

Translating Philadelphia's FY07 Ending Fund Balance: An Opportunity, Not a Panacea

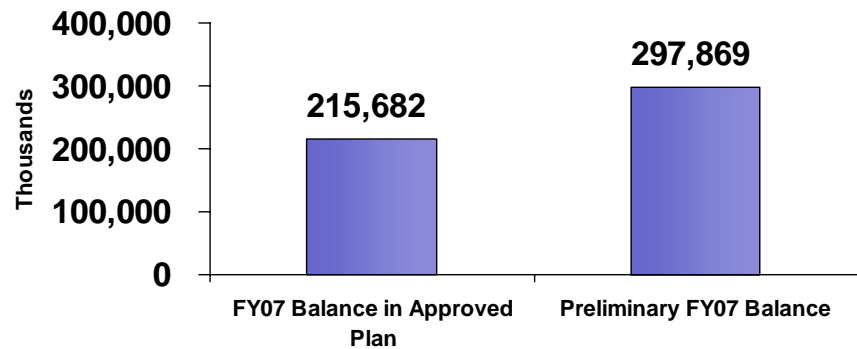
PICA Issues Report
November 1, 2007

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The FY07 Fund Balance

Preliminary numbers show that the City's actual FY2007 ending fund balance was more than \$80 million higher than the amount included in the PICA approved FY2008-FY2012 Five-Year Plan.

The Preliminary FY07 Fund Balance Was Much Higher Than Anticipated in the FY08-FY12 Five Year Plan

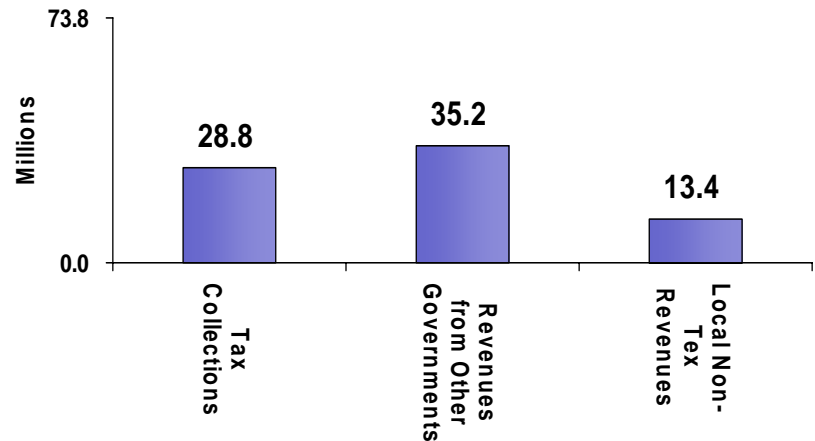


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Why Was the Fund Balance So Much Higher than Originally Projected?

1. Tax collections were \$29 million higher than the amount included in the Plan, primarily because of the wage, business privilege and real estate transfer taxes.
2. Revenues from other governments were about \$35 million higher than anticipated, mostly because of the timing of state reimbursements for expenses borne by the Department of Human Services.
3. Non-tax revenues were \$13 million higher than the amount included in the Plan, primarily because of better than anticipated interest earnings

Tax Collections and The Timing of State Revenues Were the Biggest Contributors to the Larger than Anticipated Fund Balance



