PICA Staff Report
on the
City of Philadelphia's
Quarterly City Manager's Report

Third Quarter of FY2007

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May 22, 2007

PICA Staff Report on the City of Philadelphia's Quarterly Report
Third Quarter of FY2007

Overview

The Quarterly Report projects that the City's fund balance will drop by $83 million to $172 million during FY07. The fund balance is projected to fall because of the continuing rapid growth in the costs of employee healthcare, pensions, prisons and debt service.

The projected FY07 fund balance and the projected total FY07 revenues and obligations are all consistent with the amounts included in the FY08-FY12 Five-Year Plan that the Mayor submitted to City Council in February.

FY06's actual obligations were approximately $14 million lower than the FY06 3rd quarter report's projections. Based on recent history, it is likely that FY07 obligations will be close to or slightly below current projections.

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Overview (cont.)

FY06's actual tax collections were approximately $90 million higher than the FY06 3rd quarter report's projections. The largest contributors to this increase included the business privilege tax (BPT) which ultimately exceeded the projection by $44 million and the real estate transfer tax (RTT) which ultimately exceeded the projection by $20 million.

Whether the City will meet or exceed its revenue projections in FY07 will depend in large part of the strength of BPT collections and the last two months of wage tax collections. The other major tax revenues – property, RTT and sales – are all close to projection. The RTT in particular is failing to achieve the rapid growth of the past several years as the Philadelphia real estate market slows.

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Overview (cont.)

The City needs tax revenues to again be substantially higher and obligations to be lower than its 3rd quarter report projections if it is to be able to cover the FY08-FY12 Five-Year Plan's risks.

The Plan's major risks include the following:

- the FY08 budget has approximately $80 million more in state and federal funding for the Department of Human Services than the State has certified;
- the Plan still assumes that PGW will repay its $45 million loan;
- the Plan includes no money for salary increases for the four years not covered by current collective bargaining agreements;
- the Plan has more aggressive wage tax base growth than previous plans; and
- the Plan does not include additional funding to help alleviate the fiscal challenges confronting the School District of Philadelphia and SEPTA.

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Projected General Fund Balance for FY2007 in Quarterly Report: **$171.7M**

Projected General Fund Balance for FY2007 in the FY08- FY12 Plan: **$171.7M**

Change in General Fund Balance from the FY08-FY12 Plan: **$ 0M**

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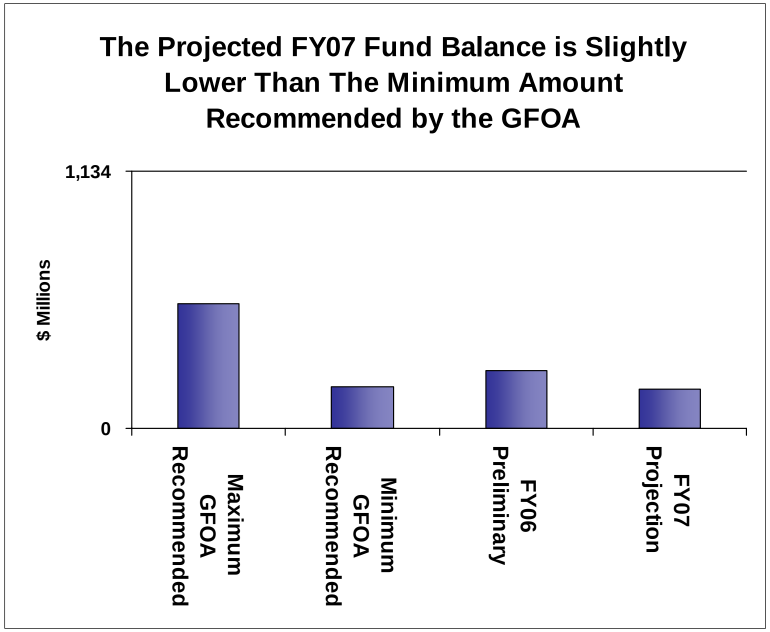
Fund Balance

- The projected FY07 fund balance is slightly lower than the minimum amount recommended by the Government Finance Officer's Association.
  - The GFOA recommends that fund balances be 5% -15% of revenues in order to provide contingencies against unexpected events during the year;
  - At $172M, the City's projection is about $11M lower than the minimum balance that the GFOA recommends and $365M lower than the high end of the Association's guidelines.
- While the City's projected FY07 fund balance is close to the minimum level recommended by the GFOA, it almost certainly will fall further below that level in FY08 and the other years included in the Plan.



