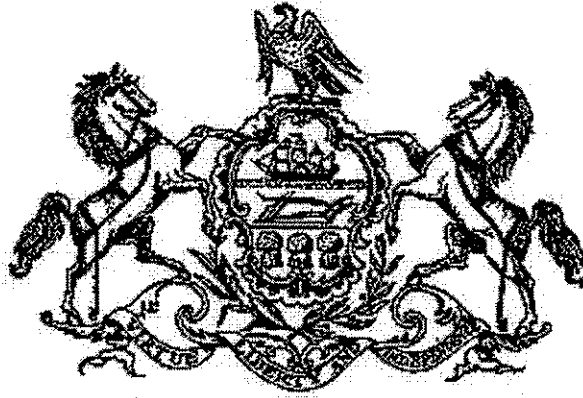


# **Pennsylvania Intergovernmental Cooperation Authority**



**Annual Report  
for  
Fiscal Year 2007**

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**October 16, 2007**

**PENNSYLVANIA INTERGOVERNMENTAL  
COOPERATION AUTHORITY**

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Vice Chairperson

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Alik Bonarou ..... Director of Program Analysis  
Andrew Wietstock ..... Analyst  
Deidre A. Morgenstern ..... Accounts Manager  
Kim Richardson ..... Secretary/Receptionist

**Professional Advisors**

Authority Counsel

Reed Smith LLP

Independent Auditors

Isdaner & Company, LLC

## The Mission of the Authority

The mission of the Authority, as stated in its enabling legislation, 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; and*
- (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.*

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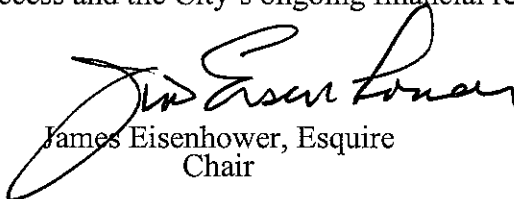
October, 2007

To: The Governor and the General Assembly of the Commonwealth of Pennsylvania  
The Chairperson and the Minority Chairperson of the Appropriations Committee of the  
Pennsylvania Senate  
The Chairperson and the Minority Chairperson of the Appropriations Committee of the  
Pennsylvania House of Representatives  
The Mayor, the City Council and the Controller of the City of Philadelphia  
Other Parties Concerned with the Maintenance of Financial Stability of and Achieving  
Balanced Budgets for the City of Philadelphia

As the Pennsylvania Intergovernmental Cooperation Authority ("PICA") marks its sixteenth anniversary, we are pleased to provide you with this Annual Report for the fiscal year ended June 30, 2007 ("FY2007"). In 1991, the City of Philadelphia ("City") faced a deficit of \$137 million, and lacked a coherent fiscal planning mechanism. The City projects it will end FY2007 with a surplus of over \$215 million, and projects positive fund balances for the next five years as part of the continued success of the annual Five-Year Financial Plan required by PICA. Though the City faces challenges, including a high debt burden, a large Pension Fund liability, underinvestment in core infrastructure, an uncompetitive tax structure, rapidly increasing health insurance costs, and a struggling Philadelphia Gas Works, we remain confident in PICA's ability to help the City maintain a positive fiscal outlook.

Even after sixteen years, PICA continues to have a significant role in the ongoing City financial recovery. FY2007 activity included: (1) the approval of a Five-Year Financial Plan for Fiscal Years 2008 through 2012 which anticipates balanced budgets and tax reductions in each component year; (2) monitoring Five-Year Financial Plan compliance; (3) publication of issues papers on the key fiscal challenges facing the City; (4) continuing review and monitoring of the City's operations; (5) oversight as to utilization of remainder moneys borrowed by PICA for City capital projects, productivity enhancements and indemnity costs; (6) beginning an assessment of key City facilities; and (7) service as the primary independent source of objective financial information and opinion for the benefit of the citizens of the City and the Commonwealth as well as for the media, the financial community and other outside observers.

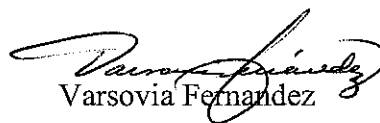
The PICA Board has been gratified by the recognition PICA regularly receives from the financial community and the media for its successful performance as the agency charged with the responsibility for oversight and monitoring of the City's finances. We would be remiss if we failed to acknowledge and express our sincere appreciation for the continuous support PICA receives from the Governor and the General Assembly, and also for the ongoing cooperation of Philadelphia's Mayor, City Council and City Controller. This support and cooperation are vital factors to PICA's continuing success and the City's ongoing financial recovery.



