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

Fourth Quarter of FY2007

Submitted to PICA on August 15, 2007

August 16, 2007

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

Overview

The Quarterly Report is consistent with the approved FY08-FY12 Five Year Plan in projecting that the City's fund balance will drop by almost $40 million to $216 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.

Preliminary revenue figures make it appear that the fund balance will be larger than the amounts shown in the Quarterly Report and the Plan. Collections for the business privilege, wage and real estate transfer taxes are all likely to be larger than the Plan's projections.

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

Overview (cont.)

As discussed in the PICA Staff report on the FY08-FY12 Five-Year Plan, it is essential for revenues to be higher than the amounts included in the Plan so that the City can cover that Plan's risks.

The Plan's major risks include the following:

- 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 School District's continuing financial challenges make it likely that the District will again seek additional funding from the City; and
- there is a strong possibility that the growth in prisons costs will exceed the amounts included in the Plan.

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

Projected General Fund Balance for FY2007 in Quarterly Report: **$215.7M**

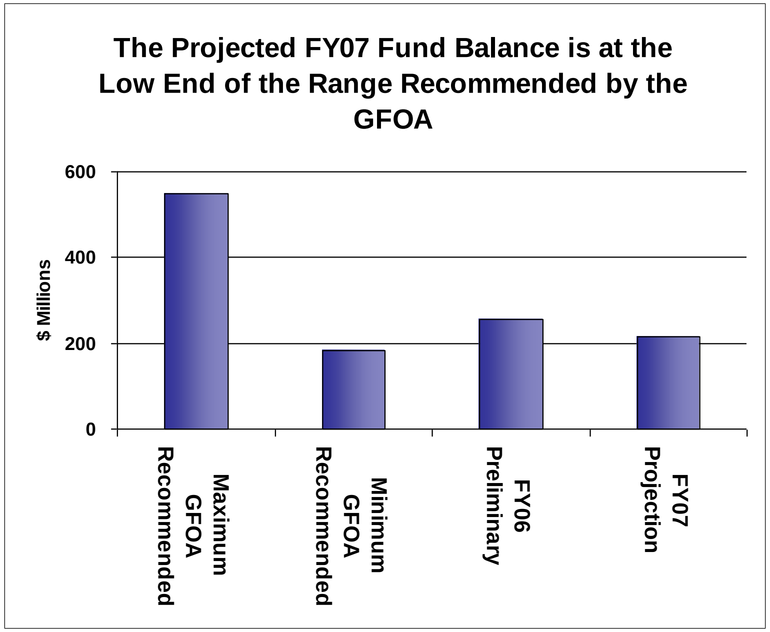
Projected General Fund Balance for FY2007 in the FY08- FY12 Plan: **$215.7M**

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

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

Fund Balance

- The projected FY07 fund balance is at the low end of the range 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 $216M, the City's projection is about 6% of FY07 revenues and is $330M lower than the high end of the Association's guidelines.
- While the City's projected FY07 fund balance is above the minimum level recommended by the GFOA, it almost certainly will fall far below that level in other years included in the Plan.



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

Revenue Projections

Projected General Fund Revenues for FY2007 in Quarterly Report:	**$3,665.1M**
Projected General Fund Revenues for FY2007 in the FY08-FY12 Plan:	**$3,665.1M**
Change in General Fund Revenues from the FY08-FY12 Plan:	**$ 0M**

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

Obligations Projections

Projected General Fund Obligations for FY2007 in Quarterly Report: **$ 3,723.9M**

Projected General Fund Obligations for FY2007 In the FY08-FY12 Plan: **$ 3,723.9M**

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

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

Key Revenue Projections: Taxes

- The Quarterly Report projects that taxes will equal the amounts projected in the FY08-FY12 Plan, but actual collections make it appear that the final wage, business, privilege and real estate transfer tax numbers will be higher than the amounts included in the Plan and the Quarterly Report.
- The Report projects that taxes will grow by $38 million in FY07 – far more slowly than the growth in City's fastest growing expenditures.

