1998.

Chart of Averted Quantifiable Risks to the Five-Year Plan

($ in thousands)

	FY 1999	FY 2000	FY 2001	FY 2002	FY2003	TOTALS
Major Risks						
Personal Property Tax[1]	(16,962)	(17,549)	(18,156)	(18,785)		(71,452)
Riverboat Gambling		(17,500)	(35,000)	(36,050)		(88,550)
Total Risks Averted for Each Year	(16,962)	(35,049)	(53,156)	(54,835)		(160,002)
Cumulative Total Averted Risks	(16,962)	(52,011)	(105,167)	(160,002)	(160,002)	

[1] Does not include a potential $58 million the City may be required to refund if this tax is successfully challenged.

Chart of Quantifiable Risks to the Five-Year Plan[1]

($ in thousands)

	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002	FY2003	TOTALS
Major Risks							
Unidentified Reductions		0	(5000)	(10000)	(15000)	(20000)	(50000)
Other Significant Risks							
Potential FOP Labor Contract[2]		(6900)	(19044)	(22881)	(23578)	(24522)	(96925)
Total Risks for Each Year		(6900)	(24044)	(32881)	(38578)	(44522)	(146925)
Cumulative Total Risks		(6900)	(30944)	(63825)	(102403)	(146925)	
Plan-Projected Fund Balance	132923	0	34624	33873	27271	51133	
Fund Balance if All Risks Realized	132923	(6900)	3680	(29952)	(75132)	(95792)	
Fund Balance if All Risks Realized as a Percent of:							
Individual Year		-0.3%	0.1%	-1.1%	-2.7%	-3.4%	
Cumulative Plan		-0.3%	0.1%	-0.4%	-0.7%	-0.7%	

[1] Assumes State takover of court funding in accordance with the Montamuro Plan.

[2] Projected Class 100 (personnel costs) impact if the next FOP contract runs from July 1, 1998 to June 30, 2000 and matches the 3% and 4% raises in FY99 and FY2000, respectively, as provided for in the IAFF, AFSCME District Council 33, and AFSCME District Council 47 contracts.

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STAFF REPORT ON FY1999-FY2003 FIVE-YEAR FINANCIAL PLAN

MITIGATED PRIOR CONCERNS AND AVERTED PRIOR RISKS TO THE PLAN

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PERSONAL PROPERTY TAX

Five-Year Financial Plans approved in prior years relied in part on revenues from the State-authorized Personal Property Tax (PPT). The Pennsylvania Supreme Court stopped short of resolving a challenge to the tax on constitutional grounds. The Justices did however declare that the tax "facially discriminates against interstate commerce."[2]

In the State Supreme Court ruling, the responsibility for determining the status of the PPT has been remanded to the Court of Common Pleas in Montgomery County, Pennsylvania. That Common Pleas Court must determine whether the tax is deemed a compensatory tax--a tax which "advances a legitimate local purpose that cannot be adequately served by reasonably nondiscriminatory alternatives."[3]

On April 7th, the President Judge of the Montgomery County Court was ordered by the Pennsylvania Supreme Court to appoint a trial judge to take up the case, which was then to be heard within 180 days.

Philadelphia had attempted to protect itself against the loss of an important revenue stream, and had also attempted to protect itself if the courts ruled that refunds of prior years' collections were required (potentially as much as $58 million) by approving an alternative two-pronged Personal Property Tax which did not require (rely upon) State authorization. The alternative PPT was intended to replicate the net revenue stream the City had previously enjoyed, while also covering any refunds that might be ordered by the Courts as a result of the ongoing litigation. PICA Staff, in last year's Plan Report, voiced its concern that the new tax, as then enacted, would be hard pressed to withstand legal challenge and presented a major risk to the Plan.

City Council subsequently passed legislation repealing the original PPT and also the portion of the alternative PPT designed to replace the ongoing annual revenue stream, while leaving in place the portion of the legislation designed to hold the City harmless in the event of a court ordered refund of the original State-authorized PPT.

Accordingly, the current Plan does not include $71.5 million in PPT revenues which the City had previously anticipated would be realized during the years FY 1999 through FY 2002. PICA Staff commends the City Administration for its decision to discontinue reliance on a revenue source with significantly questionable prospects of withstanding legal challenge.

The City has taken a prudent step which is totally consistent with a Rendell Administration primary strategic objective (as laid out in the City's Strategic Plan) to:

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[2] Annenberg v. Comm. Of Pennsylvania, J-109, PA S. Ct., 1, 1997
[3] Fulton Corp. v. Faulkner, 516 U.S. 325, 331, 116 S. Ct. 848, 854, 133 L. Ed. 2d 796, 805 (1996)

> ***Cut the Cost of Doing Business*** *by reducing taxes; by rationalizing and simplifying the tax structure; and by working for business cost reductions.*

The City's action in no longer relying on an untested and at best questionable revenue source is an encouraging sign of commitment to realistic future balanced budgets and financial plans.

RIVERBOAT GAMBLING

The City, in its FY 1996-2000 Plan, approved in the Spring of 1995, began projecting future (out year) revenues it anticipated would be realized from yet-to-be legalized Riverboat Gambling. Each subsequent Plan, up to and including last year, anticipated out year revenues from Riverboat Gambling. The major difference from year to year was that each year the anticipated future revenue stream was pushed back to start one year later in the out years of the Plan.

Last year's Plan anticipated a revenue stream which would begin in FY 2000. With each passing year, the probability of realizing this proposed revenue source became less plausible. Also, with each passing year this "new" revenue source became more of a concern for a successor administration. If the pattern established in the previous years had been repeated in the current Plan, all of the gaming revenue would have been projected to be realized by a successor administration.

In each prior year, PICA Staff questioned the reasonableness and appropriateness of relying on Riverboat Gambling proceeds as a viable revenue source. PICA Staff concerns relative to the prior Plan's inclusion of riverboat gambling revenues were that:

- Given the existing political realities, it didn't appear probable that Riverboat Gambling would be legalized in the Commonwealth in the projected time frame.
- Continually pushing the anticipated revenue out to future years was placing an onerous burden on a successor administration.

To mitigate PICA Staff concerns that the successful implementation of the previously approved Plans were too dependent upon a speculative new revenue source, the City consistently linked the successful recognition of Riverboat Gambling revenue with its continuation of the Wage Tax reduction program, which is of a similar magnitude, as follows:

> The Current Plan assumes that the progressive year-by-year reductions in wage tax rates ... will not be instituted if riverboat gambling is not legalized, unless a determination is made in future Five-Year Plans that the City can maintain a balanced General Fund budget on a long-term basis and sustain necessary City service levels if these rate reductions are carried out, even in the absence of legalized riverboat gambling.[4]

PICA Staff, in last year's Plan Report, pointed out that more than half of the time frame of that Plan would be under the governance of a successor administration; that the Plan created an expectation that the tax reduction program would continue past the tenure

[4] *City of Philadelphia Five-Year Financial Plan, Fiscal Year 1998-Fiscal Year 2002,* p. 6.

of the current administration; and that by including an unproven and potentially nonexistent revenue stream to keep the budget balanced in the last three years of the Plan, the current administration was not truly budgeting for the tax reductions in those years.

In recommending approval of last year's Plan, PICA Staff had indicated that since the budget would become dependent on riverboat gambling in FY2000, the final year of the Rendell Administration, it was once again “reasonable and appropriate” for the out year revenues to include such revenue; however, absent a change in sentiment in the State Capitol on the issue, PICA Staff indicated that it would be much more skeptical about recommending approval of any future Plan which included this anticipated revenue source.

PICA Staff had become increasingly wary of the ongoing practice as the years passed with no strong indication that riverboat gambling would be legalized in Pennsylvania.

In this year's Plan, the City Administration responded with a commendable course of action. Its removal of a previously anticipated $88.5 million of speculative revenues from the present Plan is much more fair to the successor administration, allowing that administration the freedom to choose between present and potential revenue sources. At the same time, it removed a major risk to future balanced budgets. The inclusion of Riverboat Gambling revenue in future plans without State and City legislation enabling gaming would make it very difficult for PICA Staff to recommend any such Plan approval.

METHODOLOGY FOR PROJECTING REVENUES AND EXPENDITURES

In previous years, PICA Staff, while acknowledging the City's ongoing improvement in projecting overall revenues and expenditures, continually criticized its methodology for projecting tax revenues and non-personnel, non-debt service expenditures. Subsequent to last year's Staff report, the City took the commendable step of purchasing and initiating use of a well regarded computerized economic modeling program.

PICA Staff is encouraged by the City's acquisition and adoption of more precise economic modeling methodology and awaits the improved results which are expected to be derived. The City's application of the new technology is still limited and consequently, PICA Staff intends to closely monitor its use in the months and years ahead.

Background on the REMI Model and the City's Application Thereof

In November of 1997, the City purchased an Economic-Demographic Forecasting and Simulating (EDFS) model from Regional Economic Models, Inc. (REMI). The model was designed with the objective of improving the quality of research-based decision making in the public and private sectors. It is calibrated to many subnational areas (states, regions, cities, etc.) for forecasting and policy analysis by government agencies, consulting firms, nonprofit institutions, universities and public utilities throughout the United States. Model simulations are used to estimate the economic and demographic effects of economic development programs, transportation infrastructure investments, environmental improvements, regulations and projects, energy and natural resource conservation programs, state and local tax changes, and other policy initiatives.

For the City's purposes, the REMI model is capable of taking more than twenty years of historic data and producing baseline projections of what can be expected in the regional economy in the future. Since acquiring the model, the Revenue Department and the Office of Budget and Program Evaluation have worked together to evaluate the revenue estimates that appear in the current Plan.