James Eisenhower, Esquire  
Chair



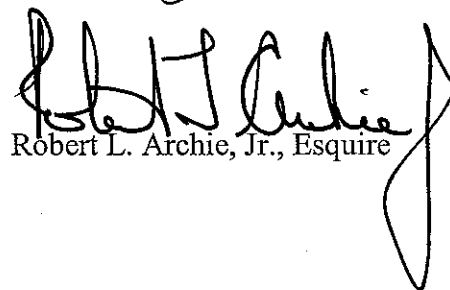
William J. Leonard, Esquire



Varsovia Fernandez



Michael A. Karp



Robert L. Archie, Jr., Esquire

## **PICA Annual Report Requirements**

The Pennsylvania Intergovernmental Cooperation Authority Act for Cities of First Class, Act of 1991, P.L. 9, No. 6 at §203(b)(5) requires PICA:

To make annual reports within 120 days of the close of the Authority's fiscal year commencing with the fiscal year ending June 30, 1992, to the Governor and the General Assembly describing its progress with respect to restoring the financial stability of assisted cities and achieving balanced budgets for assisted cities, such reports to be filed with the Governor, with the presiding officers of the Senate and the House of Representatives, with the Chairperson and the Minority Chairperson of the Appropriations Committee of the Senate and the Chairperson and the Minority Chairperson of the House of Representatives and with the Governing Body, Mayor and Controller of the assisted city.

§207 of the Act further provides for an annual audit to be included with the Annual Report, as follows:

Every Authority shall file an annual report with the Chairperson and the Minority Chairperson of the Appropriations Committee of the Senate and the Chairperson and the Minority Chairperson of the Appropriations Committee of the House of Representatives, which shall make provisions for the accounting of revenues and expenses. The Authority shall have its books, accounts and records audited annually in accordance with generally accepted auditing standards by an independent auditor who shall be a certified public accountant, and a copy of his audit report shall be attached to and be made a part of the Authority's annual report. A concise financial statement shall be published annually in the Pennsylvania Bulletin.

## Overview - PICA and its Role

### PICA Act

The Pennsylvania Intergovernmental Cooperation Authority ("PICA") was created in 1991 to assist the City of Philadelphia (the "City") in overcoming a severe financial crisis. At that time, the City was burdened with a growing cumulative operating deficit, lacked resources to pay mounting overdue bills from vendors, had been pushed below the investment grade level by national rating agencies, had instituted an across-the-board hiring freeze, was in a mode in which the quality of municipal services being provided was rapidly eroding, and verged on bankruptcy. PICA was created through the joint efforts of concerned Philadelphians and State officials who envisioned a structure which would assist the City in putting its revenue collection and spending processes in order, and at the same time reach a consensus on its future priorities, assets and limitations. The PICA Act was a compromise fashioned to meet the requirements of the Pennsylvania Constitution, the concept of local government Home Rule, and the interests of the State in the preservation of the financial integrity of its municipalities. PICA's role, a combination of cooperation, assistance and oversight was determined to be of vital importance in both a financial and political sense. PICA was designed to be a catalyst in the City's re-evaluation of the role and priorities of municipal government.

### Cooperation Agreement

The Intergovernmental Cooperation Agreement negotiated by and between PICA and the City and finalized in January of 1992 formalized the relationship contemplated by the PICA legislation. The powers and duties of the respective participants envisioned in the legislation were put into place with the execution of the Agreement. PICA was designed to be much more than a vehicle to raise otherwise unavailable funds for Philadelphia. It has the responsibility to evaluate and approve annually revised Five-Year Financial Plans, to monitor compliance by the City with such Plans, and the power to instruct the Commonwealth's Secretary of the Budget to withhold both substantial Commonwealth financial assistance and the net proceeds of the PICA Tax (after PICA debt service) should the City fail to comply with its duty to balance such Plan in each of its years.

### The PICA Organization

The Authority Board determined at the outset that PICA should not become overburdened with staff, preferring instead to impress upon the City the necessity for Philadelphia to develop and implement its own solutions to its problems. The Authority's staff, which totals seven, is organized to evaluate the actions of the City and to issue appropriate reports thereon to assist those who are properly charged with administration of City affairs or development of underlying policies.

### PICA Financial Assistance to the City

The issuance of bonds to provide the funds directly required to assist the City to avoid insolvency and for essential capital programs was an important initial role of the Authority. That role has been successfully completed and the Authority's "new money" bond issuance powers have expired. Authority bond issuance is currently limited to refinancing existing Authority debt in order to realize net debt service savings to the City.



Through debt issuance and capital program earnings the Authority has provided in excess of \$1,188 million to directly assist the City, allocated to the following purposes:

<u>Purpose</u>	<u>Amount (thousands)</u>
Deficit Elimination/Indemnities Funding	\$ 269,000
Productivity Bank	20,000
Capital Projects	518,003
Retirement of Certain High Interest City Debt	<u>381,300</u>
TOTAL	<u>\$1,188,303</u>

### **The Five-Year Financial Plan Process**

PICA has consistently emphasized its firm belief that the City's continuing fiscal rehabilitation is dependent upon its continuing success in addressing both financial and managerial issues; that the process is less one dealing with finance than assessing the financial results of managerial decisions. Effective strategic planning and the institutionalization of change are matters which the City must continue to focus upon in order to assure that its considerable assets continue to be applied intelligently and consistently. The Plan process helps to document the City's intentions and the results of its actions.