Tax	FY07 Quarterly Report	Change from Plan (in millions)	Change from FY06 (in millions)
Wage/ Earnings	$1,151.3	**$0.0**	**$40.1**
Business Privilege	$423.0	**$0.0**	**$7.5**
Real Property	$402.6	**$0.0**	**$6.8**
Real Estate Transfer	$210.0	**$0.0**	**-$26.4**
Sales	$135.0	**$0.0**	**$7.2**

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

Key Revenue Projections: Local Non-Taxes

- The Quarterly Report, like the Plan, moves the projected receipt of the Eagles' $8M rent from FY07 to FY08. The rent was initially due in FY02, but is now the subject of a legal dispute between the Eagles and the City.
- Emergency medical service fees and interest earnings are both projected to be higher than originally budgeted. The FY07 adopted budget projected that EMS fees would total $24.5 million and interest earnings would equal $23 million. They are each now projected to be $27 million, a combined $6.5 million over budget. Total local non-tax revenues, however are projected to decline very slightly from FY06 to FY07.

Item	FY07 Quarterly Report	Change from Plan (in millions)	Change from FY06 (in millions)
Licenses and Permits	$44.4	**$0.0**	**$1.4**
Court Fees and Fines	$33.8	**$0.0**	**$5.2**
EMS Fees	$27.0	**$0.0**	**$2.0**
Interest Earnings	$27.0	**$0.0**	**-$1.6**

Key Revenue Projections: Revenues from Other Governments

- In the Quarterly report and the FY08-FY12 Plan, the City drops its projection for 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.
- While the City projects that it will receive $22 million from the Parking Authority for FY07, it appears that it may fall well short of that number.
- Despite a projected $20 million decrease in revenues from the federal government, overall revenues from other governments are projected to increase by over $70 million as revenues from the State, the PICA Account, the Parking Authority and the convention center are all projected to increase.

Item	FY07 Quarterly Report	Change from Plan (in millions)	Change from FY06 (in millions)
Human Services Reimb.	$543.7	**$0.0**	**$50.4**
PICA Account	$237.0	**$0.0**	**$7.0**
Pension Aid – State Act 205	$57.7	**$0.0**	**$0.4**
Health Department Reimb.	$56.0	**$0.0**	**$4.8**
Parking Authority	$22.0	**$0.0**	**$3.4**
Convention Center Offset	$21.7	**$0.0**	**$3.5**

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

Key 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. Half of that increase is in the cost of benefits.

Item	FY07 Quarterly Report	Change from Plan (in millions)	Change from FY06 (in millions)
Employee Benefits	$880.0	**$0.0**	**$119.8**
Department of Human Services	$592.5	**$0.0**	**$35.9**
Police	$495.9	**$0.0**	**$22.8**
Prisons	$206.7	**$0.0**	**$12.4**
Debt Service	$191.8	**$0.0**	**$31.9**
Fire	$188.7	**$0.0**	**$16.9**

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

Key Financial Issues Raised in the Quarterly Report:

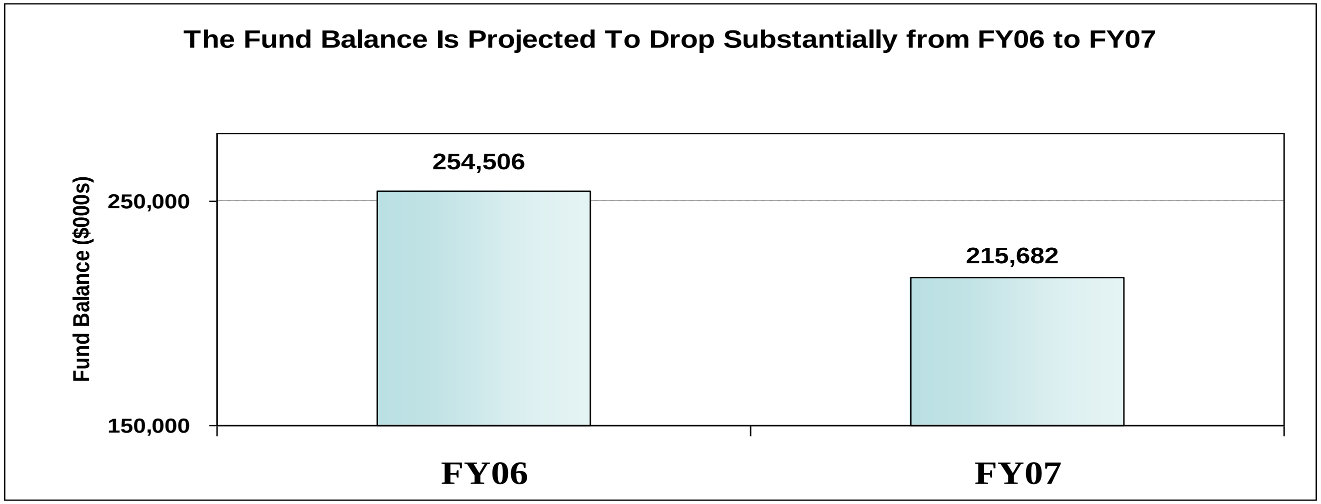
- Declining Fund Balance
- Expenditure Growth
- Volatile Revenue Sources
- Reduced Reliance on Wage Tax
- Cuts in Federal Reimbursements
- Philadelphia Parking Authority

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

Key Financial Issues Raised in Quarterly Report:

Declining Fund Balance

The quarterly report projects a $39 million – 15% -- 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.