However, the estimates that appear in the Plan were derived independently of the REMI model. The baseline forecast from the REMI model was used as a method of verifying the reasonableness of certain trends that were assumed in the revenue estimates. In particular, the City focused on the REMI model's forecasts for employment, wages, and disposable income (as an indicator of sales tax growth) to compare its internally calculated projections with those of the model. In each case, the Plan indicates that the City's revenue forecasts were based on assumptions about the City's economy that were more conservative than conditions forecast by the REMI model.

It remains to be seen whether the differential between the City's projections and those of the REMI model are attributable to what the City has identified as its conservative approach to projecting revenues, or if the differential represents an inaccuracy which could be corrected by a broader application of the REMI model's forecasts in making projections.

Possibly Mitigated Prior PICA Staff Concerns Regarding Tax Revenues

PICA Staff, in reporting on prior Plans, voiced its ongoing concerns as to tax revenue projection methodology. It now appears that the actions taken by the City, in acquiring the REMI model and beginning to utilize it in Plan preparation, could finally quell PICA Staff's concerns with respect to tax revenue projections. Those concerns include:

- The City not using economic modeling in calculating tax revenue projections.
- Calculations which do not incorporate data on employment trends, population shifts, property values, retail and tourism activity, or other economic indicators.

Continued PICA Staff Concerns Regarding Tax Revenues

The City continues to experience a problem in projecting "prior year" (i.e., delinquent) tax revenue collections. Projections consist of replications of amounts shown as expected to be received in the current fiscal year, with minor adjustments in the out years. The City unfortunately does not presently consider the potential net effect of such factors as enacted and proposed tax changes or enforcement efforts on out year collections.

This City's method of developing prior-year collection projections can be partially attributable to data shortfalls. In the past, tax revenues were often attributed to the wrong tax year (due to technical deficiencies and human error). The historical data shortfall problem could be significant enough to render prior-year collection data unreliable for modeling purposes.

The City has begun to address this issue, most significantly as it relates to Business Privilege Tax payments for new business starts. It has thus raised PICA Staff's expectations that the ongoing acquisition and implementation of automated electronic data management systems will result in the problem finally receiving necessary attention and correction.

PICA Staff continues to assert that projections can be significantly improved by considering economic and collection trends--as is the case with the REMI model--in addition to the specific factors of rate changes, new collection efforts, or accrual changes. While the net impact of the methodological insufficiency may not be significant over a one-year period, the Plan's out years are vulnerable to substantive error--a matter of increasing concern given that collection of 85% of the revenues projected in the current plan will be the responsibility of a successor administration.

Continuing PICA Staff Concerns Regarding Non-Personnel Expenditures

The Plan's underlying obligation growth assumptions once again appear to be highly optimistic. The assumptions include no growth in FY99 for all classes of expenditures other than personnel and debt service and 1.5 % annual growth for each of the out years. These baseline assumptions are identical to the prior Plan's assumptions of no growth in the first year and 1.5 % annual growth thereafter.

These assumptions may result in severely underestimated expenditures, particularly in the out years, since it is unlikely that costs for contracted services, materials, supplies, and equipment will continue to grow at the assumed rate, which is less than half the projected rate of inflation. This point is exacerbated, once again, by the fact that 85% of the costs projected in the current plan will be the responsibility of a successor administration.

Since projections for individual departments often differ from the Plan's underlying obligation growth assumptions based on department specific issues and considerations, the impact of the overall assumptions may be limited. However, the City does not stipulate where the underlying assumptions are applied and where other considerations are taken into account. Thus, it is difficult to calculate the difference between the City's assumptions and costs that could be expected if expenditure growth more closely tracked projected annual inflation.

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Pennsylvania Intergovernmental Cooperation Authority

STAFF REPORT ON FY1999-FY2003 FIVE-YEAR FINANCIAL PLAN

MAJOR RISKS TO THE PLAN

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THE FIRST JUDICIAL DISTRICT OF PENNSYLVANIA

In last year's Staff Report, the First Judicial District of Pennsylvania (FJDP) was identified as a cost center of significant concern. The State Supreme Court had directed the Commonwealth of Pennsylvania to assume financial responsibility for the State courts on or before January 1, 1998. PICA Staff was concerned that (as happened) the City would be forced to maintain funding beyond the first six months of FY98. An additional concern was that, if the "zero-growth" budget agreement was not renewed, the City might be required to provide funding to the FJDP above and beyond what the City was known by PICA Staff to be holding in reserve in the Plan.

Subsequent to the approval of last year's Plan, the State Supreme Court appointed "Master" issued a four-phase plan, under which the Commonwealth is to gradually assume responsibility for statewide funding of a unified court system. However, Phase I of the Court Master's Plan (spanning FY 1999 through the end of FY 2000) and likewise the Commonwealth's adopted FY 1999 budget provides for only approximately $2.4 million in state court funds for the FJDP.

The current Five-Year Plan contains no direct appropriation for the FJDP. The City Administration has based its court budgeting policy on the contention that the State--in response to court rulings--will provide for all Pennsylvania court funding--including the FJDP. The State however has not budgeted for the majority of the FJDP's costs. The combined State and City actions have left the FJDP with a funding gap in excess of $100 million for FY99. The FJDP has instituted legal action to require the Mayor and City Council to appropriate such funding. PICA Staff is concerned that the City's failure to initially appropriate funds for a vital government function may jeopardize the viability of the Five-Year Plan.

Background on the FJDP

The FJDP is made up of three judiciaries that together comprise the Philadelphia Court System: Court of Common Pleas; Municipal Court; and Traffic Court. The FJDP is not a City department. It is a separate institution entirely under the direction and control of the Pennsylvania Supreme Court. Despite the lack of direct expenditure control authority, Philadelphia--like all of Pennsylvania's counties--is responsible for funding the bulk of it's court (FJDP's) costs locally, as part of the City's budget.

Predictably, being presented with a substantial unfunded mandate by the State, and with a lack of authority over the courts' operations, there has historically been disagreement over what amount the Philadelphia Courts require for annual operating funds and what the City should pay. This disagreement, worsened by the City's fiscal crisis, reached an impasse when the City rejected the FY91 budget request of the courts. Ultimately, the State Supreme Court intervened and created the FJDP. Consequently, beginning in FY92, the FJDP began to operate under an (adjusted) zero-growth (and zero-reduction) budget agreement between the City and the Supreme Court. That agreement has worked reasonably well in comparison to past practices and was last renewed on January 1, 1998.

Legal Rulings Related to Court Unification

In it's 1987 ruling in County of Allegheny v. Commonwealth of Pennsylvania, 517 Pa. 65, 534 A.2d 760 (1987) (hereinafter Allegheny I), the Pennsylvania Supreme Court voided county funding for local courts "as offending the constitutional mandate for a unified [judicial] system."[5] Until the 1996 successor case to Allegheny I, Pennsylvania State Association of County Commissioners, et al. v. Commonwealth of Pennsylvania et al., 545 Pa. 324; 681 A.2d 699 (Pa. 1996) (herein after Allegheny II), the Pa. Supreme Court had not sought to enforce its 1987 decision.

Following the 1987 decision in Allegheny I, the Pennsylvania Legislature did not attempt to execute the State Supreme Court's ruling--with the minor exception of appropriating $1 million for the purpose of studying the issue. However, those funds were not expended and subsequently lapsed back into the State's General Fund.

As a result of Allegheny II, in July of 1996, a Court Master was appointed to recommend a plan to implement the unification of Pennsylvania's various courts. What the Justices did in Allegheny II was to essentially grant the petition for a "writ of mandamus", a decree which set a deadline for the General Assembly to implement the unified funding scheme by January 1, 1998.

The City's Response to Legal Rulings on Court Unification

The Rendell administration has taken the position that "the General Assembly [should] accept its constitutional responsibility to fund Pennsylvania's courts adequately.[6]

Accordingly, last year's Five-Year Plan appropriated full funding for the FJDP in the City's proposed operating budget for the first half of FY98 only--July 1, 1997 through December 31, 1997--and then ceased any further appropriations to the FJDP. This policy of making no appropriation for the FJDP has also been followed in the current Plan and City budget--with the exception that this year there are no funds directly appropriated for the entire budget year or the period covered by the current Five-Year Plan. Funds to cover the second half of FY98 and all of FY99 were not entirely deleted from the plan, but rather, were placed into reserve accounts. Those funds for FY98 have since been returned to the account for the FJDP but only following full councilmanic procedures, including passing a transfer ordinance to officially return the funds to the FJDP accounts.

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[5] Pennsylvanians for Modern Courts, "Memorandum on Statewide Funding of Local Courts", July 1997, pg. 1.

[6] *City of Philadelphia Five-Year Financial Plan, Fiscal Year 1998-Fiscal Year 2002,* p. 207

The Administration has gone on record with its priorities, in the event that any new funds become available as a result of a transition of funding responsibility to the State. Those priorities include:

- to accelerate the City's multi-year tax reduction program;
- to support the Philadelphia School District, which faces a projected deficit of more than $85 million in FY99;
- and to support the City's Economic Stimulus Program.

The Court Master's Plan

Senior Justice Frank J. Montemuro was appointed by Order of the State Supreme Court to recommend a plan to unify Pennsylvania's various courts in July of 1996. During the course of his research, Justice Montemuro requested and was granted by the Supreme Court two ninety-day extensions for the delivery of his report.

On July 31, 1997, Justice Montemuro issued his report that outlined a four-phase plan--the first two phases of which would take place during the period from July 1, 1998 to July 1, 2000. Phase I calls for the State to take over the cost of funding of approximately 150 administrative court personnel statewide. According to the Administrative Office of Pennsylvania Courts (AOPC), of those 150 positions, the FJDP will account for twelve. Based on the figures provided by the AOPC, the estimated cost of funding those twelve court employees will total $2.4 million for both FY99 and FY2000.