As mandated in the PICA Act (and as further refined by the Intergovernmental Cooperation Agreement), the Plan is required to include:

- Projected revenues and expenditures of the principal operating funds of the City for five fiscal years (the current fiscal year and the next four); and
- Components to (i) eliminate any projected deficit for the current fiscal year; (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 Plan through sound budgetary practices, including, but not limited to, reductions in expenditures, improvements in productivity, increases in revenues, or a combination of such 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- and long-term credit markets.

There also are statutorily mandated standards for development of the Plan (and the manner in which it is to be evaluated by PICA):

- all projections of revenues and expenditures are to be based upon consistently applied reasonable and appropriate assumptions and methods of estimation;
- revenues are to be recognized in the accounting period in which they become both measurable and available; and

- cash flow projections are to be made based upon reasonable and appropriate assumptions as to sources and uses of cash, including factors intended to provide a complete picture of cash demands.

The PICA Act also mandates standards for the basis for estimation of City revenues:

City Sources - current or proposed tax rates, historical collection patterns, and generally recognized econometric models;

State sources - historical patterns, currently available levels, or on levels proposed in a budget by the Governor;

Federal sources - historical patterns, currently available levels, or levels proposed in a budget by the President or in a Congressional budget resolution; and

Non-tax sources - current or proposed rates, charges or fees, historical patterns and generally recognized econometric models.

Deviations from such standards for estimation of revenues and appropriations which are proposed to be used by the City are to be disclosed specifically to the Authority and approved by a "qualified majority" of the Authority (four of its five appointed members). The Authority's Board generally has required that conservative criteria be used, and the result of the PICA process has been credible budget and Plan-making.

The Plan is also required to include a schedule of projected City capital commitments (and proposed sources of funding), debt service projections for existing and anticipated City obligations, a schedule of payments for legally-mandated services projected to be due during the term of the Plan and a schedule showing the number of authorized employee positions (filled and unfilled), inclusive of estimates of wage and benefit levels for various groups of employees.

The PICA Act requires that the Authority solicit an opinion or certification from the City Controller, prepared in accordance with generally accepted auditing standards, with respect to the reasonableness of the assumptions and estimates in the Plan. The PICA Act does not, however, require that the Controller's determinations bind the Authority in its evaluation of a proposed Plan.

The PICA Act (§209) and the Cooperation Agreement (§409(b)) require submission of quarterly reports by the City concerning its compliance with the current 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 a qualified majority declare the occurrence of a "variance", which is defined in §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 §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 Effect of a "Variance"**

The statute mandates the submission of monthly reports to PICA by the City in the event of a determination by the Authority of the occurrence of a variance. That situation occurred once in PICA's history. In November of 1992, the City projected a variance of \$57 million (2.5%) for the 1993 fiscal year, and the Authority agreed with that assessment on December 9, 1992. Thereafter, until May of 1993, the City filed required monthly reports. The City was relieved of its burden to make monthly reports when the Authority approved the City's plan of correction in conjunction with its approval of the City's Five-Year Financial Plan for FY93-FY98 in May of 1993.

As provided in §210(e) of the PICA Act, legal consequences flow from a determination by the Authority of the existence of a variance. 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 deal with a continuing variance are to direct the withholding of both specific Commonwealth funds due the City and that portion of the 1.50% tax levied on the wages and income of residents of the City in excess of the amounts necessary to pay debt service on PICA's bonds. Any amounts withheld would be paid over to the City after correction of the variance.

### **PICA "Threshold" Policies**

From its inception, PICA has held to the following policies in its evaluation of Philadelphia's Plans, initiatives, proposals and performance:

Emphasis on Structural Change - Consistent City failure to deal effectively with a long list of areas of government operations and service delivery contributed to the need for PICA. The City shall continually be encouraged to rethink existing policies and practices and to avoid sacrificing long-term progress for short-term gain.

Focus on Long-Term Progress - Meaningful strategic planning, institutionalization of appropriate change, focus on attaining long-term structural balance and on implementing pragmatic economic stimulus policies and procedures are matters of paramount importance and are to be emphasized in the PICA oversight process.

Infrastructure Programs - A meaningful capital program is a visible and tangible element of a City's social contract with its residents. The capital program, including proper maintenance of capital assets, is a key element to long-term fiscal stability. A consistent policy to adequately fund and staff infrastructure maintenance shall be continually encouraged.

Consistent Application of Stated Assumptions - Inconsistent application of unstated assumptions frequently caused pre-PICA City budgets to lack credibility, and made reliable assessment of prospects of attaining the results of such budgets impossible. PICA's Plan review process shall focus on assumptions utilized being both visible and consistent in their application.

Use of Credible Revenue Estimates - Realistic revenue estimates are a vital component of the City's budgeting and Plan preparation process and shall be a matter of primary concern in PICA's Annual Plan review process.

While it would be incorrect to claim that PICA threshold policies have resulted in all desired effects coming to fruition, they have contributed substantially to City procedural improvements.