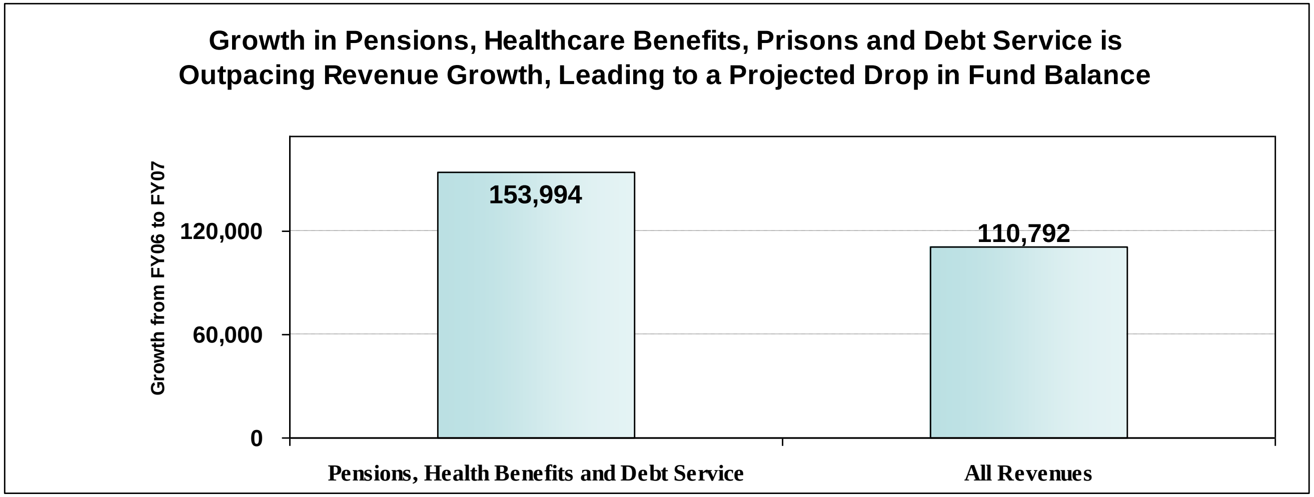


PICA Staff Report on the City of Philadelphia's Quarterly Report Fourth **Quarter of FY2007**

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 $111 million. The four fast growing items, combined with costs for the Department of Human Services, have increased from 38% of the budget in FY01 to a projected 46% of the budget in FY07.