FJDP Seeks Mandamus Action

The President Judge of the FJDP, recognizing that the City did not properly appropriate funding for the FJDP in the FY 1999 budget, instituted legal action to compel the Mayor and City Council to appropriate such funding on May 11, 1998.

While acknowledging that the City's efforts to speed Commonwealth funding of the courts is justified, PICA Staff could not endorse the City's course of action. Had the FJDP not forced the issue by its legal action PICA Staff would have recommended that the Plan not be approved.

Relevant Factors Considered in PICA Staff Analysis of City's FJDP Funding Strategy

PICA Staff had studied what it considered to be relevant factors, including:

- the Court Master's Phase I funding plan;
- the approved Commonwealth FY99 budget;
- the threat to the City of legal action by the FJDP;
- the City's ability to act in a timely manner to remedy the court funding crisis before the start of FY 1999; and

had initially concluded that such factors placed the City's ability to carry out a vital function of government in dire jeopardy. In accordance with the PICA Act and the PICA Agreement, PICA Staff felt it would have to recommend that the PICA Board not approve the Five-Year Plan until funding was properly in place for the Courts. This unfortunate situation thus jeopardized approval of an otherwise viable Plan.

Conclusion

Last year's Plan methodology of appropriating only six months of the First Judicial District of Pennsylvania (FJDP) funding was deemed viable in as much as it conformed to the existing circumstances. The decision by the City to take a "no-appropriation" stance--for FY99 and thereafter--was not deemed viable and appeared to jeopardize the continuance of a vital governmental function. However, due to the legal action initiated by the President Judge of the FJDP, final determination about requiring the City to appropriate such funding is now in the hands of the Courts for adjudication.

PICA Staff will continue to closely monitor the legal rulings related to court funding and likewise the actions taken by the City in response to those rulings. In absence of a court ruling favorable to the City, or Commonwealth provision of sufficient additional State funds to operate the FJDP, PICA Staff believes that the City of Philadelphia will be required to appropriate the funds currently being held in reserve accounts to the FJDP accounts. Further, under such circumstances, the City will be required to revise its funding policy as well as amend this and future Five-Year Plans in accordance with the guidelines set forth in the PICA Act and PICA Agreement.

PICA Staff is also concerned about the precedent setting nature of the City procedure of not directly appropriating but instead holding funds in reserve--as is the case with the FJDP. Under the current cooperative climate between this Mayor and City Council, the risk of those appropriations ending up anywhere but their intended destination is minimal. PICA Staff is not confident that under different conditions, with a successor Mayor and with a different Mayor/City Council relationship, that the appropriations in question could reasonably be expected to be viewed as secure.

TARGET BUDGETS AND UNIDENTIFIED "FUTURE TARGET SPENDING REDUCTIONS"

The Five-Year Plan anticipates a cumulative $50 million in unspecified expenditure reductions over its final four years as a result of the continued use of target budgets. PICA Staff has previously expressed its reservations as to the continued effectiveness of the target budget process. PICA Staff's concerns about the use of target budgets as a management tool which will continue to result in monetary savings have not been abated.

It is Unknown Whether Target Budgets Will Continue to be Effective

The target budget process was developed by the Rendell Administration as a way to contain spending to levels below the budgetary limits set by City Council. Following City Council's adoption of a budget, the Administration develops target budgets for each department and cost center, typically below the appropriated level. The savings generated by keeping to the target budget provide a cushion for unexpected revenue shortfalls or expenditure needs during the fiscal year.

Two years ago, PICA Staff noted a reduction in the size of the cushion created by the target budget process. Last year the target budget cushion returned to a level commensurate with that of previous years. This year's anticipated cushion is once again in proportion with previous years.

Cushion Created by Target Budget		
Period	Percent of Original Budget	Dollar Amount
FY93	1.35%	$30,975,746
FY94	1.48%	$34,062,475
FY95	1.59%	$37,838,312
FY96	.56%	$13,237,876
FY97	1.59%	$38,540,321
FY98	1.45%	$36,437,000

Source: *Quarterly City Managers Reports,* First Quarter FY93, FY94, FY95, FY96, FY97, and FY98.

In response to PICA Staff's expressed concerns on this matter, the City Administration indicated that target budget levels are based on circumstances unique to each year. PICA Staff then requested a list of the items under consideration for the years FY99 through FY2003 that might result in net obligation reductions of the magnitude specified. Thus far the City has not satisfactorily responded to that request.

There is Insufficient Explanation Regarding "Future Target Spending Reductions"

The Plan's projection of a positive General Fund balance after FY99 relies in part on significant savings anticipated to be achieved as a result of "Future Target Spending Reductions." The Rendell Administration has demonstrated that savings can be derived from the use of target budgets. However, in its projection of potential savings from this management tool, the City Administration has again recognized all of the anticipated savings from the unidentified reductions in the last four years of the Plan. Without adequate explanation of how the projected "Future Target Spending Reductions" might be achieved or any attribution of reductions to particular departments, it is difficult for PICA Staff to gauge whether the Plan's projected out year savings are reasonable.

PICA Staff continues to believe that under current circumstances--even in absence of sufficient supporting data--it is *possible,* although in no way certain that the Rendell Administration can achieve savings from the use of target budgets during its tenure.

We feel obligated to go on record that a continuing effort to project balance based on undisclosed areas of probable cost cuts will likely precipitate an adverse response next year. That will be the current administration's final Five-Year Plan; and four-and-a-half years (or 90%) of that Plan will be under the governance of a successor administration.

The Intergovernmental Cooperation Agreement between the City and PICA requires that a new Mayor, within ninety days of assuming office, either propose revisions to or adopt the then existing Plan. PICA Staff believes it vitally important that he or she not be faced with the problem of accepting responsibility for unidentified spending reductions.

Conclusions

PICA Staff recognizes that target budgets are an innovative and currently effective management tool which to date have had a direct positive impact on expenditure levels. However, PICA Staff remains skeptical about relying upon them to reduce forecasted expenditures in future years. PICA Staff would not consider it appropriate for an administration facing the closing days of its tenure to commit its successor to unidentified cuts which if not undertaken or achieved, would jeopardize balanced budgets.

Therefore, PICA Staff henceforth will require adequate evidence that projected budgets are balanced based on specific objectives. Conversely, PICA staff will view projected budgets which rely upon the proposed use of any management tool that may not be effective or in existence in the future as unnecessarily risky, and as posing a significant threat to Plan approval.

Pennsylvania Intergovernmental Cooperation Authority

STAFF REPORT ON FY1999-FY2003 FIVE-YEAR FINANCIAL PLAN

SIGNIFICANT RISKS TO THE PLAN

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LABOR CONTRACTS

The Rendell Administration successfully concluded labor agreements and arbitration negotiations with all four of the City's major collective bargaining units in 1996. Except for the contract with the Fraternal Order of Police, Lodge 5 (FOP), which expires at the end of FY98, those agreements cover the first two of the five years in the Plan.

Paying for the Current Contracts

PICA Staff applauds the City's attempt to identify sources of anticipated ongoing savings to help fund the cost of the labor contracts. In addition to savings resulting from the contracts themselves, reductions in PICA debt service payments as a result of a PICA debt refunding and reduced electricity costs resulting from a negotiated arrangement with Peco Energy are earmarked to the increasing costs of the labor contracts. Nonetheless, the bulk of such labor costs will have to be borne by the General Fund without specific savings or new revenues identified to pay for them.

To help cover the costs of the present contracts in FY99 and FY2000, the City anticipates utilizing a projected FY98 surplus of $132.9 million. Once the accumulated surplus is spent down, the Plan, which until last year relied on questionable revenues (Riverboat Gambling Taxes--$88.5 million--and the Personal Property Tax--$71.5 million) now primarily relies upon unidentified Target Spending Reductions ($50 million over the life of this Plan) to maintain budget balance under the present labor contracts. PICA Staff is concerned about whether or not the City will be able to pay for the continuing costs of its labor contracts once its accumulated surplus is spent down.

The Uncertainty of the Next FOP Award

In discussing the cumulative costs of the current labor contracts, the City Workforce chapter of the Plan assumes that the FY98-FY2000 FOP negotiated settlement or arbitration award will follow that of the International Association of Firefighters, Local 22 (IAFF) contract for FY99 and FY2000. However, the Plan's Police Department expenditure projections provide no increase in police personnel costs that may result from the FOP contract process. This results in a cumulative underestimate of approximately $97 million over the time frame of the Plan.

PICA Staff recognizes the City's concern that Plan provision of any amount for an unknown labor contract outcome would compromise the City's ability to negotiate. However, it is important to remain aware that the current administration has an obligation both to be prepared for the result of the negotiation/arbitration process and to ensure that the next administration is not burdened with inappropriate additional labor costs.

Redesigning Government Initiative

As part of the labor contracts, the City agreed to a two-year moratorium on new competitive contracting initiatives that would result in either layoffs or demotions of current City employees. A labor-management initiative was established with AFSCME District Councils 33 and 47 that aims to improve services and minimize costs for selected City functions.

The Office of Labor Relations is the coordinating City office for this initiative, which is also benefiting from the assistance of Harvard University's John F. Kennedy School of Government. The City is attempting to concentrate this effort on areas it had previously identified for its competitive contracting initiative. Other areas for improvement may also be identified during this process.

PICA Staff is disappointed that the City has given up the ability to contract out activities, even if for only two years. On the other hand, since the people who serve on the front-line in unionized positions often know best how to improve city government, there is great potential for labor-management cooperation on improving city government.

Considering that progress to date has been limited to a small number of department-specific initiatives with few quantifiable gains, PICA Staff remains skeptical about what the net benefit might be for this otherwise innovative approach.