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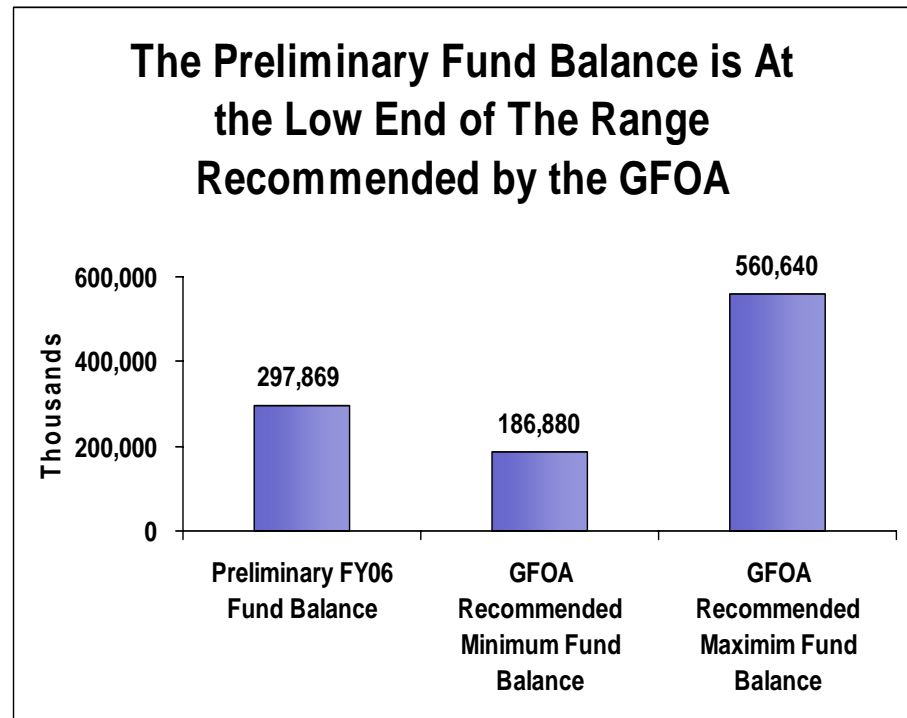
What Does the Increased Fund Balance Indicate?

- The increased fund balance is a sign that the City's fiscal health continues to be moderately better than forecast.
- The increases in wage and business privilege tax collections is another sign that the City's economy is doing better than anticipated.
- Collections showed signs of slowing down during the first quarter of FY08 as both real estate transfer tax collections and sales tax collections were lower than they had been during the first quarter of FY07. The collections declines could be a sign that the economy is weakening.

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Why Isn't The Increased Fund Balance A Panacea?: Benchmarking

Even at 8% of revenues, the fund balance is at the lower end of the 5% to 15% of revenues that the Government Finance Officers' Association says is the appropriate balance for a local government. The GFOA says having an adequate fund balance is an essential hedge against long-term and short-term risks.

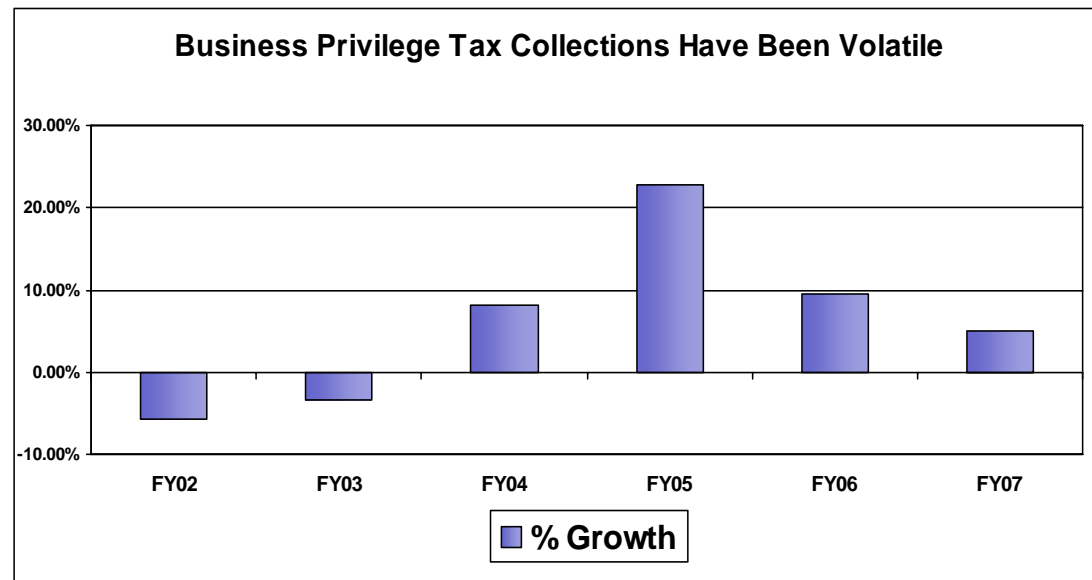


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Why Isn't The Increased Fund Balance A Panacea?: Volatile Revenues

Rapidly increasing business privilege tax collections have been one of the prime contributors to the growth in the City's fund balance. The tax has, however, been extremely volatile.