Revenue Projections

Projected General Fund Revenues for FY2007 in Quarterly Report:	**$3,651.1M**
Projected General Fund Revenues for FY2007 in the FY08-FY12 Plan:	**$3,651.1M**
Change in General Fund Revenues from the FY08-FY12 Plan:	**$ 0M**

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Obligations Projections

Projected General Fund Obligations for FY2007 in Quarterly Report:	**$ 3,753.9M**
Projected General Fund Obligations for FY2007 In the FY08-FY12 Plan:	**$ 3,753.9M**
Change in General Fund Obligations from the FY08-FY12 Plan:	**$ 0M**

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Key Revenue Projections: Taxes

- The Quarterly Report projects that taxes will equal the amounts projected in the FY08-FY12 Plan, but the accuracy of that projection will depend in large part on business privilege tax collections and May and June wage tax collections.
- It is likely that combined real estate transfer, sales and property tax will be close to projection.

Tax	FY07 in FY08 Plan	FY07 in Quarterly Report	Change (in millions)
Wage/ Earnings	$ 1,141.4	$1.141.4	**$0.0**
Business Privilege	$ 408.0	$408.0	**$0.0**
Real Property	$407.8	$407.8	**$0.0**
Real Estate Transfer	$ 210.0	$210.0	**$0.0**
Sales	$ 135.0	$135.0	**$0.0**

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Key Revenue Projections: Local Non-Taxes

- The Quarterly Report projects receipt of the Eagles' $8M rent in FY07. The rent was initially due in FY02, but is now the subject of a legal dispute between the Eagles and the City.
- The quarterly report projects that the City will receive $6 million from the sale of City assets, but no revenue from a strategic marketing initiative. In the FY07 budget, the strategic marketing initiative had been projected to generate $2.5 million and the sale of assets was projected to produce $10 million.

Item	FY07 in FY08 Plan	FY07 in Quarterly Report	Change (in millions)
Licenses and Permits	$44.4	$44.4	**$0.0**
Court Fees and Fines	$33.8	$33.8	**$0.0**
Emergency Medical Service Fees	$26.0	$26.0	**$0.0**
Interest Earnings	$23.0	$23.0	**$0.0**

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Key Revenue Projections: Revenues from Other Governments

- In the Quarterly report and the FY08-FY12 Plan, the City drops its projection for the amount of reimbursements that it will receive for FY07 costs incurred by the Department of Human Services by over $30 million from the amount included in the FY07 budget, in part because of reduced estimated costs. The Plan, however, assumes that reimbursements will increase by $75 million in FY08.
- The City projects that its largest other sources of revenues from other governments will all equal the amounts projected in the FY08-FY12 Plan.

Item	FY07 in FY08 Plan	FY07 in Quarterly Report	Change (in millions)
Human Services Reimbursements	$ 543.7	$543.7	**$0.0**
Pension Aid – State Act 205	$57.7	$57.7	**$0.0**
Health Department Reimbursements	$ 56.0	$56.0	**$0.0**
Parking Authority	$22.0	$22.0	**$0.0**
Convention Center Offset	$21.7	$21.7	**$0.0**

Major Changes in Obligations Projections

- While the six largest expenditure areas for the City are projected to equal the amount included for FY07 in the FY08 budget, they are estimated to increase by just under $240 million – 10% -- in just one year.

Item	FY07 in FY08 Plan	FY07 in Quarterly Report	Change (in millions)
Employee Benefits	$880.0	$880.0	**$0.0**
Department of Human Services	$592.5	$592.5	**$0.0**
Police	$495.9	$495.9	**$0.0**
Prisons	$206.7	$206.7	**$0.0**
Debt Service	$191.8	$191.8	**$0.0**
Fire	$188.7	$188.7	**$0.0**

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Key Financial Issues Raised in Quarterly Report:

- Reduction in Fund Balance
- Expenditure Growth
- Volatile Revenue Sources
- Reduced Reliance on Wage Tax
- Cuts in Federal Reimbursements
- Philadelphia Parking Authority