THE EFFECTS OF WELFARE REFORM ON SERVICE DEMANDS

In March of 1997, both the State and Federal governments enacted dramatic welfare reform legislation that has already altered eligibility and the level of support provided to those in need. The enacted changes will continue to be phased in over the next few years.

It is likely that the most dramatic impact will occur during, or shortly after March of 1999. This is when the two year countdown is complete for approximately 38,000 heads of households in Philadelphia who currently receive benefits--the majority of which are single mothers. At that point, unless these individuals are working at least twenty hours per week, or are involved in "work-related" activity such as vocational training, they will no longer qualify for public benefits.

These changes are expected to increase the demand on City services and may pose an increasingly significant risk to the Plan.

Welfare Reform Described

Numerous financial supports have been (and are being) taken away from low-income City residents. With few exceptions, Pennsylvania's legal immigrants no longer qualify for Food Stamp benefits under the new Federal legislation. In addition, as many as 18,000 legal immigrants residing in Philadelphia could still possibly lose their Supplemental Security Income and/or Medical Assistance. An additional 352,000 residents will see a reduction in Food Stamp benefits. Eighteen thousand residents will become ineligible for General Assistance under the State’s new eligibility guidelines, adding to the 25,900 who lost General Assistance over the previous two years because of other caseload reductions. The State has also eliminated Medical Assistance coverage to an estimated 62,000 Philadelphians considered “able-bodied adults” who do not work at least 100 hours per month.

The State’s new welfare plan eliminates the $50 child support pass-through to custodial parents, reducing the cash income of many families in need. The plan also enacts Federally mandated work requirements and lifetime limits of five years. Over the long term, these latter two elements will reduce the number of families eligible for assistance with no guarantee that those who lose it will no longer be in need of such assistance.

Federal welfare reform mandates that Food Stamp eligibility for childless “able-bodied adults” be limited to three months out of every three years, unless the individual is working 80 hours per month. For the second consecutive year, Pennsylvania has successfully requested and received a waiver of this mandate for a number of “surplus labor” vicinities, including Philadelphia. However, the waiver covers only one year, and there is no guarantee that it will be renewed each year thereafter.

The City has estimated that during the current fiscal year, its citizens may lose as much as $374 million in benefits. The potential loss of this income within the City will likely have multiplier effects throughout the City's economy, lowering the flow of money and possibly resulting in a loss of jobs and City tax revenues. More directly, as individuals lose cash and health care benefits, they often turn to the City in greater numbers for assistance.

These Reforms will Lead to Increased Demands on City Services

Philadelphia has lost over 100,000 jobs since 1988. Yet, thousands of government assistance recipients are now being required to find jobs. In addition to an insufficient number of jobs, there is often a disparity between the educational level of government assistance recipients and current employer needs. Without a realistic opportunity for most of these individuals to find work to provide self-support, they will begin to turn elsewhere for the support they need.

As described by one State Department of Public Welfare regional administrator, "[Welfare reform] has nothing to do with saving money. It doesn't save any money at all. It's about shifting costs."[7] The City, under existing law and political realities, has become the provider of last resort for many social services; and will in all likelihood attempt to meet the increased need, notwithstanding the current Administration's comments to the contrary.

To date, individual City department representatives have been unable to thoroughly quantify the impact of welfare reform in fiscal terms, or on service demand in general. However, they all indicate that there has been an impact. Further, while these individual representatives have exhibited a reluctance to make specific projections as to what the impact of welfare reform will be going forward, all recognize the significance of the March 1999 deadline and are devoting much attention to preparing for the inevitable surge in demand for services.

The Office of Emergency Shelter and Services (OESS), the Department of Human Services (DHS) and the Department of Public Health (DPH) are the City entities that will most likely have to absorb the greatest burdens resulting from welfare reform.

OESS

OESS provides emergency shelter and homeless prevention services. Demands for these services are expected to increase as greater numbers of people lose resources they depend upon to maintain a home. Evidence indicates that the number of homeless individuals has already increased, not only because of welfare reform measures but also

[7] Bill Hangley, Jr. and Erin Mooney, "Health Care and Welfare: A Brief Assessment of the Impact of Welfare Devolution on Medicaid, Medical Assistance and the Greater Philadelphia Region," 21st Century League, March 1997, p. 20.

due to the cumulative effects of the State General Assistance reductions. Simultaneous to this increased demand for shelter is the expectation that State and Federal funding for these services will continue to be scarce.

DHS

Based only on the State welfare reform legislation, DHS projected two years ago that demands on child welfare services will dramatically increase. Part of the anticipated increase is attributed to certain foster family households that, to date, have relied on cash assistance and are now expected to turn to foster care payments because of the work requirements and time limits associated with cash assistance. The rest of the anticipated increase is attributed to cuts in public assistance that are expected to increase service demand as the result of increased poverty and its associated sociological problems.

Due to the vagaries of the State's needs-based budget process, DHS has not projected any effect resulting from the State changes in annual plans that it presented to the State. For FY98, DHS, in information provided to PICA, projected that referrals would increase by 10% (1,398) and caseload would increase by 1,500 (a 13% increase from a caseload of approximately 11,500). The Federal welfare changes are expected to increase caseload projections even further.

DPH

The elimination of Federal Medical Assistance benefits to legal immigrants, certain disabled children, drug and alcohol addicts, former General Assistance recipients, and those who do not meet work requirements is not expected to result in a decreased need for health care. Indeed, it is projected that without primary preventative care, those who need medical attention will wait until their situation worsens, leading to higher costs for individual cases. In those situations, hospital emergency rooms will probably be called upon to absorb the demand and the associated costs for those services.

For primary care services, however, many residents who lose their benefits will turn to the City's district health centers, which historically have served all requests for care regardless of insurance status. The district health centers have seen an increase in the number and proportion of visits that are not covered by insurance. In addition to greater numbers of citizens lacking primary care health insurance, the anticipated declining state of the health of the City's population as a result of a loss of other assistance is likely to increase service demands on the health centers. In an attempt to meet this increased demand, the City's FY 1999 budget for district health centers includes a $1 million increase over the prior commitment.

Simultaneous to eligibility changes, the Medical Assistance (MA) population is being shifted to a managed care system. Due to changeover confusion, it is expected that many individuals will not properly register for MA benefits, or will not designate the district health centers as their primary care facility, but that they will still use the health centers for primary care needs. DPH is implementing systems to keep such instances to a minimum. It is unknown how successful the department will be. Additionally, given the competitive nature of the managed care arrangement, the district health centers will be challenged to retain enough insured patients to continue to support services for the uninsured.

The City's Efforts to Reduce the Negative Impact of State and Federal Welfare Reform ("Greater Philadelphia Works")

On April 13, 1998, the Mayor introduced "Greater Philadelphia Works" (GPW), a plan which incorporates $50 million in Federal funds to attempt to move 15,000 of the approximately 65,000 Philadelphians currently receiving public assistance into jobs over the next two years. The GPW plan will attempt in each of the next two years to place, train and keep 7,500 welfare recipients in jobs. The aim is keep welfare recipients employed by monitoring their progress from training to job placement.

Key elements of the GPW plan include:

- Businesses in the region will give welfare recipients jobs or training
- SEPTA will add bus routes to transport workers to City and suburban job locations
- Federal funds will allow the City to provide placement assistance and personal job counselors to help ensure job retention
- Federal funds will allow the City to pay for extended childcare.

The $50 million is part of $3.1 billion in direct aid to cities for welfare reform. Unfortunately, the formula that State Department of Public Welfare used to calculate Philadelphia's share of Pennsylvania's funds is based on caseload and not on the City's ability to locally fund programs to replace State and Federal welfare. Therefore, the City, an already revenue-strapped municipality, will be called upon to pay the majority portion of the fiscal and social costs of welfare reform.

The Future Effects of Welfare Reform are Unknown

The effects of welfare reform will grow over the next several years, even without further narrowing of eligibility or funding reductions. In spite of the City's aggressive, proactive efforts to stem the tide of current welfare recipients turning to the City for assistance, these efforts will barely make a dent in closing the gap between the number of individuals coming off welfare and the lack of locally available jobs.

Perhaps what is most disturbing about the devolution of responsibility for public welfare from the Federal and State governments to the City is that the already financially overburdened City is being forced to create and maintain a new welfare system. Unless the Federal or State governments reverse course, the City will continue to face a growing challenge to balance an increasing demand for social services with decreased revenue for those services. The City will need to be vigilant not to spend beyond its means in these areas. The current administration has made clear its commitment to financial responsibility. However, given the emotional and political aspect of these services, the political climate in both the Federal and State capitols, and the apparent collision course on which the City's welfare recipients appear to be headed, it will be difficult for the City to maintain such a commitment and remain within its fiscal limitations.

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Pennsylvania Intergovernmental Cooperation Authority

STAFF REPORT ON FY1999-FY2003 FIVE-YEAR FINANCIAL PLAN

OTHER GENERAL FUND CONCERNS

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UNFUNDED PENSION FUND LIABILITY

As has been discussed in prior PICA Staff Reports, the City remains burdened by a significant unfunded pension liability. Approximately 50% of the actuarially determined Pension Fund liability has been funded. The unfunded benefit obligation presently exceeds $2.6 billion.

This shortfall may in fact be underestimated because of the City's aggressive assumption that the Pension Fund will earn a 9% annual return on its investments, (10.1% earned in FY97). However, utilizing that assumption, the City is following a schedule which presently purports to eliminate the unfunded liability by FY 2019.

The present payment schedule for eliminating the actuarially determined unfunded liability requires gradually increasing annual General Fund payments to an amount of more than $250 million--(approximately $37 million of which will be State funded) by FY 2003, the final year of this Five-Year Plan. The payment required at the end of the liability reduction schedule would be more than double the FY 2003 amount.