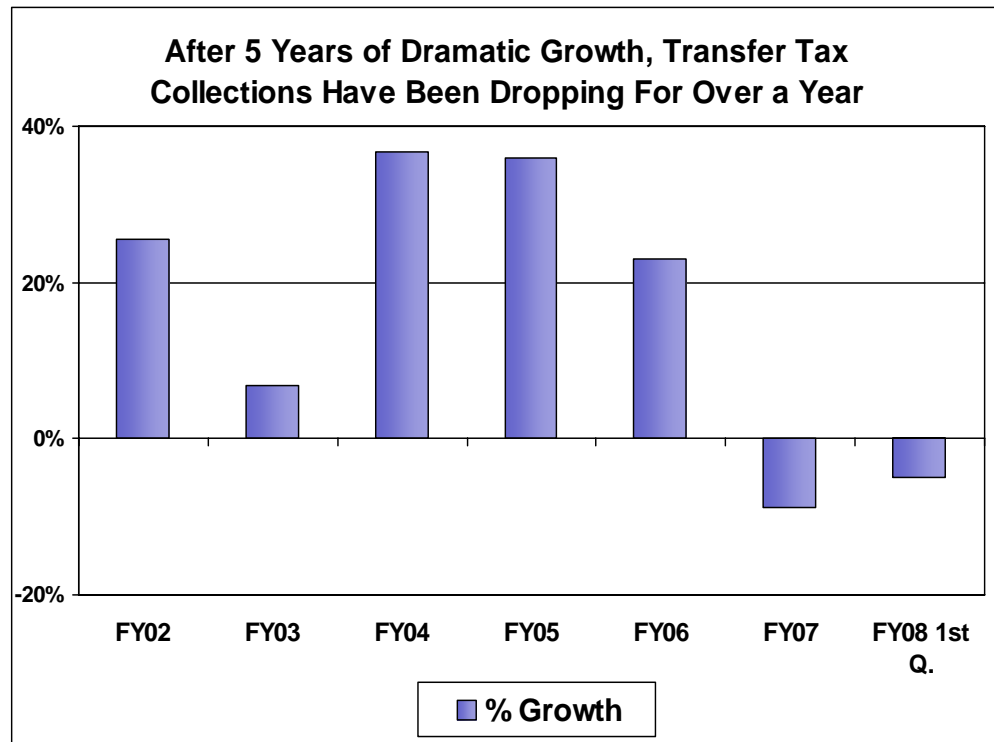
Business Privilege Tax collections, which have increased by almost \$130 million in the last three fiscal years, declined in both FY02 and FY03.