### **Philadelphia City Controller**

An unforeseen benefit of the PICA Act's requirement that PICA solicit an opinion from the City Controller as to the reasonableness of Plan assumptions and estimates has been the extensive cooperative professional relationship which has developed between PICA Staff and the Controller's Office. The mutually beneficial professional relationship includes ongoing cooperation on matters of common concern; joint reviews of Plan components including appropriate joint meetings with City department heads and chief operating personnel pertinent thereto; cooperation on capital project reviews and reviews of PICA funded special purpose grants to the City; PICA assistance for Controller special situation studies; and specific Office of the Controller personnel assigned responsibility for effective ongoing liaison with PICA Staff. The assistance provided to PICA by the City Controller is sincerely appreciated. Cooperation between its "oversight" and "watchdog" entities has substantially benefited the City.

### **Providing Comment on Pending Legislation**

In accordance with its oversight duties, PICA continues to provide comments and fiscal analysis on City legislation which impacts the City's fiscal situation. Further, PICA upholds its responsibility to provide analysis on appropriate legislation before the General Assembly, in accordance with the PICA Act § 203 (c) (5), which empowers the Authority "to make recommendations to the Governor and the General Assembly regarding legislation or resolutions that affect Commonwealth aid or mandates to an assisted city or that concern an assisted city's taxing power or relate to an assisted city's fiscal stability."

### **Corporate Entities and The School District of Philadelphia**

"Corporate Entities" are defined in §1.01 of the Cooperation Agreement as "an authority or other corporate entity, now existing or hereafter created, of which one or more members of its governing board are appointed by the Mayor and which performs governmental functions for the City". The Agreement provides that the City shall cooperate with PICA in any PICA request to look into the operations of either the Corporate Entities or the School District of Philadelphia.

To date, PICA has not devoted any substantial attention to the operations of such City related institutions, but it has offered its expertise to the School Reform Commission, the CEO of the School District of Philadelphia and the Commonwealth's Secretary of the Budget, and has provided informal assistance where appropriate.

In accordance with legislation passed by the General Assembly, PICA Staff has had initial discussions with the Pennsylvania Convention Center and representative of the Commonwealth regarding development of a Financial Plan for expansion. PICA Staff is ready to prepare an analysis of the plan and risks once it has been completed. PICA Staff also remains prepared to play any appropriate role in regard to developments at the Philadelphia Gas Works.

## **The Work of PICA - Fiscal Year 2007**

### **Approval of the FY2008-FY2012 Plan**

Review and recommendation for approval of the City's FY2008-FY2012 Five-Year Financial Plan was a major component of PICA Staff activities during FY2007. The Plan as presented to Council in February contained so many unreasonable assumptions that it was clear that changes would be needed before PICA Staff could recommend to the Board that the Plan be approved. The Plan was then thrown further out of balance during the Administration's budget negotiations with City Council when real estate tax revenue totaling \$95 million over the life of the Plan was shifted from the City's general fund to the School District, \$16 million in funding was added to City agencies and another \$10 million was shifted to City Council to be used to provide additional funding to the School District. The combined impact of those actions was to add \$217 million to the problems that the Plan already faced.

By far the largest of the speculative assumptions in the initial Plan pertained to state and federal reimbursements and wage tax growth, but the Plan included a number of other speculative items. PICA Staff made its concerns known through letters and discussions with administration officials. In a May letter, PICA Staff wrote that unless the City removed the speculative items from the Plan or explained how the Plan would be balanced even if the speculative items were not removed, it would recommend to the PICA Board that it disapprove the Plan.

In response, the City made a substantial number of changes to the Plan, such as: Shifting \$70 million of appropriations for the Department of Human Services from the general fund to the grants fund; capping projected growth in the wage tax base at four percent annually; increasing the projected rate of growth for prisons systems costs; reducing the amount of projected real estate tax collections in FY07; eliminating assumed savings from health benefit initiatives; and, providing additional funding to the School District.

While these changes mitigated much of the risk highlighted by PICA, additional actions, some of which PICA considered to be bad policy, were required in order to bring the Plan in to balance. These changes included: freezing the reductions in the gross receipts portion of the business privilege tax beginning in FY10; eliminating the funding that City Council added to the budgets of an array of City departments; eliminating the Productivity Bank; recognizing additional wage and business privilege tax revenues collected in FY07; reducing the amount of projected debt service payments; projecting receipt of PILOTS from the casino operators and the Phillies and Eagles; and, cutting the Fleet Acquisition Budget. A full discussion of these actions can be found in the PICA Staff Report, available on the PICA website at [www.picapa.org](http://www.picapa.org).