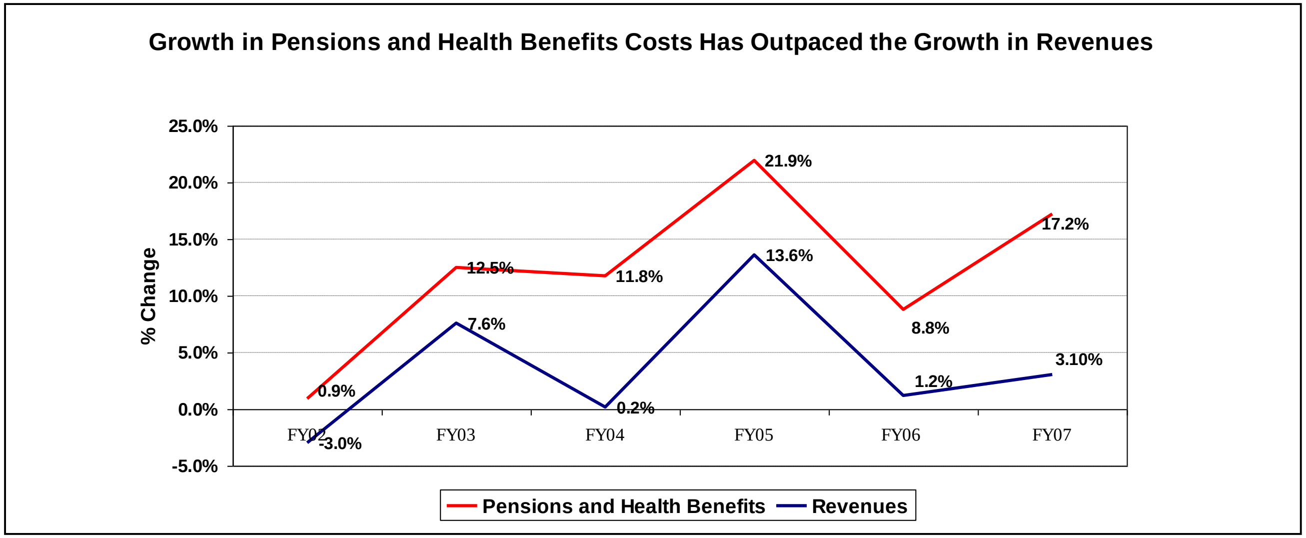


PICA Staff Report on the City of Philadelphia's Quarterly Report Fourth **Quarter of FY2007**

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.



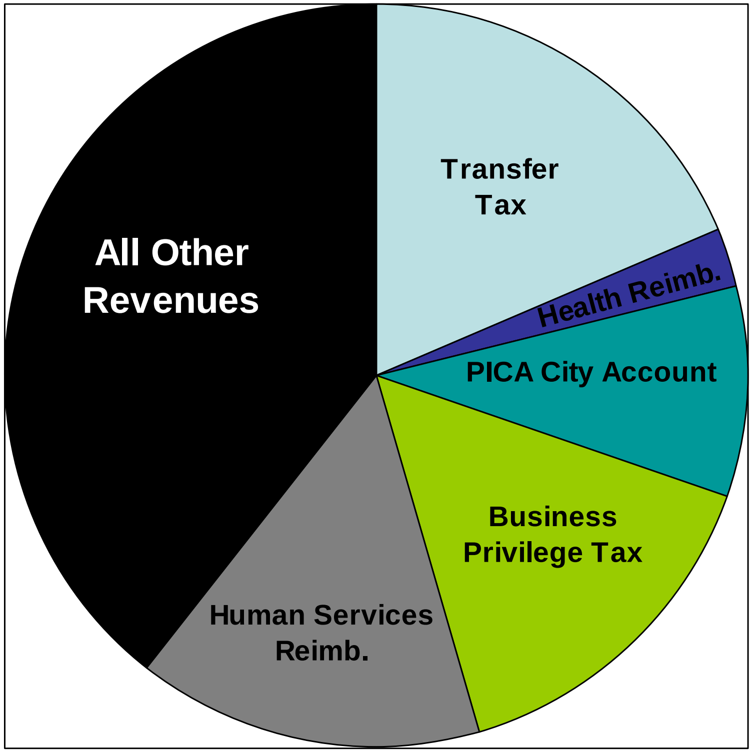
PICA Staff Report on the City of Philadelphia's Quarterly Report Fourth **Quarter of FY2007**

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 1.5% annually from FY01 through FY07.