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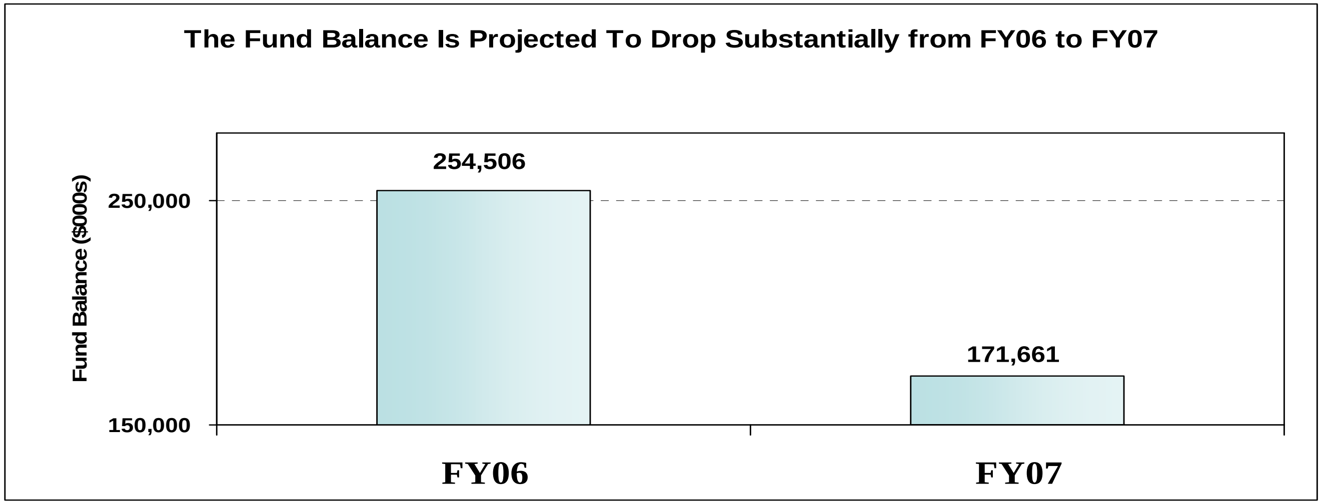
Key Financial Issues Raised in Quarterly Report:

Declining Fund Balance

The quarterly report projects an $82.8 million drop in the City's fund balance as expenditures are projected to grow more quickly than revenues. If the City does not correct that imbalance between revenues and expenditures, it is likely that the City will run deficits before the end of the plan period.



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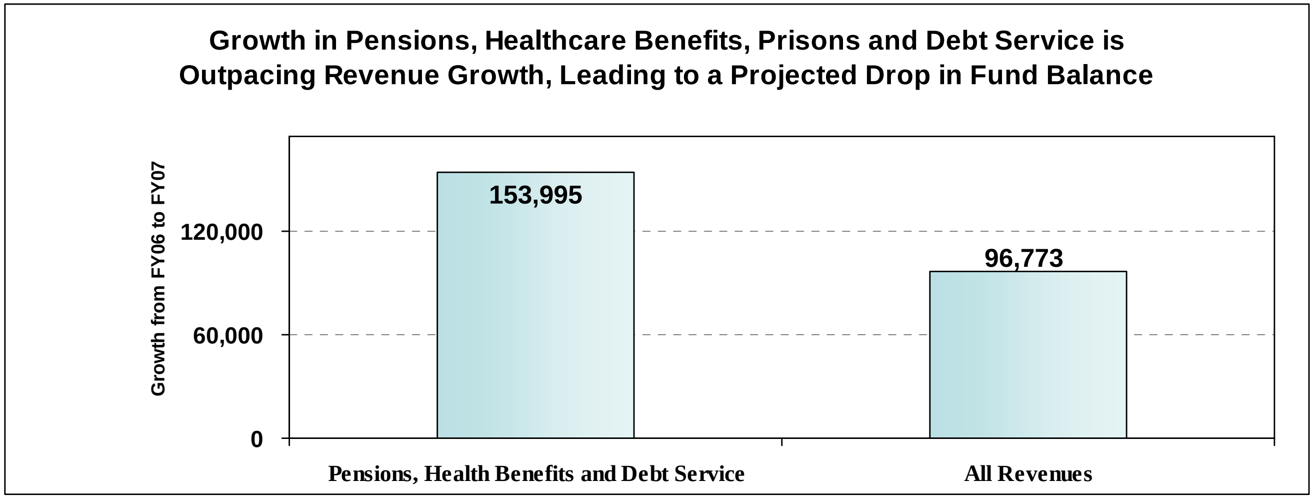
Key Financial Issues Raised in Quarterly Report:

Declining Fund Balance

The fund balance is declining in large part because pensions, health benefits, debt service and prisons costs are growing far faster than revenues. These items are projected to grow by a combined $154 million from FY06 to FY07 while revenues are projected to grow by $97 million. The four items, combined with costs for the Department of Human Services, have grown from 38% of the budget in FY01 to a projected 46% of the budget in FY07.