These changes enabled the Plan to narrowly meet the statutory requirement of a financial plan which projects balanced budgets, based upon reasonable assumptions for each year of the Plan. While PICA Staff did recommend approval of the Plan, it noted that "in last year's report, PICA Staff said that its recommendation should in no way be viewed as an endorsement of the Plan or its approach to fiscal management. That is still true, but with more urgency since a year has passed and the City has still shown very little progress in addressing the long-term issues it faces. Time is not on the City's side in dealing with these issues. The longer the City waits to deal with these problems, the more challenging they will become. Philadelphians cannot afford for the new mayor to propose a Plan that does as little as the FY08-FY12 Plan does to address the City's long-term issues."

Although approved by the Board on the basis of the Staff's recommendation, the Plan contained two speculative items as well as six significant risks to the continuing fiscal health of the City:

### Speculative Items

1. **PHILADELPHIA GAS WORKS:** The Plan assumes that the Philadelphia Gas Works will repay a \$45 million loan to the City in FY09. Given PGW's fiscal condition, it is extremely unlikely that the City will receive that payment. Moreover, there is a real possibility that future fiscal crises at PGW will require additional city subsidies.
2. **THE EAGLES' LUXURY BOX PAYMENT:** The FY08 budget projects that the City will receive \$8 million from the Eagles before the end of FY07 in payment of rent for luxury boxes in Veterans Stadium. It is the fourth straight budget in which the City has made that assumption and it will be the fourth straight budget in which that assumption has been wrong.

### Significant Risks

1. **PERSONNEL COSTS:** The largest risk in the Plan is also the City's largest cost area – personnel costs. While all of the City's five-year plans have had labor costs risk, the FY08-FY12 Plan has *seven* years of labor cost risk. In addition to having the contracts of all four of its major unions expire at the end of FY08, the City still has unresolved health insurance issues dating back to FY06 for uniformed employees and to FY07 for non-uniformed employees. The potential that the contracts will cost more than budgeted is one of the largest risks facing the Plan.
2. **SCHOOL DISTRICT OF PHILADELPHIA:** The Mayor and City Council have agreed to provide at least \$20 million in additional funding to the School District in FY08 and at least \$105 million over the life of the FY08-FY12 Plan. The District, however, still faces substantial fiscal challenges and may eventually turn to the City for additional funding.
3. **GAMING COSTS:** The Administration's inclusion of revenues from proposed new casinos creates two distinct risks. The first is that any delay caused by the need for local legislation or by successful legal challenges would delay the City's receipts of revenues. Secondly, since the Plan includes revenues from gaming, but no City costs, any of the City costs that are likely to be created by the opening of new casinos will create a hole in the Plan.
4. **GROWTH IN THE NUMBER OF INMATES IN THE CITY'S PRISON SYSTEM:** The Administration's previous plans have all proven to be overly optimistic in their projections for the growth in the prisons census and costs. It is likely that the FY08-FY12 Plan will continue that trend.
5. **STATE AND FEDERAL FUNDING FOR THE DEPARTMENT OF HUMAN SERVICES:** The Department of Human Services' spending increased by about \$140 million from FY01 through FY07. That increase has been made possible, in large part, by increased reimbursements from the state and federal governments which are beyond the control of the City government. There is still a possibility that attempts to constrain spending by either the federal or state government will

lead to reductions in funding for the City and leave the City faced with the choice of reducing services or increasing funding.

6. **REIMBURSEMENTS FOR THE PENNSYLVANIA CONVENTION CENTER:** There have been substantial signs of progress in the potential construction of a new convention center. The state has included funding for the expansion in the FY08 budget and the City has included \$15 million annually in the Plan beginning in FY10 to fund its commitment to an expanded center. Despite the progress, PICA has yet to see a financing plan for the expansion. Until that financing plan and an agreement between the Commonwealth and the City are finalized, PICA staff will continue to view the expansion of the Center as a risk to the five-year Plan.

The Staff Report on the City of Philadelphia's Five-Year Financial Plan for Fiscal Year 2008-Fiscal Year 2012, dated July 26, 2007 and comprising 53 pages, is available by contacting PICA at 215-561-9160 or at our website [www.picapa.org](http://www.picapa.org).

### **City Capital Program**

Oversight of the capital program continued to be a key element of PICA's work in FY2007. PICA Staff has continually noted the need for the City's capital program to be guided by an overall strategic plan. PICA Staff continues to monitor the relationship of the capital program to other Citywide programs.

In FY2006 a PICA Issues Paper focused on the ongoing underfunding of the City's investment in its core infrastructure. While the City's own Planning Commission recommends that \$185 million be invested annually to properly maintain its infrastructure, the City's Capital Program assumes no more than \$55.2 million in any of the next six years. After a series of PICA Staff meetings with City officials, it became clear that the City did not have adequate information regarding what critical repairs were not being done and what level of investment would be needed to merely ensure that City facilities were safe and operational, and that the only way that both PICA and City officials could get a better understanding of the urgency of the City's capital needs was for PICA to commission a study.

On November 1, 2006, PICA issued a request for proposals for firms to assess the physical condition of various City facilities in order to provide a working tool that will allow City officials to prioritize and allocate capital funding. The project will also allow the City to expand its ongoing maintenance schedule for the facilities covered by the project. In order to ensure that the project was manageable, PICA chose to focus on the most important city facilities - police, fire, prisons and health facilities, and the interior of City Hall.