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

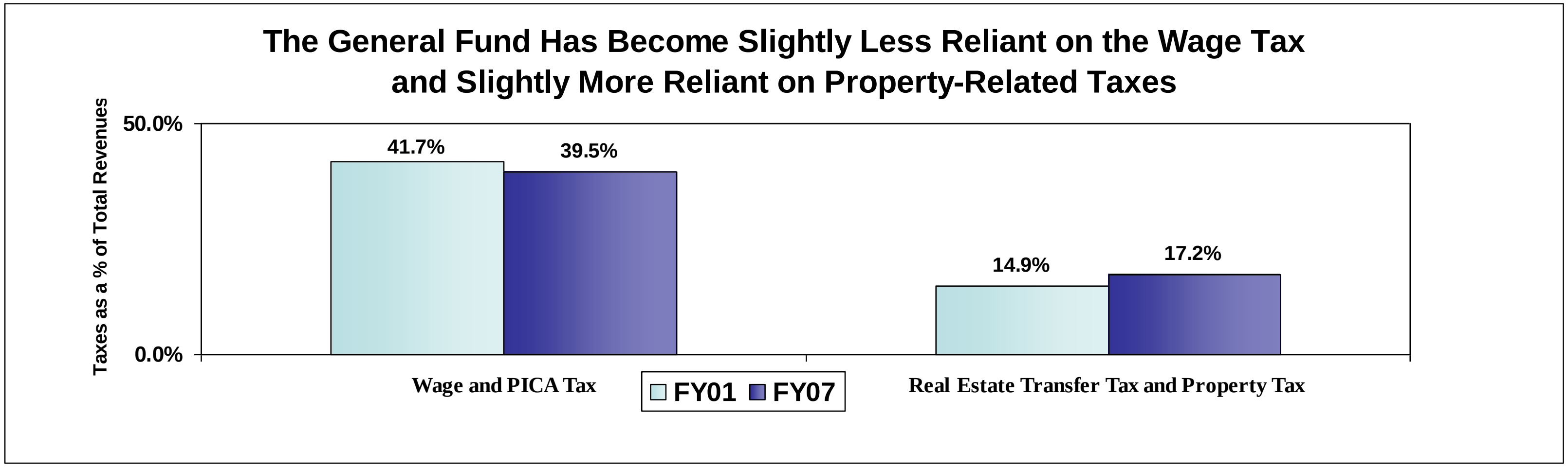


PICA Staff Report on the City of Philadelphia's Quarterly Report Fourth **Quarter of FY2007**

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. This trend, however, is almost certain to end in FY08 as the City is shifting about $19 million worth of millage to the School District.

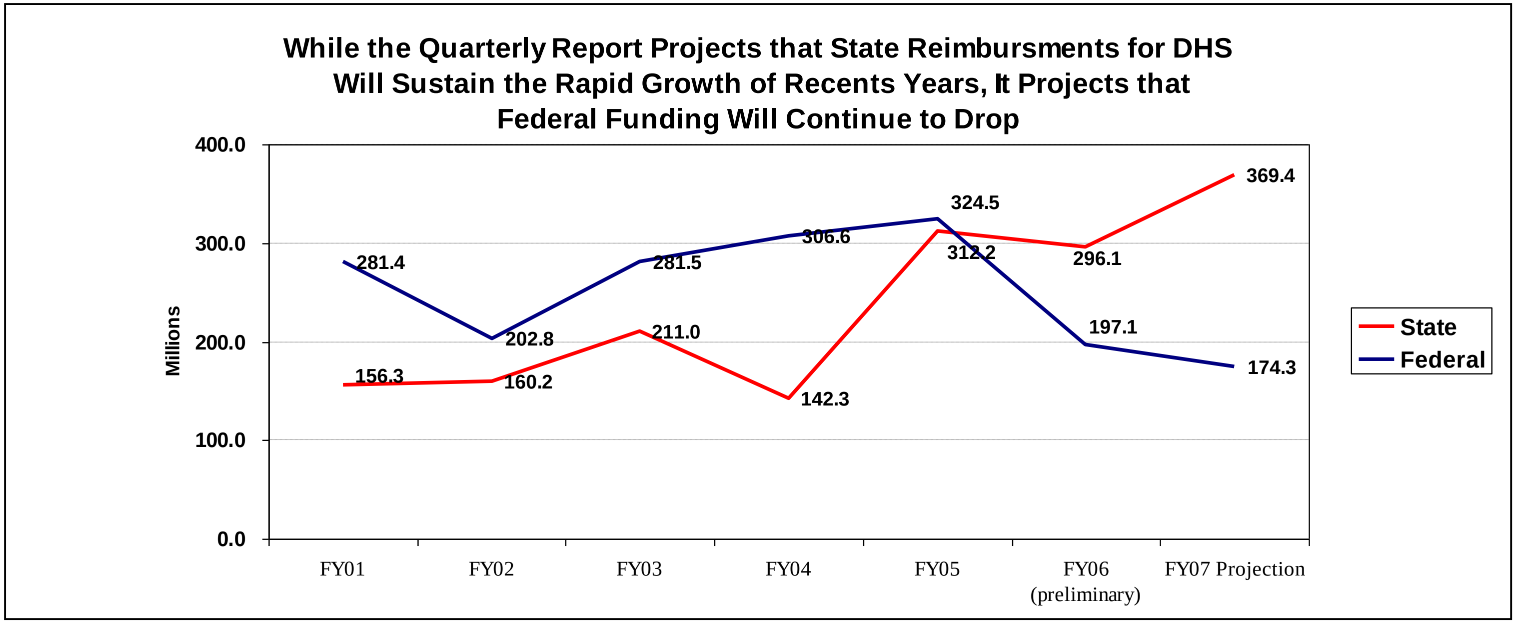


PICA Staff Report on the City of Philadelphia's Quarterly Report Fourth **Quarter of FY2007**

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.