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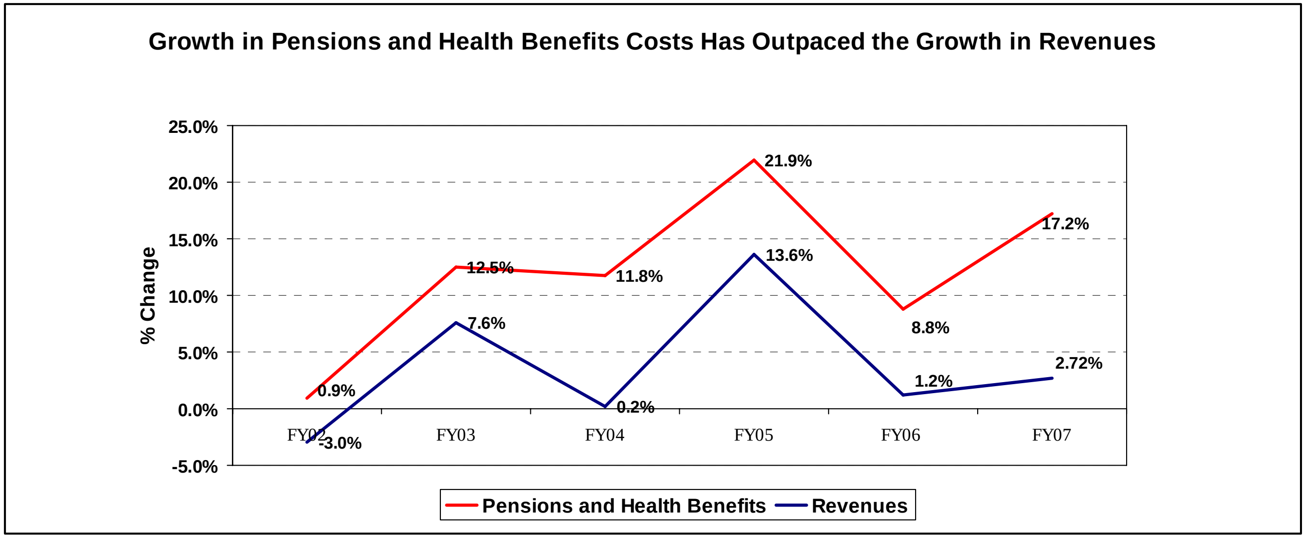
Key Financial Issues Raised in Quarterly Report:

Expenditure Growth

The difference between the growth rates for revenues and just two of the fastest growing expenditure areas – pensions and health benefits – helps illustrate that revenue growth cannot keep up with these items' dramatic growth. Pensions and health benefits have grown faster than revenues in each of the last six years, with this year's gap eclipsing those of the previous five years.



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Key Financial Issues Raised in Quarterly Report:

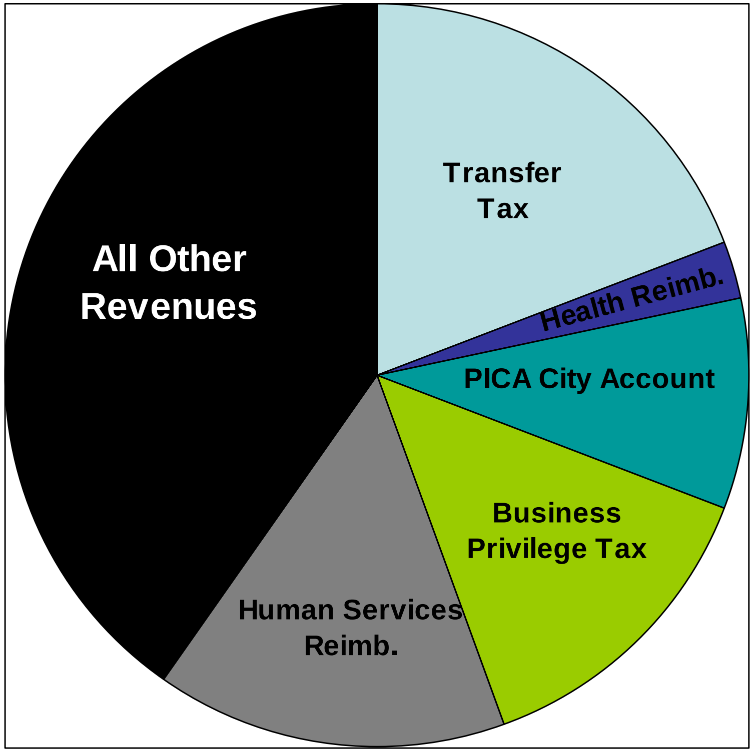
Volatile Revenue Sources

- About 60% percent of the growth in revenues from FY01 through the FY07 projections is from only five sources (*see chart*).

- With the exception of the PICA City Account, all of these revenue sources are highly volatile. BPT revenues and the state and federal reimbursements each have declined in at least one year since FY01 and transfer tax collections, which are highly dependent on the strength of the real estate market, have declined in FY07.

- Excluding these five areas, revenue growth is project to average less than 2.5% annually from FY01 through FY07.

The General Fund is Very Dependent on a Small Number of Sources for Its Revenue Growth



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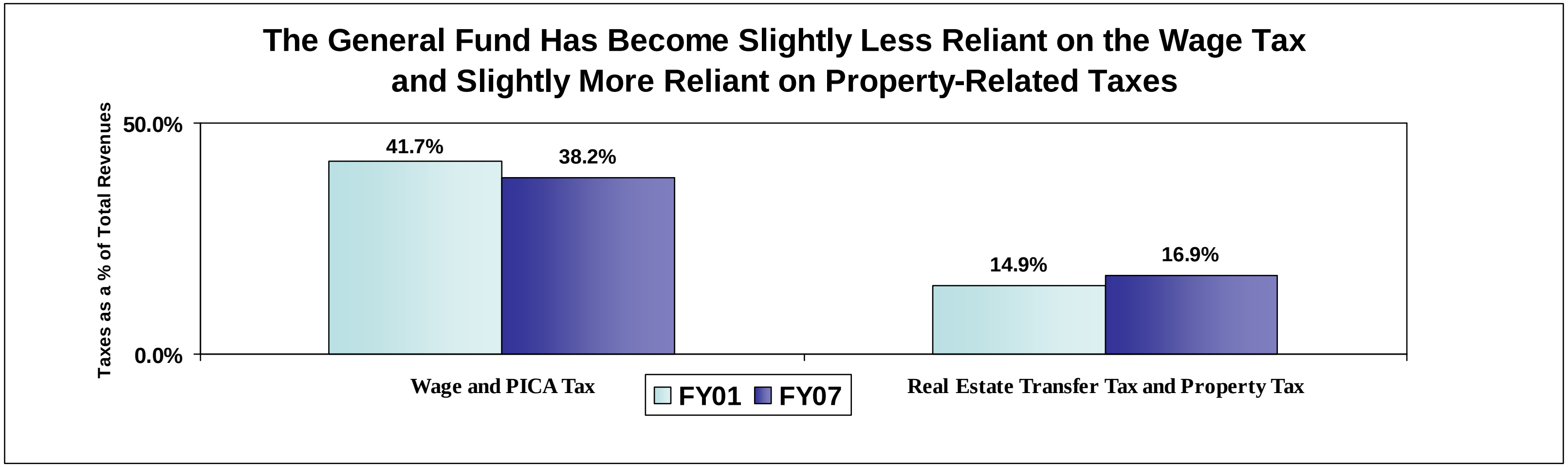
Key Financial Issues Raised in Quarterly Report:

Reduced Reliance on Wage Tax

The dramatic increases in real estate transfer tax collections combined with smaller increases in property tax collections and the continuing cuts in wage tax rates have led to a small, but real, shift for the general fund towards more reliance on property based taxes. The shift makes the city less vulnerable to changes in income but more vulnerable to downturns in real estate.