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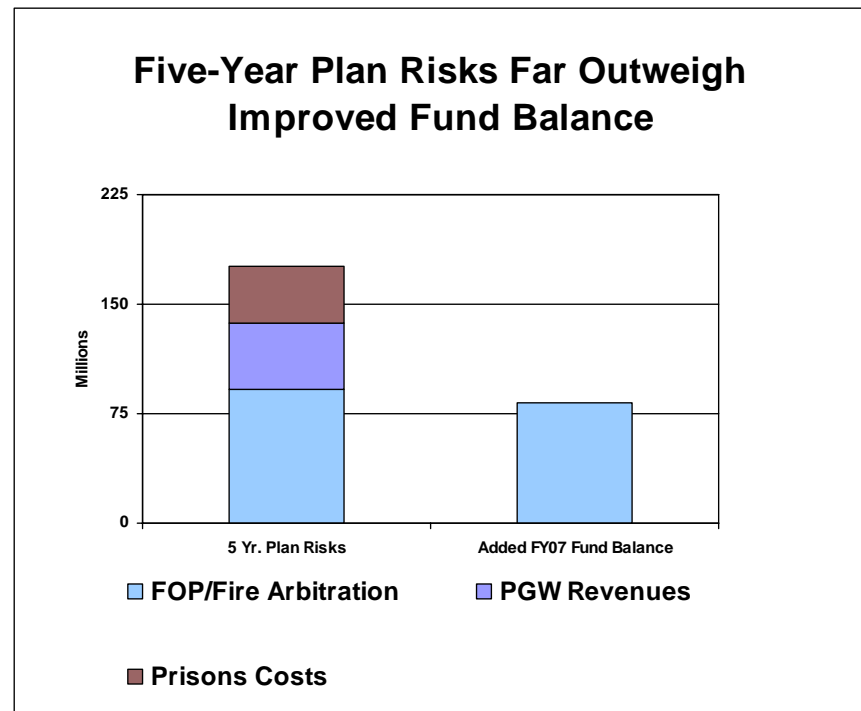
Real estate transfer tax collections have begun to slow. After growing by just over 200 percent from FY01 through FY06, collections declined during FY07 and again during the first quarter of FY08.



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Why Isn't The Increased Fund Balance A Panacea?: Risks

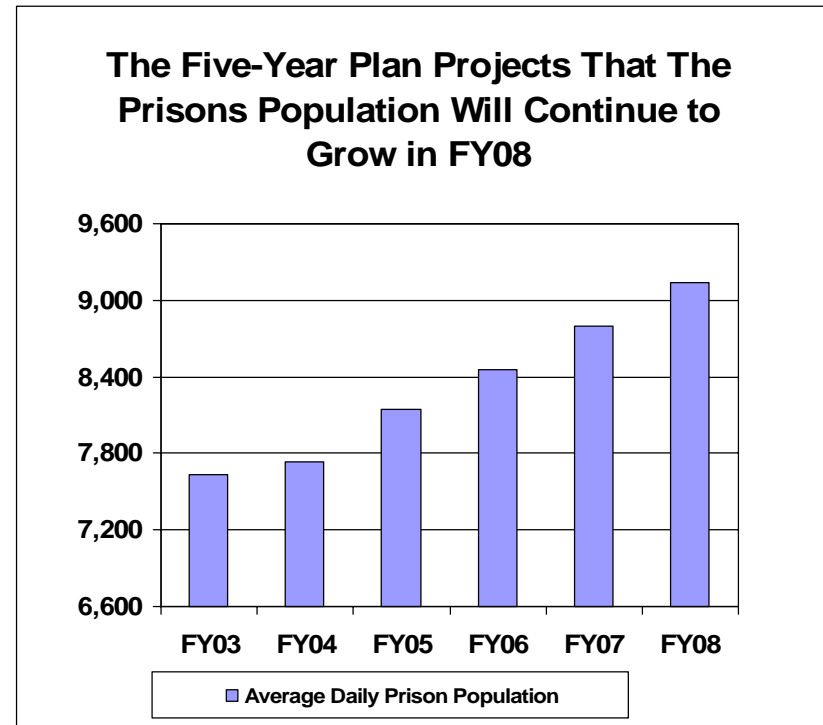
- **Labor agreements and awards.** The Administration has agreed to large increases in health benefits contributions for the firefighters union and is waiting for a ruling on the police union's benefits. The City's agreements with all four of its unions are up again at the end of next fiscal year.
- The Five Year Plan still includes \$45 million in revenues from **PGW** that the City might not receive.
- **The potential for continued reductions in federal funding** creates a substantial risk that City funding for the Department of Human Services will have to increase or services will have to be reduced.