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

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, which would be up from $18.6M in FY06, but $3M below the amount included in the original FY07 budget. It is likely, however, that actual collections will come in slightly below the City's projections.

- Legislation enacted last spring has increased parking fines and increased the amount of revenue the City receives.

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

Key Managerial Issues Raised in Quarterly Report:

- Staffing Increases
- Increases in Overtime
- Other Managerial Issues

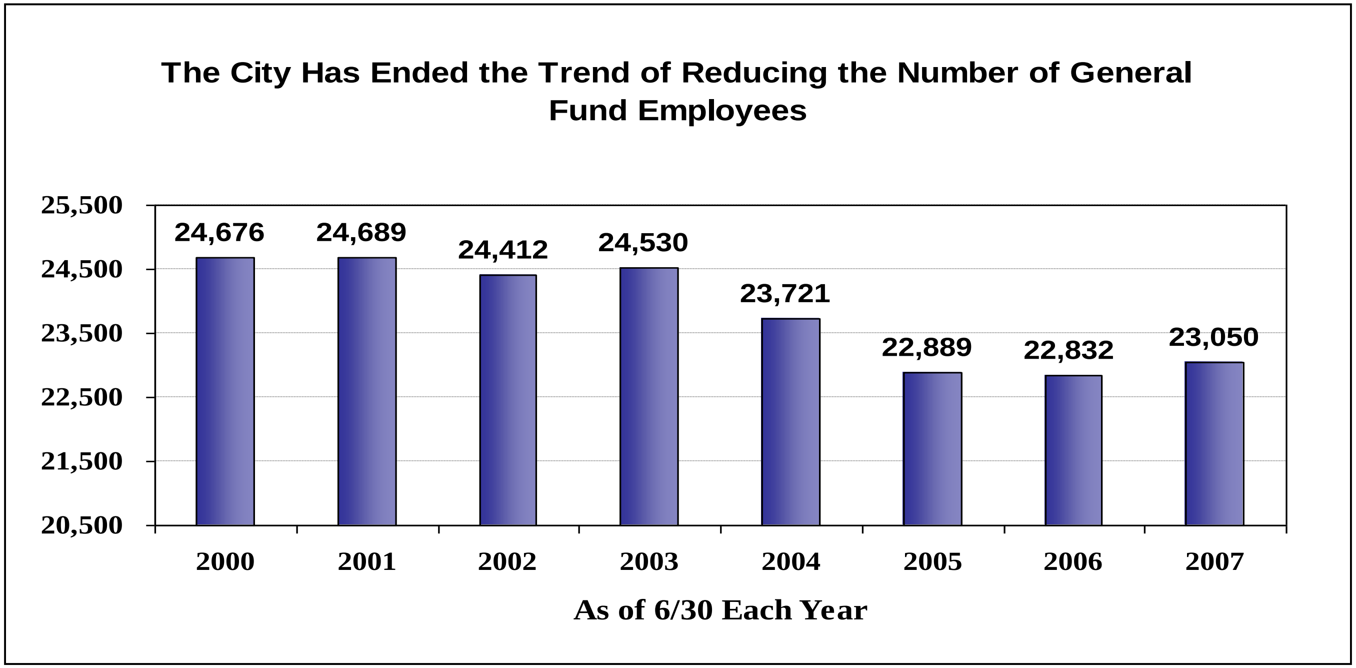
PICA Staff Report on the City of Philadelphia's Quarterly Report Fourth **Quarter of FY2007**

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 and increased slightly in FY07. The trend of reducing the size of the City's workforce appears to have ended.

.



Key Managerial Issues Raised in Quarterly Report

Staffing Increases

- Increases in Police and Fire staffing helped push overall staffing slightly higher in FY07. Staffing in the City's three other largest general fund agencies declined slightly.