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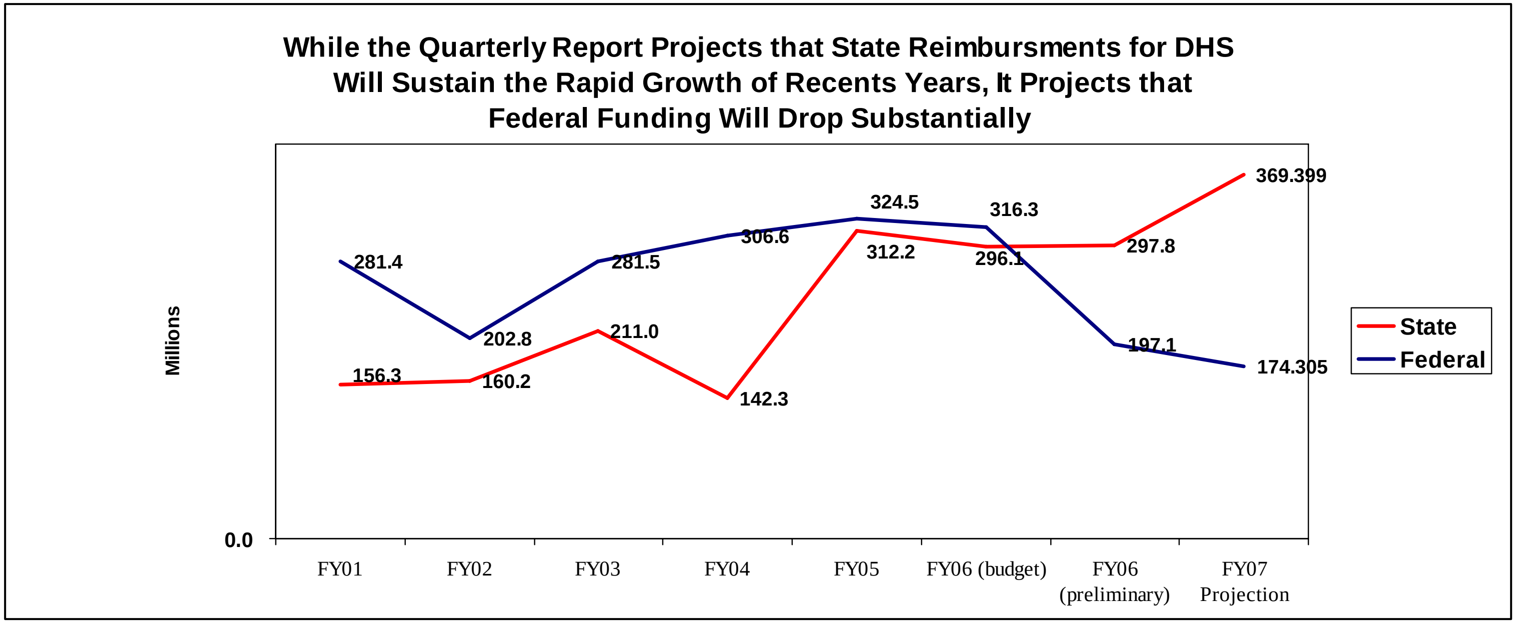
Key Financial Issues Raised in Quarterly Report:

Cuts in Federal Reimbursements

The quarterly report demonstrates the risk of being dependent on a small number of revenue sources for growth by showing that one of those sources – federal reimbursements for human services costs -- is projected to be $150 million lower in FY07 than it was in FY05.



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Key Financial Issues Raised in Quarterly Report:

Philadelphia Parking Authority

- The City projects that it will receive $22M in parking violation fines from the Parking Authority in FY07, up from $18.6M in FY06, but $3M below the amount included in the original FY07 budget.
- Legislation enacted last spring has increased parking fines and increased the amount of revenue the City receives.

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Key Managerial Issues Raised in Quarterly Report:

- Staffing Increases
- Increases in Overtime
- Other Managerial Issues

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Key Managerial Issues Raised in Quarterly Report

Staffing Increases

- The City reduced staffing substantially from the end of FY03 to the end of FY05, but staffing remained virtually unchanged in FY06 – dropping by less than half a percent -- and is projected to increase by almost 1,000 filled positions in FY07. The increase would undo a substantial portion of the progress the City had made in cutting the size of its workforce.