After reviewing the 12 proposals (representing 34 firms), three were chosen for follow-up questions with PICA and representatives of the City. Since the selection of the winning proposal in January of 2007, the assessment team led by CDA&I has been able to maintain the agreed upon schedule and provide the necessary tools for the City's capital assessment and maintenance needs. The project is expected to be completed by the middle of October, 2007.



PICA Staff notes that the City has yet to complete all of the projects originally approved at the time of the various bond issuances. PICA Staff will continue to press the City to complete these projects.

### **The Tax Base and the Local Economy**

The City's high tax burden for individuals and businesses remains a major obstacle to economic development. The continuing tax cuts proposed in the FY2008-FY2012 Plan are a positive step toward addressing this problem, though the cuts in the Business Privilege Tax are slated to end in FY2010. However, even with the implementation of the tax reductions, significant tax differentials will remain between the City and competing locations in the suburbs and elsewhere. While State and Federal policies drive some of the tax differential, the City government can still do much to promote a more competitive tax structure. The City can further increase productivity, cut costs, improve tax enforcement and make appropriate changes in the levels and mix of City services provided, consistent with a strategic plan.

### **Fiscal Update and Long-Term Fiscal Issues Reports**

During FY2007, PICA Staff issued periodic reports when the City released a Quarterly Managers Report as well as an analysis of the finalized Fund Balance when it was released in early November. PICA Staff also issued three Issues Papers on long-term fiscal challenges facing the City:

1. City Budget Behind Bars: Increasing Prison Population Drives Rapidly Escalating Costs. An analysis of how the dramatic increase in prison population is driving up costs for the criminal justice system in the City.
2. Health/Medical Benefits: Burning a Hole in The Budget. An analysis of how the rapid increase in health benefits costs continue to consume more and more of the City's resources that diverts funds that could be used for essential services or to attack the many long-term issues facing the city.
3. Look Before You Leap: The Fiscal Situation that Awaits the Next Mayor. An analysis of the enormous short-term and long-term financial issues that will face the next Mayor upon taking office in January, 2008.

Copies of these, and all PICA reports, are available by contacting PICA at 215-561-9160 or at our website [www.picapa.org](http://www.picapa.org).

### **Citizens Guide to the Budget**

During FY2007, PICA Staff continued to do periodic updates and added new analyses to "A Citizen's Guide to the Budget" found on its website. The Citizen's Guide to the Budget is designed to help better inform the public about the City of Philadelphia's Budget. The information in the Guide uses the most recently approved five-year plan and is updated as the City updates its projections in its Quarterly Manager's Reports. The Guide also contains links to additional information, including historical trends, more in-depth data, and relevant PICA reports. The Guide may be found at our website [www.picapa.org](http://www.picapa.org).

## **Goals for PICA - Fiscal Year 2008**

### **Ongoing Goals**

During the next fiscal year, PICA Staff will continue to:

- Encourage the City to address long-term issues such as, the City's dangerously high debt burden, the pension fund's growing cost and increasing unfunded liability, Philadelphia's uncompetitive tax structure, the persistent underinvestment in the City's infrastructure and the need for a Rainy Day Fund.
- Focus on the need for City departments and agencies to produce strategic plans which delineate specific actions to be undertaken and measurable goals to be achieved that assist in attaining the goals of the Five-Year Plan.
- Promote the further development and use of departmental performance measures that contribute to a better understanding of and capacity to manage departmental activities.
- Provide assistance to the new administration as it begins to address the fiscal issues facing Philadelphia.
- Oversee PICA-funded City capital projects, stressing essential improvements to the City's capital project management and the benefits derivable from coordinated strategic and capital planning.
- Present the results of the facilities assessment project and assist the City in incorporating the results of the study in capital planning as well as utilizing the planning tools expected to result from the project.
- Encourage identification of additional City capital funds available for reprogramming and utilize these funds for projects meeting PICA's statutory criteria.
- Provide technical assistance to help inform the ongoing debate about reforming Philadelphia's tax and regulatory structures.

### **Plan Review and Approvals**

PICA Staff looks forward to the FY2008 review of the City's Five-Year Financial Plan, Fiscal Year 2009-Fiscal Year 2013 (including Fiscal Year 2008) with the input of the professional staff of the City Controller. The Plan will need to produce reasonable revenue and expenditure projections and reasonable prospects for continued General Fund balance while addressing the long-term issues facing the City.

### **Achieving Balanced Annual Budgets**

All five years of the current Plan assume an annual operating deficit, ranging from \$18 million to over \$64 million. The City needs balanced annual Operating Fund budgets to achieve true fiscal stability.

### **Providing Reliable Information to Inform Policy Debates in the City**

PICA Staff will continue to provide reliable and unbiased data and analysis to help inform the public policy debates which are sure to arise during the coming Fiscal Year. Through Issue Papers, periodic Staff Reports, public testimony, and briefings for the executive and legislative branches of the City and the Commonwealth, PICA will spur discussion about the issues which challenge the City's ongoing fiscal stability.