Department	FY06 Year-End	FY07 Quarterly Report Projection	Change
Police	7,287	7,424	**137**
Fire	2,270	2,399	**129**
Prisons	2,225	2,176	**-49**
First Judicial District	1,936	1,928	**-8**
Streets	1,849	1,814	**-35**
Total of Five Departments	15,567	15,741	**174**

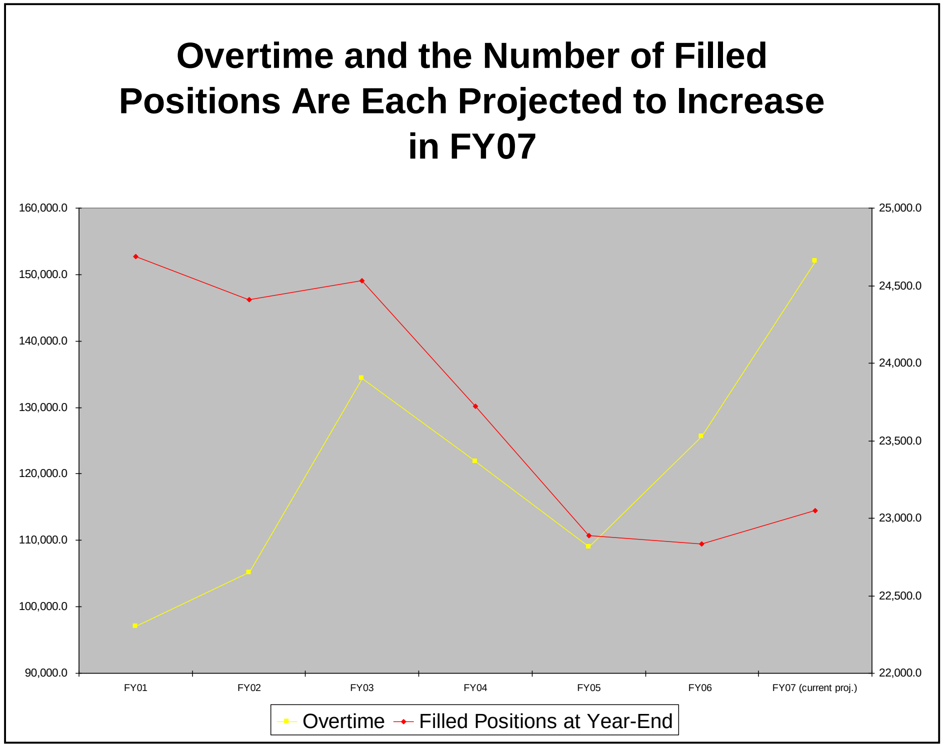
PICA Staff Report on the City of Philadelphia's Quarterly Report Fourth **Quarter of FY2007**

Key Managerial Issues Raised in Quarterly Report:

Increases in Overtime

The slight increase in staffing is not projected to reduce overtime. In fact, overtime and staffing, which each dropped in both FY04 and FY05, are each projected to increase in FY07. Overtime is projected to increase by over $25m.

- While overtime is projected to increase in a number of departments, the largest projected increases are $12m in the Police Department (to $61M), $4.2m in the Prisons System (to $23.5M) and $5.6 million in the Fire Department (to $31M);
- 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.



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

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, with overtime costs accounting for most of that increase.

- 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.

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

Key City Budget Characteristics

Cost Areas Projected to Exceed $100M in FY2007

Item	FY01 (Ms)	FY01% of Budget	FY06 (Ms)	% Of Budget	FY07 QR (Ms)	% of Budget
Human Services	$442	15.3%	$557	16.3%	$593	15.9%
Police	$442	15.3%	$473	13.8%	$496	13.3%
Pensions Plus Pension Obligation Bonds	$194	6.7%	$347	10.1%	$419	11.3%
Health/Medical Benefits	$187	6.5%	$292	8.5%	$329	8.8%
Prisons	$143	5.0%	$194	5.7%	$207	5.6%
Debt Service	$131	4.5%	$160	4.7%	$192	5.1%
Fire	$148	5.1%	$172	5.0%	$189	5.1%
Public Property (excl. Septa Subsidy)	$104	3.6%	$112	3.3%	$122	3.3%
Health	$109	3.8%	$105	3.1%	$114	3.1%
Courts	**$112**	**3.9%**	$114	3.3%	$113	3.0%