The present pension obligation funding methodology is based on past State and Court mandates. Currently, the City increases its contribution annually at an actuarially determined rate, with the intended result being that the unfunded pension liability will be eliminated by the year 2019.

In an effort to reduce the adverse impact of growing annual payments to its Pension Fund, the City, in 1997, proposed amendments to PA Act 205 which the State legislature has enacted. The amendments allow the City to change its unfunded liability amortization program once the Pension Fund reaches a 70 % funded level. The City expects that to occur in the year 2012. Once the Pension Fund has been 70 % funded, the City will be allowed (under the new amendments) to annually reset a ten-year payment schedule to eliminate the remaining unfunded liability.

Each year's payment to the Pension Fund would be based on a ten-year schedule--a ten-year rolling amortization. While the Pension Fund would never be fully funded, it presumably would always be approaching fully funded status. The amendments will thus enable the City to extend its liability reduction pension payments beyond FY 2019. The City's annual payment would decrease after FY 2012, however with the implementation of the 10 year amortization methodology, *the City will eventually pay a billion and a half dollars more out of the General Fund for its Pension Liability than it would have otherwise paid.*

The City's actuaries project that 70% funding would provide sufficient assets to cover all accrued benefits at that time. (In laymen's terms, if the City went out of business at that point, its future pension liabilities for services to that date would be covered.) Pension funds typically try to accumulate funding in excess of actuarially-projected current benefit accruals to partially mitigate increases resulting from future pay increases and plan changes. Such additional funding acts as a cushion to reduce the future need for increased contributions.

PICA Staff acknowledges that the State's enactment of the City proposed amendments to PA Act 205 permits the City (if it exercises the right to do so) to reduce what presently appear to be potential budget-busting payments from the General Fund in the years to come. PICA Staff is pleased that the City is continuing to explore our prior year suggestion pertaining to possible issuance of pension bonds. PICA Staff is uncomfortable with the potential risk of additional annual contributions being required if the Pension Fund fails to meet its 9.0% annual earnings assumption. Accordingly, we suggest that the City urgently consider other reasonable and responsible solutions to help reduce its Pension Fund liability payments from the General Fund in future years.

INDEMNITIES

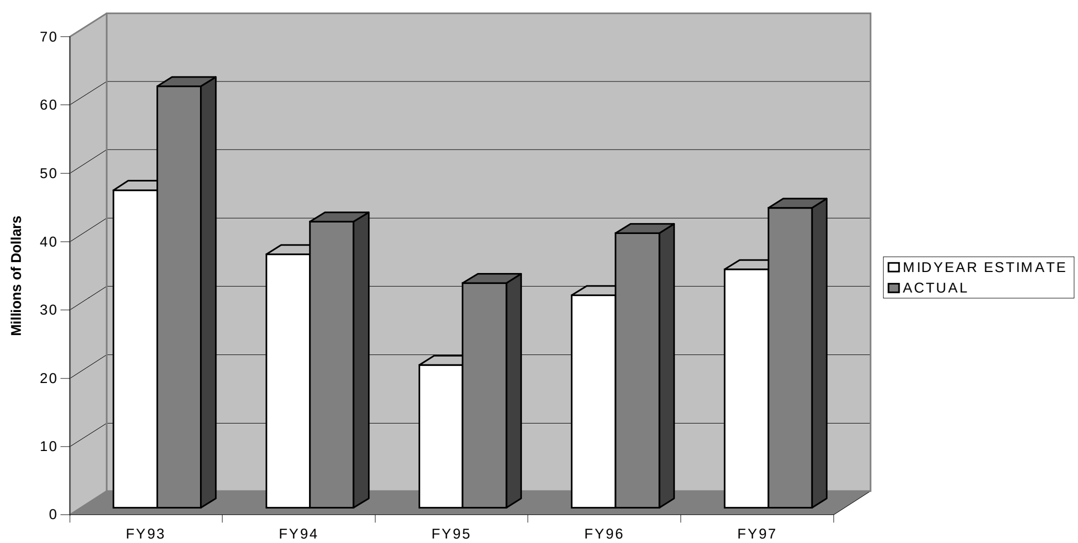
PICA Staff has consistently admonished the City regarding its indemnity budgeting methodology, deeming the process inadequate and the results achieved grossly imprecise. PICA Staff's call for placing a higher priority on efforts to improve the accuracy of projections continues to be ignored.

Inaccurate Indemnity Budgeting Fails to Identify $48.5 million in Costs to the City

In last year's Staff Report, it was noted that actual annual indemnity costs have consistently exceeded the Five-Year Plan estimates. The chart below demonstrates the difference between estimated and actual costs. PICA Staff had projected that the FY97 $34.9 million mid-year estimate of indemnity costs was, once again, significantly below what the actual figures would be.

PICA Staff's projection of an appropriation shortfall was again accurate. The FY97 actual indemnity costs to the General Fund were $43.9 million **(26% higher than originally budgeted)**. The City's track record with respect to projecting indemnity costs shows a clear pattern of underestimating such costs.

Comparison of Estimated and Actual Indemnity Costs



Note: Mid-year estimate is as presented in the respective Five-Year Plan

PICA Staff again strongly urges that the City adopt a rational indemnity budgeting methodology. PICA Staff views this year's Five-Year Plan's indemnity cost estimates as once again being highly questionable. By virtue of consistently underestimating the FY93-FY97 costs for indemnities, the City was exposed to an aggregate $48.5 million of initially unanticipated costs to the General Fund.

The City Faces Marginally Decreased Aggregate Risk

The City's Comprehensive Annual Financial Report (CAFR) for the year ended June 30, 1997 estimates an aggregate risk of the cost of future indemnities in the General Fund as a "probable" $99.1 million, a 5% decrease from the prior year. The CAFR's estimate of aggregate "reasonably possible" indemnity costs in the General Fund totaled $112.7 million--an 8% decrease from the prior year. While PICA Staff is encouraged by the marginal reduction in the aggregate risk reported for financial statement purposes, we do not consider that as justification for maintaining the current methodology of preparing Plan indemnity cost projections.

Conclusion

Recognizing the difficulty inherent in budgeting for indemnities, PICA Staff in the report on the previous Five-Year Plan recommended the City Finance and Law Departments work together to improve the methodology for estimating and budgeting for indemnities, and align its indemnities budget with its CAFR-projected aggregate loss deemed "probable" and "reasonable possible." The City has yet to act on PICA Staff's recommendations. Consequently, the City's General Fund is once again potentially exposed to a significant understatement of indemnities costs over the life of the current Five-Year Plan.

STRATEGIC PLANNING

The City of Philadelphia issued a citywide strategic plan in 1995 as an appendix to that year's Plan. It stated that all operating departments would be expected to complete their own strategic plans by the end of September 1995 and indicated that copies would be provided to PICA Staff as they were completed. Since that time, only five departments have provided PICA Staff with copies of their departmental strategic plans--or a report as the reasons for their delay in executing the planning process. With the exception of those put forth by the Mayor's Office of Information Services (MOIS) and the Water Department, the departmental strategic plans provided to date have not been particularly impressive. However, they do provide *some* focus to the City's broad range of activities and a guide for proceeding with improvements.

PICA Staff understands that the City has numerous priorities and that focusing on a strategic planning process can be challenging and seemingly superfluous. However, such a process is vital to preparing for future challenges. As the City has already discovered, proper strategic planning can surface creative, service enhancing and money saving ideas and help to build a dedicated and enthusiastic workforce. Unfortunately, based on the actions to date, PICA Staff can only conclude that the City Administration is not making the strategic planning process a serious priority.

The Process Behind the City-Wide Strategic Plan was Top-Down

The 1995 city-wide strategic plan was developed primarily from the input of senior City officials. There was some representation from the private sector and from a handful of community organizations. However, as PICA Staff has previously noted, the process failed to include sufficient representation from the City's numerous neighborhood groups, town watch groups, local foundations, businesses, or city residents at large. This resulted in a strategic plan that focuses on the basic mainstays of the Rendell Administration but which did not build a constituency interested in the overall planning process or its outcome.

The City primarily operates under what PICA Staff has previously described as an intuitive, top-down management style. During the period of the City's dire fiscal crisis this style proved necessary and useful. However, PICA Staff believes the Administration now needs to shift its management style to a more inclusive, bottom-up structure. It remains vitally important that the central administration provide a unified vision and that it keep a handle on the financial and service level operations of each department. However, where possible, decision-making should be shifted down the hierarchical ladder to enable front-line employees to more efficiently and effectively identify service needs and handle job demands.

A strategic planning process incorporating the input of a wide range of employees at different levels of the city hierarchy, or even of individual departments, would provide a more diverse range of perspectives and ideas, as well as being more likely to garner the support and commitment of a greater number of City employees.

The Strategic Plan Itself is Insufficient

The strategic plan, a 42-page compilation of graphs, charts, and narrative, has no overarching mission statement for the City. The 140-word vision statement includes at least six distinct areas of focus. Each of the ten primary strategic objectives has three to five strategies. The city has not yet formally reported on these strategies, or on the Plan's 63 Measures for Progress.

A formal strategic planning process is not a one-time endeavor. It must be constant and ongoing and result in the following:

1. A mission statement for the organization
2. An environmental scan and conclusions about future scenarios in a three- to five-year period
3. Basic goals for the time period in the scan, and goals for the coming one-year period
4. Strategies and action steps that will move the organization toward the goals
5. Implementation plans that assign responsibilities for action steps.[8]

The City needs a succinct mission statement. It should then spell out specific and measurable goals and objectives that should be tracked to ensure that the mission is being pursued. Departments can then develop strategies and action plans that explain how they are going to contribute to the overall City goals and objectives, in addition to any goals and objectives the departments may have beyond the city-wide ones. The Administration and City Council can then measure departmental progress in implementing strategies and action plans and see whether they are helping attain city-wide goals and objectives. This process then needs to begin over again, with a reevaluation of the City's mission, goals, and objectives, making sure that they are still relevant and comprehensive.