### **Assessment of City of Philadelphia Facilities**

In the Fall of 2007, PICA expects to release the results of the Facilities Assessment project and will work with the City to integrate the findings and tools produced by that project.

### **The School District of Philadelphia**

The possibility of PICA being of substantial assistance to both the Commonwealth of Pennsylvania and the City of Philadelphia in the matter of School District financial oversight was originally proposed by the Courts, has twice been a matter of legislative discussions, and has been endorsed by the Mayor and several members of City Council. In early FY2007, PICA staff began working with the Governor's Office on a review of the School District's finances. PICA's budget includes reserve funding for such an analysis.

### **Improving Philadelphia's Tax Structure**

PICA will continue to publish papers, provide testimony, and provide technical assistance regarding the ongoing efforts to make Philadelphia's tax structure more efficient and effective while maintaining the integrity of the City's Five-Year budget planning process.

### **Overall Goal**

PICA's overall goal continues to be assisting the City to become more proactive in serving its citizens; to define its service delivery philosophy; and then to consistently deliver such services within the constraints of available resources. No less will be acceptable.

## **Future City Reporting to PICA**

### **Regular Reporting Required**

The reporting system established in the Cooperation Agreement and in the PICA Act requires a regular flow of data from the City to PICA. This system is the fundamental device used by PICA Staff in its ongoing evaluation of City progress in its fiscal rehabilitation. PICA Staff anticipates working closely with the Administration to ensure that there is no lapse in the flow of information PICA requires to fulfill its mission.

### **Data to be Received by PICA Includes:**

**Revised Plan.** The PICA Act and the Cooperation Agreement contemplate the continuous existence of a Plan encompassing the current fiscal year and the four fiscal years thereafter, and require that a new year be added to the then-existing Plan not later than 100 days prior to the end of each fiscal year. The City's Five-Year Financial Plan, Fiscal Year 2009-Fiscal Year 2013 (including Fiscal Year 2008) is thus anticipated to be received by PICA by March 23, 2008.

**Quarterly Plan Reports.** Under the Cooperation Agreement (§409(b)), the Authority receives reports from the City on a quarterly basis (within 45 days after the end of each fiscal quarter) concerning the status of compliance with the Plan and associated achievement of initiatives. The Cooperation Agreement (§409(e)) 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, by department, be prepared and submitted not later than 20 days after the close of each fiscal quarter. This report details the receipt and use of Federal and Commonwealth Funds by the City. A separate report details the eligibility for fund withholding by the Commonwealth (at PICA's direction) in the event the City cannot propose credible measures to balance a Plan which has been declared at "variance" by PICA.

**Prospective Debt Service Requirements Report.** The Cooperation Agreement requires submission of a report detailing prospective debt service payments by the City, as well as lease payments, 60 days prior to the beginning of a fiscal quarter, and upon each issuance of bonds or notes or execution of a lease.

### Time Table of FY2007 Reporting Requirements

<b>Due Date</b>	<b>Description</b>
October 22, 2007	Receipt of 1st Quarter FY2008 Grants Revenue Fund Contingency Account Report
November 1, 2007	Receipt of 3rd Quarter FY2008 Prospective Debt Service Requirements Report
November 15, 2007	Receipt of 1st Quarter FY2008 Plan Report, Supplemental Funds Report and report concerning Commonwealth funds which may be withheld
January 21, 2008	Receipt of 2nd Quarter FY2008 Grants Revenue Fund Contingency Account Report
January 31, 2008	Receipt of 4th Quarter FY2008 Prospective Debt Service Requirements Report
February 15, 2008	Receipt of 2nd Quarter FY2008 Plan Report, Supplemental Funds Report and report concerning Commonwealth funds which may be withheld
March 20, 2008	Submission of proposed revision to Plan and addition of FY2013
April 21, 2008	Receipt of 3rd Quarter FY2008 Grants Revenue Fund Contingency Account Report
May 1, 2008	Receipt of 1st Quarter FY2009 Prospective Debt Service Requirements Report
May 15, 2008	Receipt of 3rd Quarter FY2008 Plan Report, Supplemental Funds Report and report concerning Commonwealth funds which may be withheld
July 21, 2008	Receipt of 4th Quarter FY2008 Grants Revenue Fund Contingency Account Report
August 1, 2008	Receipt of 2nd Quarter FY2008 Prospective Debt Service Requirements Report
August 15, 2008	Receipt of 4th Quarter FY2008 Plan Report, Supplemental Funds Report and report concerning Commonwealth funds which may be withheld

**Appendix A:**  
**Financial Statements**  
**and**  
**Report of Independent Auditors**

**ISDANER &  
COMPANY, LLC**

**ISDANER &  
COMPANY, LLC**  
CERTIFIED PUBLIC ACCOUNTANTS

**ISDANER &  
COMPANY, LLC**

**PENNSYLVANIA INTERGOVERNMENTAL  
COOPERATION AUTHORITY**

**JUNE 30, 2007**

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## Management Discussion of Financial Operations

The Board of the Pennsylvania Intergovernmental Cooperation Authority (the "Authority" or "PICA") offers the following narrative overview and analysis of the financial activities of the Authority for the fiscal year ended June 30, 2007.