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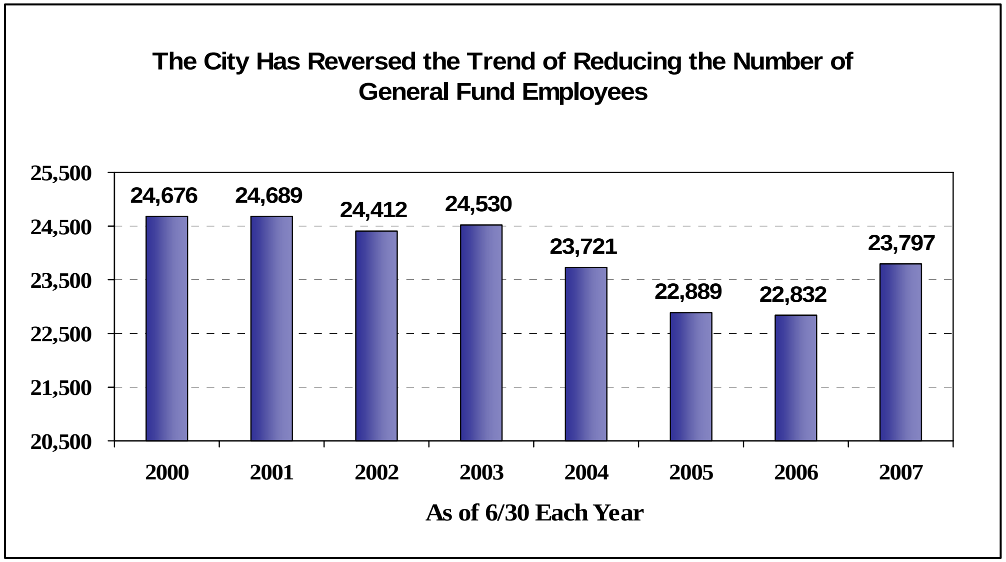

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Key Managerial Issues Raised in Quarterly Report
Staffing Increases

- While 19 departments are projected to add at least 10 full time employees during FY07, about 600 of the almost 1,000 projected added jobs would be in only five departments.

Department	FY06 Year-End	FY07 Quarterly Report Projection	Change
Fire	2,270	2,417	**147**
Human Services	1,703	1,816	**113**
Police	7,287	7,508	**221**
Prisons	2,225	2,268	**43**
Public Health	622	695	**73**
Total of Five Departments	14,107	14,704	**597**

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Key Managerial Issues Raised in Quarterly Report:

Increases in Overtime

- The increase in staffing is not projected to reduce overtime. In fact, overtime and staffing are each projected to increase in FY07. Overtime is projected to increase by over $20m. Overtime and staffing each dropped in both FY04 and FY05.
  - While overtime is projected to increase in a number of departments, the largest projected increases are $8.5m in the Police Department (to $57M), $3.7m in the Prisons System (to $22.9M) and $5.3 million in the Fire Department (to $30.7M);
  - As recently as FY03, Fire overtime was just under $10M. The Department's overtime has risen in large part because of a change in sick leave policy and because the Fire Department reconfiguration plan was not implemented.

Overtime and the Number of Filled Positions Are Each Projected to Increase in FY07

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Key Managerial Issues Raised in Quarterly Report:

Other Management Issues

- The average monthly inmate population in the Prison System continues to increase. The Quarterly Report projects a 5.1% increase in FY07 and a 9.1% increase in just two years. At the same time, prisons expenditures are projected to be about $12.5M over the adopted FY07 budget.

- The average number of employees on light duty status because of injuries is projected to jump from 255 in FY06 to 300 in FY07 after having dropped slightly from 284 in FY05. At the same time, the number of employees on no duty status is projected to increase to 200 after having jumped from 158 in FY05 to 190 for FY06.

- The average number of emergency shelter beds is projected to increase to 2,800, a 10% increase in just two years.

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Key City Budget Characteristics

Cost Areas Projected to Exceed $100M in FY2007

Item	FY06 (Ms)	% Of Budget	FY07 QR (Ms)	% of Budget
Human Services	$556.6	16.3%	$592.5	15.8%
Police	$473.1	13.8%	$495.9	13.2%
Pensions Plus Pension Obligation Bonds	$346.5	10.1%	$419.2	11.2%
Health/Medical Benefits	$291.8	8.5%	$344.5	8.8%
Prisons	$194.3	5.7%	$206.7	5.5%
Debt Service	$159.9	4.7%	$191.8	5.1%
Fire	$171.8	5.0%	$188.7	5.0%
Public Property (excl. Septa Subsidy)	$112.2	3.3%	$121.7	3.2%
Health	$105.1	3.1%	$114.4	3.0%
Courts	$114.1	3.3%	$112.9	3.0%

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Key City Budget Characteristics (continued)