The City's strategic plan of three years ago did not provide for such outcomes. Its strategic planning efforts continue to lack a mission statement and implementation plans with assigned responsible parties.

Even a statement as simple as "City government must do all it can to create the environment for a working economy that will provide good jobs and real opportunity for its citizens"[9] would be appropriate for a mission statement.

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[8] Gerald L. Gordon, Strategic Planning for Local Government, Washington, D.C.: International City/County Management Association, 1993, p. 9.
[9] *Philadelphia 2000 - Strategic Plan*, City of Philadelphia, January 1995, p. 3.

There has been no Formal Follow-up to the City-Wide Strategic Plan

According to the City administration, the City attempted to document the progress made toward the goals of the citywide strategic plan. The final report ended up looking very much like the Five-Year Financial Plan. What is needed is not a recital of the City accomplishments to date. What is needed is an inventory of what still needs to be done, not only from the goals of the original strategic plan but also from an ongoing process that evaluates the changing demands on City government.

The City needs to ensure that it is continuously focusing on its long-term goals. The only way to do this, and to show the public that it is doing so, is to report on a regular basis (even if only every two or three years) that its goals are still appropriate and that it is making progress toward them.

The Failure to Fully Commit to Strategic Planning has set a Poor Precedent for Future Administrations

The City has failed to thoroughly utilize strategic planning. Consequently, its ability to identify and achieve goals that will benefit current operations has been hindered. The result is a lost opportunity to institute a mindset with City managers and the general workforce that could benefit Philadelphians for many years beyond the tenure of the current administration.

This latter point will be more acute in FY2000, as a new administration takes control of City government. The lack of an adequate commitment to strategic planning sets a poor example and precedent for that new administration about how contemporary municipal governments should view and execute strategic planning. PICA Staff will continue to scrutinize the City's efforts and hopes for an emphasis on strategic planning both now and in the next millenium.

Conclusion

PICA Staff can only conclude what is painfully obvious. The City continues to view its strategic planning process as a low priority. This lack of attention limits the City’s ability to plan for the future and diminishes the value of efforts which have been made on both the city-wide and departmental strategic plans. Continuing to view the process as less than a high priority will impede any future strategic planning effort and benefits.

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CAPITAL PROGRAM OFFICE

PICA Staff is pleased that the Capital Program Office (CPO) appears to be meeting its stated goals of completing projects "faster and [potentially] cheaper…". The CPO has been reducing costs through generally better assessment of project costs and by taking advantage of processing efficiencies. The CPO has also demonstrated both upgraded information reporting and the improved general management of capital projects. These developments were highlighted during the CPO's annual meeting with PICA Staff.

The CPO is Decreasing the Project Backlog at a Rate Equivalent to Stated Goals

The Capital Program Office is on target to achieve the goal of reducing the capital project backlog. Previously, the Capital Program Office identified a backlog of 137 projects that were more then one month behind schedule. Now, 68 of those projects (or 50%) have been completed as of the midpoint of FY98. This effort has allowed the CPO to achieve its FY98 goal. At the current rate of progress, CPO is on target to achieve its stated goal of eliminating the aggregate project backlog by the end of FY99.

The Capital Program Office has Introduced Project and Administrative Efficiencies

The CPO has introduced three main efficiencies that have the long-term potential to reduce the cost of capital projects. First, professional service contract awards are now issued within three weeks. Second, consultants' payment invoices are processed within thirty days. Third, cost analyses of projects have become more accurate, which in turn provides more accurate project budgets and further reduces the chance of inadequate funding of projects.

These actions are likely to have two significant effects. First, they appear to be reducing administrative overhead costs. Second, and perhaps more importantly, these efficiencies may result in a reduction of the premium which the City is charged by contractors seeking to cover their costs (real or perceived) for dealing with an inefficient bureaucracy.

The Capital Program Office has Adopted Improved Tracking and Management Systems

Since last year's Plan Report the CPO has presented ongoing reports to PICA Staff with regard to the tracking of groups and projects. These reports have been improved to include a higher level of detail than past reports. One report, a monthly status and activity report, provides general information on the activity of the Capital Program Office. A second highly detailed internal report lists each project, funding and scheduled sub-phase of activity. While the second report does not presently appear to be in wide use, its quality far surpasses that of previous project status reports.

The Capital Program Office has Merged Fairmount Park with its Operations

PICA Staff is encouraged that the CPO has merged Fairmount Park's capital program with its operations. The CPO's rigorous reorganization will only benefit the administration of Fairmount Park's capital program, and ultimately the citizens of Philadelphia.

PICA Staff Encourages the City to Act Promptly to Implement a Plan to Disqualify Non-performing Contractors

PICA Staff strongly encourages proactive efforts by the Law Department and the Procurement Department to join with the Capital Program Office in developing a plan to disqualify non-performing contracting firms. Non-performing contractors frequently tender the lowest bids and therefore receive many City contracts. Unfortunately, the substandard work performed by poorly qualified contractors often results in higher costs to the City, as a result of both cost overruns and delays from having to re-bid.

Conclusion

PICA Staff has generally been an aggressive, vocal critic of the operation and performance of the CPO. PICA Staff is now encouraged about the CPO's future prospects. We are pleased to acknowledge the major strides taken by the CPO to improve both its structure and management of its projects and groups. Nonetheless, PICA Staff will continue to closely monitor the Office's progress as it takes the next steps in aiding the City to take advantage of a leaner, more efficient citywide capital infrastructure operation.

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NON-GENERAL FUND CONCERNS

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PHILADELPHIA GAS WORKS

The most significant challenge confronting the Philadelphia Gas Works (PGW) is preparing for private market competition. The debt-laden municipal utility could very likely be outmaneuvered in a free market. Although the current management is confident that they can operate effectively in a competitive market, PICA Staff is not yet convinced. PGW is subject to political pressure, union challenges, a high debt load, and significant numbers of delinquent accounts--partially attributable to a relatively disadvantaged service population. As a publicly owned utility, PGW does not have the flexibility that its private market competitors have.

Competition will Require more Competitive Prices

Given the utility's current price structure, PGW may not be able to compete with private providers in the residential market. Currently, PGW's heating customers pay significantly more than suburban Peco Energy gas customers do for the same amount of gas.

In an open market, PGW also may not be able to continue its subsidy programs for senior citizens and low-income customers. In 1997 alone, the total cost for these subsidy programs was $41.96 million, nearly 8% of PGW's operating revenue. More strikingly, the cost of these subsidies was 75% higher than PGW's net income of $23.97 million.

Open market competition is presently allowed only for non-residential users--an area where PGW has already seen deterioration in its share of the market. Competing energy utilities have already moved into this area to offer lower rates than PGW, leaving PGW to rely on revenues from residential customers. At present, commercial customers account for less than 5% of PGW's approximately 515,000 customers and slightly more than 27% of annual revenues.

A 1996 *Philadelphia Inquirer* three-part series extensively detailed the many challenges confronting PGW. One of the findings of the series was,

> PGW has already seen much of its industrial load flee for cheaper alternatives. Almost all of its large customers buy their gas from brokers, whose costs are lower than those of regulated utilities such as PGW.[10]

Another telling example of how keen the competition will be is the insight provided by Harold Connelly, former vice president of PGW, in July 1995 that competition would erode PGW's customer base "within a year or two, if that."[11]

PGW's High Debt Load, While Still Debilitating, Has Made Some Recent Progress

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[10] Andrew Maykuth, "The heat is on the gas works," *The Philadelphia Inquirer*, February 18, 1996, p. A1.
[11] Ibid.

PGW continues to carry a high debt load, which severely limits its access to capital. PGW's debt-to-equity ratio remains a hefty 2.6 to 1, down from the more severe debt-to-equity ratios of 3.3 to 1 3.7 to 1, for 1996 and 1995 respectively. The high outstanding debt load and a relatively low bond rating have placed serious limits on PGW's ability to access capital.

In 1997, PGW was able to fund 90% of its capital expenditures through internally generated funds. For three years, PGW has not entered the capital market. However, PICA Staff has been told that PGW anticipates entering the capital markets during the summer of 1998 to issue bonds with a total value of $300 million ($100 million in new borrowing, $25 million for a Philadelphia Facilities Management Corp. (PFMC) lease, and $175 million in refunding of existing debt.)

The Status of Legislative Efforts to Deregulate Residential Natural Gas in Pennsylvania

On March 27, 1997, a bipartisan coalition of State legislators proposed introducing competition in the residential natural gas market. Since that time a statewide group of stakeholders, including representatives from the City and PGW has been meeting under the direction of the Pennsylvania Public Utilities Commission (PUC).

The proposal currently in development is similar to last year's legislation deregulating the electric industry, which focused on providing customers with a choice of commodity providers on the open market, while maintaining regulatory control over the distribution to customers.

To date there has been no vote in the State legislature on a gas deregulation bill and it appears that action will likely be postponed until after the November elections. The message for PGW however, should be clear. All indications are that it is a matter of when and how, not if, residential gas will be deregulated.

PGW's Strategic Plan

PICA Staff is encouraged that PGW's management has enacted a strategic plan with the ultimate goal of creating a competitive private market culture. But, changing an institutional culture as ingrained as PGW's takes time. Still, the strategic plan appropriately emphasizes customer service, core business growth, cultural transformation, efficiency and cost reduction, and new business opportunities. Only, time and continued careful scrutiny will tell how successful their efforts will be.