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

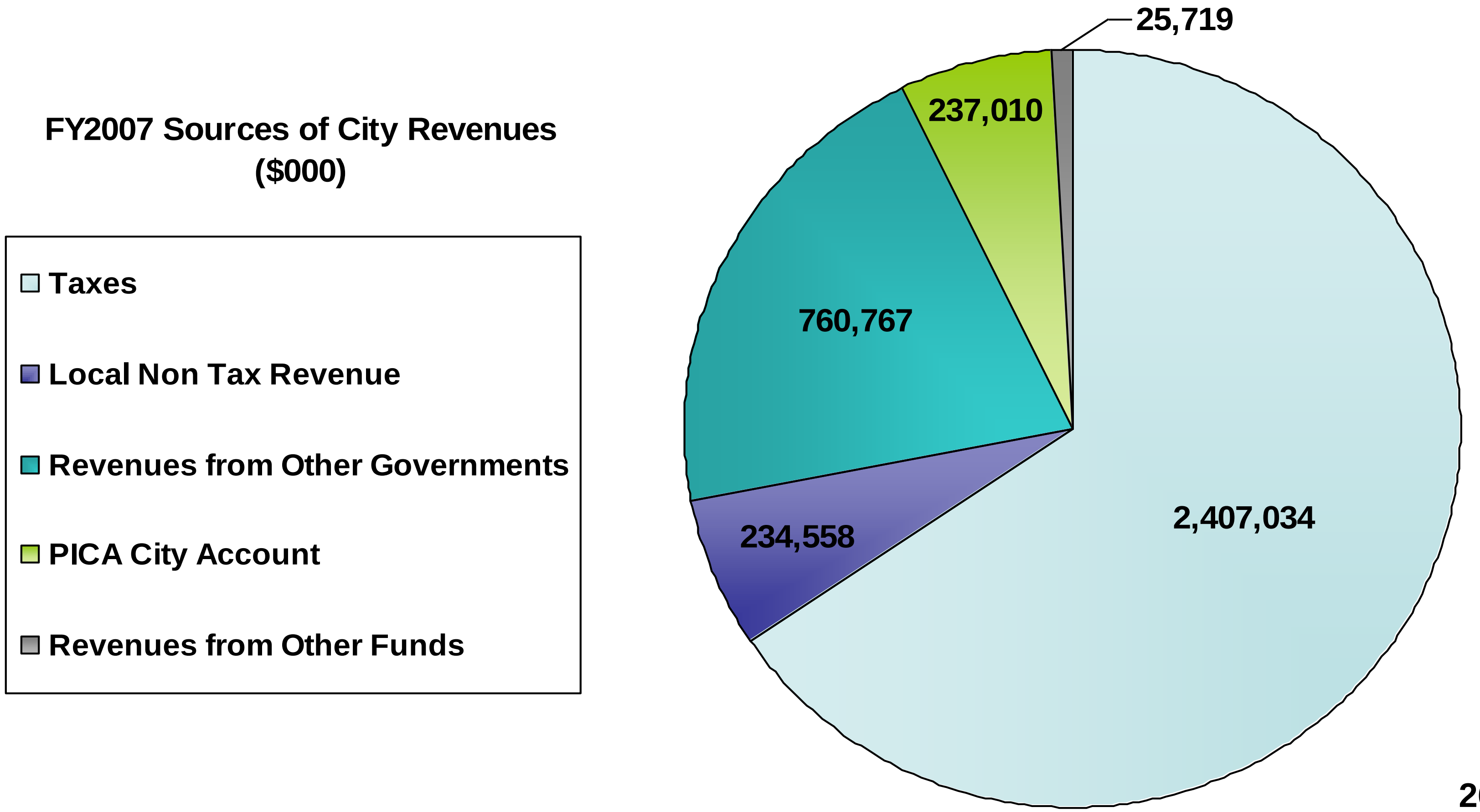
Key City Budget Characteristics (continued)

Revenue Areas Projected to Exceed $100M in FY2007

Item	FY01 Amount (in millions)	FY01% of Budget	FY06 (Ms)	% Of Budget	FY07 QR (Ms)	% of Budget
Wage and Net Profits Tax	$1,059.0	35.8%	$1,355.8	38.1%	$1,393.0	38.2%
Human Services Reimbursement	$437.7	14.8%	$495.0	13.9%	$543.7	14.9%
Property Tax	$363.4	12.3%	$395.8	11.1%	$407.8	11.2%
Business Privilege Tax	$314.0	10.6%	$415.5	11.7%	$408.0	11.2%
PICA Account	$173.0	5.9%	$236.4	6.7%	$210.0	5.8%
Sales Tax	$111.3	3.8%	$127.8	3.6%	$135.0	3.7%
Real Property Transfer Tax	$77.0	2.6%	$236.4	6.7%	$210.0	5.7%

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

Key City Budget Characteristics (continued)



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

Key City Budget Characteristics (continued)

Distribution of FY07 Expenditures ($000) -- $3.42 Billion