Revenue Areas Projected to Exceed $100M in FY2007

Item	FY06 (Ms)	% Of Budget	FY07 QR (Ms)	% of Budget
Wage and Net Profits Tax (including PICA City Account)	$1,355.8	38.1%	$1,393.0	38.2%
Human Services Reimbursement	$495.0	13.9%	$543.7	14.9%
Property Tax	$395.8	11.1%	$407.8	11.2%
Business Privilege Tax	$415.5	11.7%	$408.0	11.2%
Real Property Transfer Tax	$236.4	6.7%	$210.0	5.8%
Sales Tax	$127.8	3.6%	$135.0	3.7%

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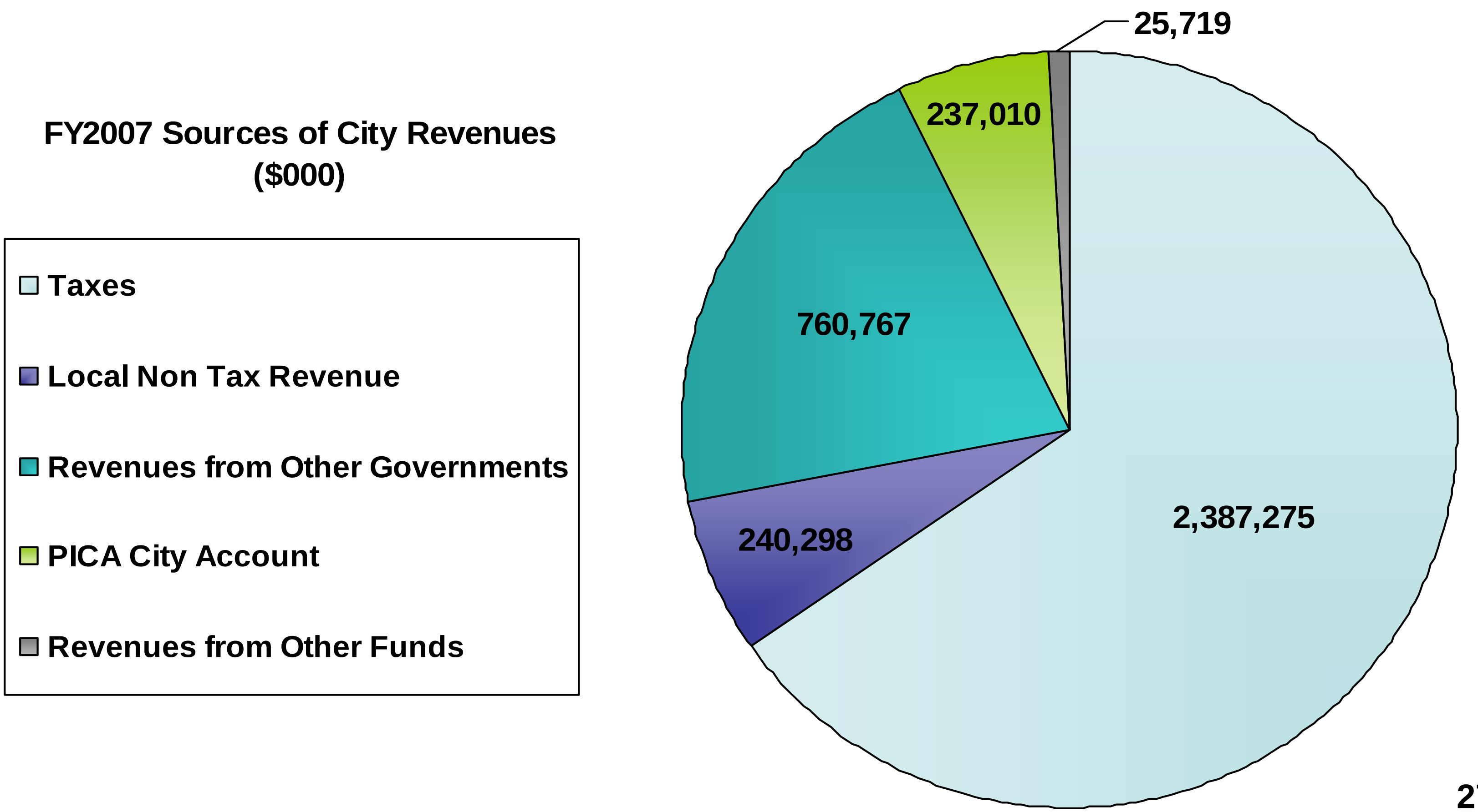
Key City Budget Characteristics (continued)



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Key City Budget Characteristics (continued)