PGW is Aggressively Pursuing New Customers

PGW has also aggressively pursued new customers and business opportunities. One major success is the partnership with Allegheny University to build and operate an energy plant for its Hahnemann campus. After an open bidding process, which included a number of private sector energy suppliers, PGW won the bid. Included in the arrangement is a provision that gave PGW the option to be a service provider to other Allegheny University sites. What is encouraging is that PGW won the bid based on its high level of service, although its price was higher than some of the competitors.

PGW has entered a cooperative agreement with QST Energy Co. (a subsidiary of a Peoria, Ill., energy company) to market electricity under the PGW brand name during the State's electric deregulation pilot program. This experience should help PGW to gain advanced knowledge as to how it can best respond to an open and competitive market.

In an effort to win new accounts, PGW has also formed a partnership with the American Gas Association to set up a financing mechanism to convert potential customers to natural gas.

PGW has Increased Collections

Another notable recent success is that PGW has increased collections. PGW has stepped-up collection procedures, which include placing liens on property served by PGW on which the customer is delinquent. One PGW official projected a resulting 10% to 20% decrease in delinquent accounts receivable for 1997. This is in addition to a drop in accounts receivable from $228 million in March 1995 to $187 million in March 1996. Even with the progress, outstanding delinquent accounts receivable remain high.

Conclusion

It is not likely that PGW and its ratepayers will feel any direct effects, positive or other wise, during the coming fiscal year as a result of gas deregulation. However, it is reasonable to project that at some point during the life of the current Five-Year Plan there will be dramatic change, both internal and external.

Notwithstanding its excellent current successes, PGW is still structurally at a competitive disadvantage. Given the subsidies it is required to provide, a decreasing captive customer base that is relatively disadvantaged, a high debt load, and a burdensome structure of governance, PGW cannot easily cut costs or react quickly to a changing market. Even if PGW successfully woos several large commercial accounts, the business practice of subsidizing costs for such accounts will work only in the near term.

At this stage, PGW recognizes that it cannot compete in the residential market on price alone and has opted to focus on providing a high level of service. However, natural gas is a commodity and consumers may well seek the lowest price with only transient consideration of service, as many commercial and industrial entities have already done.

PICA Staff is concerned that PGW, which as recently as a few years ago was regularly being touted as a potential source of "windfall profits" to the City through sale and privatization, may now have entered an era in which its potential becomes increasingly negative as a significant drain on the City's financial and competitive status. For all these reasons, PICA Staff will continue to closely monitor developments in the State legislature as well as the progress that PGW makes in an effort to prepare for competition.

Pennsylvania Intergovernmental Cooperation Authority

STAFF REPORT ON FY1999-FY2003 FIVE-YEAR FINANCIAL PLAN

APPENDIX A

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APPENDIX A

Statutory Background, Plan Review Methodology and Summary of Events

Overview

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

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

Statutory Basis -- The PICA Act

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

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

avoid default on existing obligations and chronic cash shortages that will disrupt the delivery of municipal services;

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

(A) increased managerial accountability;

(B) consolidation or elimination of inefficient city programs;

(C) recertification of tax-exempt properties;

(D) increased collection of existing tax revenues;

(E) privatization of appropriate city services;

(F) sale of city assets as appropriate;

(G) improvement of procurement practices including competitive bidding procedures;

(H) review of compensation and benefits of city employees; and

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

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

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

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

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

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

(2) Plan components that will:

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

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

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

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

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

(c) Standards for formulation of plan:

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

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

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

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

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

(1) be in such form and shall contain:

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

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

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

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

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

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

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

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

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

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

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

(i) are consistent with the Financial Plan;

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

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

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

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

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

City Reporting and Variances

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

> (i) a net adverse change in the fund balance of a Covered Fund of more than one percent (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.

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

Plan Review Methodology

Staff Report - The Plan, as approved by City Council on March 26, 1998, was submitted to PICA by the Mayor on May 28, 1998 and the PICA Act provides a 30 day period for review which expires June 29, 1998. Authority Staff has consulted with the City, both on the departmental level and otherwise, since the Plan was initially submitted to City Council by the Mayor on January 27, 1998 and has referred to material presented to City Council and the Controller's Office, as well as information included in reports submitted by the City to PICA and other data developed by PICA Staff. This report includes reference to materials received by the Authority through May 15, 1998.

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

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

Apart from labor-related revisions, or those required by declaration by PICA of a variance in the Plan in the future, the Plan is subject to mandatory revision on March 23, 1999 (100 days prior to the end of FY99). At that time, the City is required to add its

Fiscal Year 2004 to the Plan and make any other alterations necessary to reflect changed circumstances. Under the PICA Act, the City may determine to revise the Plan at any time and submit the revision to the Authority for its review.

Accounting Concerns - The PICA Act requires that a modified accrual accounting system be used in 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:

Estimated 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 does not on its face meet the requirements of the PICA Act and Cooperation Agreement inasmuch as it excludes funding specifically earmarked for the FJDP. However, PICA Staff after both determining that funding is available (budget reallocation required) and that the litigation commenced by the FJDP should resolve the funding responsibility issue, has deemed it appropriate to recommend approval.

Summary of Events to Date/Future Focus

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

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

PICA has provided in excess of $1,109 million in funding to assist the City, allocated to the following purposes:

Purpose	Amount (thousands)
Deficit Elimination/Indemnities Funding	$ 256,200
Productivity Bank	20,000
Capital Projects	452,081
Retirement of Certain High Interest City Debt	381,300
TOTAL	**$1,109,581**

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

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

Whether PICA will also become involved in the financial oversight of the School District of the City Philadelphia is a matter that presently is in the hands of the Supreme Court of Pennsylvania.

Future City Reporting to PICA

Absent the occurrence of a variance, receipt of an arbitration award which is at variance with the Plan or a determination by the City that further revisions to the Plan are necessary, the City will not submit a revised Plan to the Authority until March of 1999. During future months, the Authority will receive quarterly reports on the City's performance under the Plan, together with other data.

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

> Quarterly Plan Reports. The Authority receives reports from the City on a quarterly basis (45 days after the end of each fiscal quarter) concerning the status of compliance with the Plan and associated achievement of initiatives. The remaining quarterly reporting deadline for FY98 is August

17, 1998. Quarterly reporting deadlines for FY99 are November 16, 1998, February 15, 1999, May 17, 1999 and August 16, 1999. The Cooperation Agreement also requires that the City provide reports to PICA concerning Supplemental Funds (*i.e.*, the Water and Aviation Funds) on a quarterly basis.

Grants Revenue Fund Contingency Account Report. The Cooperation Agreement provides that a report on the Grants Revenue Fund Contingency Account be prepared and submitted, by department, not later than 20 days after the close of each fiscal quarter, and still to be received relating to FY98 is the report due July 20, 1998. For FY99, the reporting dates are October 20, 1998, January 20, 1999, April 20, 1999 and July 20, 1999. This report details the receipt and use of Federal and Commonwealth Funds by the City, as well as the eligibility for fund withholding by the Commonwealth at PICA's direction in the event the City cannot balance the Plan after an extended period of intensive reporting and PICA review of proposed corrective efforts.

Prospective Debt Service Requirements Reports. The Cooperation Agreement requires submission of a report detailing prospective debt service payments by the City, as well as lease payments, 60 days prior to the beginning of a fiscal quarter. The dates for submission of such reports for FY99 are August 3, 1998, November 2, 1998, February 2, 1999 and May 3, 1999.

Pennsylvania Intergovernmental Cooperation Authority

STAFF REPORT ON FY1999-FY2003 FIVE-YEAR FINANCIAL PLAN

APPENDIX B

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APPENDIX B

Schedule of Findings, Office of the City Controller

In accordance with Section 4.04(g) of the Intergovernmental Cooperation Agreement between PICA and the City, the City Controller's Office submitted to PICA its report upon the Plan forecasted General Fund financial statements for the fiscal years ending June 30, 1999 and June 30, 2000, including its opinion that the underlying assumptions provide a reasonable basis for City management's forecast and also, at the request of the PICA Board, a report upon the results of agreed upon procedures with respect to the Plan. PICA Staff is grateful for the assistance provided by the Controller's Staff in evaluating this Plan.

The Schedule of Findings of the Controller's Office resulting from its work with respect to the Plan, formally reported to PICA on May 28, 1998 (in conjunction with receipt of the Controller's report upon the performance of agreed upon procedures) is reproduced in this Appendix. Certain of such findings have been previously discussed in this report from a PICA Staff perspective. PICA Staff believes the reader will gain added value from a review of the Office of the Controller perspective on such matters.

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CITY CONTROLLER'S OFFICE
AGREED UPON PROCEDURES TO THE FIVE - YEAR FINANCIAL PLAN
FOR THE YEARS 2001 THROUGH 2003
SCHEDULE OF FINDINGS

ECONOMIC AND GENERAL FUND REVENUE FORECASTS

The Controller's forecast of local economic activity is roughly consistent with the assumed growth implicit in the Plan's revenue projections. The forecast assumptions are predicated upon (1) continuation of Wage and Business Tax reductions proposed throughout the life of the Plan, and (2) continued growth in the national economy, albeit at a slower pace compared to the recent past.

Wage & Earnings Tax

Uncertainty surrounding merger and acquisition activity poses a serious risk to the recent improvement in the City's employment picture. As a result of local industry restructuring, in combination with a slower growth national economy, the Controller's Office is currently forecasting a drop in City payroll employment of 0.2 percent between 1998 and 1999. We expect growth in the average wage paid across City establishments to keep Wage Tax base growth above an inflationary pace over the next two years.