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Why Isn't The Increased Fund Balance A Panacea?: Risks

- Continuing growth in the **prison system's population**. The average daily prison census has grown 23% since FY01 and the system's costs have grown 45% -- \$65 million. The FY08-FY12 Plan projects another 3% growth in the census in FY08, but projects that after FY08, obligations will grow 2.1% or less each year. The increased population is likely to cause increases in obligations for both contracts and overtime well beyond the amounts included in the Plan.
- The **School District of Philadelphia** still faces its own financial challenges. The District is projecting a \$15 million deficit in FY08 and faces the possibility that its expenditures will continue to grow faster than its revenues. If the District is unable to balance its budget, it is likely to turn to the City and State for additional funding.



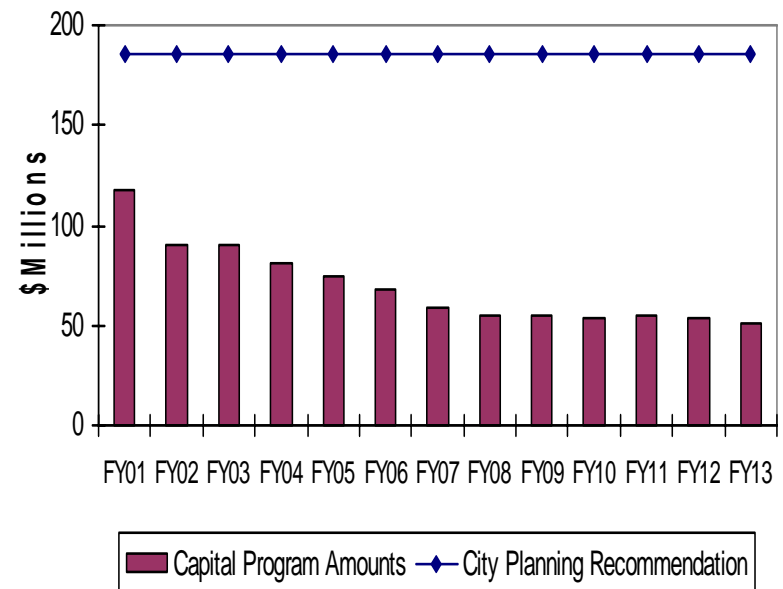
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Why Is The Increased Fund Balance An Opportunity?: Long-Term Investments

The City can use the fund balance to begin addressing its long-term financial issues. After ensuring that the fund balance gives it enough room to keep its Plan balanced despite the many risk it includes, the City could make some of the following critical investments.

- **Making An Added Contribution to the Pension Fund.** In addition to having a large unfunded pension liability, the City makes the minimum pension payment required under state law. If instead of paying that minimum, the City paid the amount required under its funding policy, it would pay about \$100 million more annually. While the additional fund balance would not be nearly enough to restore the pension fund to health, using a portion of it to make an additional contribution to the fund would be an important step.
- **Paying for Infrastructure Improvements.** The Plan includes less than a third of the amount that the City Planning Commission says is required to maintain the City's core infrastructure. If the City paid the amount the Commission said is required, it would cost over \$120 million annually. The City could use some of the fund balance to pay for a portion of those critical infrastructure needs.

The City's Capital Program Continues The Trend of Insufficient Infrastructure Investment



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Why Is The Increased Fund Balance An Opportunity?: Long-Term Investments

- **Reducing the City's debt burden.** The City's high level of fixed obligations threatens its fiscal health. As more and more of the budget is dedicated to the kinds of costs that cannot be cut during the year, the City will have fewer and fewer choices when it is faced with making mid-year budgetary corrections. In FY07, the City's debt service costs were \$43 million higher than they were in FY01. The City could use part of the unanticipated fund balance to prepay some of its long-term debt.
- **Making the City's tax structure more competitive.** Philadelphia's tax rates, particularly for the business privilege and wage taxes, should be lowered further. As has been repeatedly documented, the City's tax structure is a deterrent to job growth. The City could use some of the fund balance to offset some of the costs of tax reductions.
- **Establishing A Rainy Day Fund.** Another portion of the healthier than anticipated fund balance could be used to create a rainy day fund.