Findings:

- ✓ The Plan's base growth estimates through FY 2000 are roughly consistent with Controller's economic projections.
- ✓ The Plan's estimates assume that tax reduction and other economic development policies will work to improve the City's employment picture in the out years. Yet, the Plan includes no explicit measure of exactly how many jobs will be created by these initiatives.
- ✓ The Plan's base growth forecast of wages and employment for out-years rely, in part, on a structural economic model developed by Regional Economic models Inc (REMI). A Controller's Office review of the baseline projections produced by this model found an upward bias in the forecast of employment.
- ✓ The Plan cites tightening labor markets to support the assumption of average wage growth remaining above inflation through the out-years. This assumption is inconsistent with continuation of strong profitability assumed in the Business Privilege Tax forecast. Moreover, the labor market is expected to loosen considerably when the recent changes made to the welfare laws are brought to bear.

Real Estate Tax (Current)

The Controller's Office assumes that the Commercial and Industrial real estate markets will continue to be shaped by three patterns. First, industry restructuring and technological improvements in the labor and capital markets will continue to reduce the need (demand) for space. Second, favorable prices, generated by the slack demand, will induce some speculators to jump into the real estate market. Third, most of this speculation activity will continue to be concentrated in the hotel sector. In an effort to be conservative, the Controller's Office is assuming that the two forces will completely offset one another, yielding flat market values throughout the life of the plan.

Findings:

- ✓ The Plan assumes that there will be modest assessment growth through FY 2003. Thus, the implicit assumption is that speculation activity will outweigh the disinflationary pressures from technology and industry restructuring. The Plan also assumes that assessment growth will be met by an extremely low level of appeal losses through FY 2003. While the Controller's Office agrees with the possibility of modest improvement in real estate market activity, it is likely that the Plan's appeal loss assumption is much too aggressive.

Personal Property Tax

The State Supreme Court recently ruled that the Personal Property Tax was unconstitutional. However, this was a *preliminary* ruling. The case was remanded to Montgomery County Common Pleas Court for a *final* ruling on whether or not the tax is constitutional. The lower court is also expected to determine, if declared unconstitutional, whether or not counties are liable for a refund. In the event that counties are held liable for a refund, the City is expected to institute a one-time, one-year, tax levy against all stocks.

Findings:
- ✓ To date there is a high degree of uncertainty surrounding the legality of the new City Tax levy. In particular, there is a possibility that the new tax may be in violation of the Sterling Act. If the new tax is successfully challenged the potential liability for Philadelphia could be in excess of $55 million.

Business Privilege Tax
Beginning in FY 1999, there will be a change in the definition of who is subject to this tax. Currently, many local establishments in such industries as retailing and wholesaling operate at a competitive disadvantage since their suburban counterparts are able to make transactions inside the City limits without paying the Business Privilege Tax. In an effort to make the business environment more competitive in the City, liability for the BPT will be extended to any firm with ongoing activity in the City of Philadelphia.

Findings:
- ✓ The Plan assumes that this initiative will garner $3 million in FY 1999, then grow steadily to $9.0 million by FY 2002. While the Controller's Office agrees with this initiative from a policy standpoint, to what degree it can be enforced remains an issue. As a testament to this uncertainty, Plan estimates regarding the level and growth drawn from this initiative appear simply arbitrary.

Department of Human Services
Federal funding to DHS will be drastically altered under the new Personal Responsibility and Work Opportunity Reconciliation Act. Beginning March 1, 1997, Title IV-A entitlement spending was rolled into a fixed allocation to the states under the new Temporary Aid to Needy Families (TANF) Block Grant. The Plan assumes that reduced funding to DHS as a result of the Welfare changes will be met by additional moneys under Title IV-E and the Commonwealth under its Act 148 obligation.

Findings:
- ✓ To date, there is a considerable amount of Title IV-E money available due to the strong national economy. As such, most of the Title IV-A shortfall has been compensated for through additional billing under Title IV-E. However, in the event that the Title IV-E money becomes scarce, there is a high degree of uncertainty regarding the response by the Ridge Administration.

First Judicial District of PA
The Plan assumes that the Commonwealth will assume the financial responsibility of funding the First Judicial District (FJD) throughout the entire Plan forecast horizon.

Findings:
- ✓ The fact that there is no direct appropriation for the FJD in the City budget is inconsistent with the State Budget. It is also inconsistent with the recent transfer ordinance calling for the City to fund the FJD through the end of Fiscal Year 1998. As a result, the Other Government and Locally Generated Non-Tax revenues to the First Judicial District reported in the Plan are incorrect.

- ✓ Monies set aside for economic stimulus and additional tax reduction in the City's budget are likely to be used to fund the courts in the event the Commonwealth continues to follow the interim report issued by Special Master, Justice Frank Montemuro. Thus, in this instance we would expect no net impact on the City's fund balance.

GENERAL FUND OBLIGATIONS FORECAST

Base Methodology
The City's General Fund Obligation growth assumptions as presented in Appendix V – Base Methodology of the Five Year Plan - are deficient and misleading. The projected General Fund obligations as presented in Appendix III of the Plan increase and decrease at rates different from the obligation growth rates shown in Appendix V.

In particular the projected growth rates for Class 500 (Contributions and Indemnities), Class 800 (Payments to Other Funds) and Class 900 (Advances and Miscellaneous Payments) are misleading. The base methodology shows Class 500 obligations increasing by 1.5% annually over the life of the Plan. However, Appendix III shows these obligations to be increasing at an average rate of just 0.8% annually. In addition, while the base methodology in Appendix V shows Class 800 and 900 obligations to grow at 1.5% annually over the life of the Plan, Appendix III shows the Class 800 obligations to be relatively stable and Class 900 obligations decreasing by 1.4% over the life of the Plan.

Payroll
The Plan makes no provision for police salary increases beyond FY 1998. It seems likely that the police officers will receive a salary increase, as the Fraternal Order of Police, representing police officers, is actively involved in an arbitration process with the City. The no salary increase assumption in the Plan is especially unlikely in light of the fact that the three other City unions have negotiated wage increases through FY 2000.

In addition the Plan makes no provision for any salary increases for either uniformed or non-uniformed employees beyond FY 2000.

First Judicial District of Pennsylvania
The Plan does not provide direct appropriations for the First Judicial District of Pennsylvania (FJDP). As a result, the Governing Board of the First Judicial District has filed a *mandamus* action against the City. However, the Plan does include funding in other departmental categories that could be used to fund the FJDP. The Administration and Council have substantial latitude to reallocate the funds that have been included in other departmental categories. Thus, there is no guarantee that funds will be available should the FJDP be successful in its mandamus action.

Recent information from the Commonwealth shows that the FY 1999 General Appropriations Act failed to include any funding for the First Judicial District other than the $1.2 million appropriation required under the Montemuro plan.

Debt Service
A comparison of the current General Fund General Obligation Bond maturity registers to the related debt service schedules, indicates the General Fund Debt Service Obligations to be over-estimated throughout the life of the Plan.

The Plan estimates short-term borrowings will be $325 million with an interest rate of between 6% and 7% over the life of the Plan. Given that the last two short-term notes were issued at a premium and had an interest rate of approximately 4.50%, we believe these estimated interest rates may be overly aggressive.

The Plan also includes commitment fees and arbitrage payments related to long-term debt of $3 million and $850,000, respectively over the next five years. The City has not utilized any type of credit enhancement for the last three (3) short-term note sales. Based on this, we believe that the City will not need, or use, any credit enhancement for its short-term borrowings in the future. Nor do we believe that the City will be subject to any arbitrage payments over the life of the Plan.

Capital Plan
Our agreed upon procedures applied to the FY 1999 Capital Budget included in Appendix VI of the City's Five Year Plan included agreeing the Plan amounts to the City Planning Commission's six year funding schedule for FY 1999-2003, and verifying the mathematical accuracy of both. In addition, we determined that all projects in the FY 1999 Capital Budget were capital in nature.

We also computed the current and future legal debt capacity and compared potential debt service costs associated with the Capital Plan with projected debt service costs shown in the General Fund section of the Plan. Again, as stated in the Debt Service section of this schedule, we believe that debt service obligations are over-budgeted throughout the life of the Plan.

OTHER FUNDS

Aviation Fund

Based on our procedures applied to the Aviation Fund, we continue to see little risk to the City for those cost centers which the City shares risk with the airlines if there is a deficit, namely the Outside Terminal Area (OTA) and the International Gates.

The Division of Aviation continues to achieve surpluses from the OTA. These surpluses are carried in the Aviation Fund Unrestricted Cash Account. For FY 1998 the amount is projected to be $26.5 million. Division of Aviation representatives have stated that these holdings, plus any interest earned will be used to insulate the General Fund from having any need to contribute to the Aviation Fund over the life of the Plan.

Water Fund

Water Department management continues to assure PICA officials that there is minimal risk that the General Fund will not receive the “annual scoop” transfer of approximately $4.1 million. The Water Department continues to cut costs at both their wastewater treatment and biosolids recycling center, as well as achieve savings through an ongoing debt restructuring. As a result of these cost cutting measures and increased delinquent collections through the enforcement of the Utility Services Tenant’s Rights Act, Water Department management sees no risk in the “scoop” being eliminated over the life of the Plan.

Cash Flows

The cash flows presented in Appendix IV of the Plan for FY 1998 and FY 1999 are consistent with the estimates for General Fund revenues and obligations as presented in Appendix III of the Plan, and forecast for the monthly distribution of revenues and obligations appears reasonable. The cash flows as presented, however, do not add up to the revenue and obligation estimates that are included in Appendix IV of the Plan. The error is in the presentation of the figures shown for each month in the cash flow schedules. Subsidiary lines in both the revenue and obligation section appear as though they should be included but are not.