### Financial Highlights

- The total net assets (deficit) of the Authority at the close of the fiscal year were (\$485,567,468) representing a decrease in net deficit of \$57,911,009 over the prior year.
- At the close of the current fiscal year, the Authority's General Fund unreserved balance increased by over \$500,000 to \$6,976,167 from the prior fiscal year. All Administration costs during fiscal year 2007 were funded from the Authority's earnings on its General Fund and on its Debt Service Reserve Fund.
- The Authority's outstanding long-term debt decreased by \$51,770,000 during the current fiscal year.

### Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the Authority's basic financial statements. The Authority's basic financial statements comprise three components: 1) government-wide financial statements, and 2) governmental funds financial statements and 3) notes to the financial statements. This report also contains other supplementary information in addition to the basic financial statements themselves.

**Government-wide financial statements.** The government-wide financial statements are designed to provide readers with a broad overview of the Authority's finances, in a manner similar to a private-sector business.

The statement of net assets presents information on all of the Authority's assets and liabilities, with the difference between the two reported as net assets (deficit). Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the Authority is improving or deteriorating.

The statement of activities presents information showing how the Authority's net assets (deficit) changed during the fiscal year ended June 30, 2007. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods (e.g., uncollected taxes).

The government-wide financial statements can be found on pages 3-4 of this report.

**Fund financial statements.** A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The Authority uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

Governmental funds are used to account for all of the functions that are reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on near-term inflows and outflows of spendable resources, as well as on balances of spendable resources available at the end of the fiscal year. Such information may be useful in evaluating near-term financing requirements.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the Authority's near-term financing decisions. Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

The Authority maintains eleven individual governmental funds. Information is presented separately in the governmental fund balance sheet and in the governmental fund statement of revenues, expenditures, and changes in fund balances.

The basic governmental fund financial statements can be found on pages 5-6 of this report.

**Notes to the financial statements.** The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes to the financial statements can be found on pages 7-26 of this report.

### **Government-wide Financial Analysis**

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. In the case of the Authority, liabilities exceeded assets by \$485,567,468 at the close of fiscal year 2007.

By far the largest portion of the Authority's net deficit reflects its bonds payable. Proceeds from the PICA Tax as well as the corresponding interest earned are in part utilized to fund such debt service requirements. The Authority's bonds payable activity for the year ended June 30, 2007 is summarized as follows:

	Amount (in thousands)
Outstanding Debt at July 1, 2006	\$674,305
Debt Retired	<u>(51,770)</u>
Outstanding Debt at June 30, 2007	<u>\$622,535</u>

The Authority's cash, cash equivalents and short-term investments make up the largest portion of the total assets. Such assets are derived from the proceeds of bond issuances of years past and the related investment income. These assets are used to provide grants to the City of Philadelphia for various capital projects and to fund the required debt service reserve. During fiscal year 2007, the Authority granted approximately \$245 million to the City of Philadelphia.

Governmental activities decreased the Authority's net deficit by \$57,911,009, thereby accounting for the total decrease in net deficit during fiscal year 2007. Net deficit reduction was due primarily to the retirement of long-term debt as well as better than budgeted operating fund results during fiscal year 2007.

## Governmental Funds Financial Analysis

As of the end of the current fiscal year, the Authority's governmental funds reported combined ending fund balances of approximately \$145.5 million, an increase of approximately \$4.7 million in comparison with the prior year. Approximately 57 percent of this total amount (\$83.6 million) constitutes fund balances reserved for debt service. Approximately 23 percent of the total (\$33.7 million) constitutes fund balances that are reserved for the benefit of the City of Philadelphia. The remainder of the reserved fund balances is reserved primarily for the administration of the Authority. Approximately, \$19.6 million is designated for future swaption activity relating to various derivative transactions. Approximately \$7 million constitutes unreserved fund balance, which is available for spending at the Authority's discretion.

**General Fund.** All fiscal year 2007 administration expenses of the Authority were funded from the Authority's earnings on its General Fund and on its Debt Service Reserve Fund (established from proceeds of the Authority's bond issues) and residual balances of similar earnings from prior fiscal years. No City of Philadelphia or Commonwealth of Pennsylvania tax revenues were used to pay any portion of the Authority's administrative costs in fiscal year 2007, nor are any expected to be used in fiscal year 2008 for such purpose.

The PICA Act allows the Authority several sources of income to support its operations. The statute specifically provides that the Authority may draw earnings from the various funds and accounts created pursuant to its Trust Indenture, and also directly from the proceeds of PICA Taxes to the extent investment income is insufficient. The latter allowable revenue source has never been utilized by the Authority.

The PICA Act requires that the Authority adopt an annual budget (for the fiscal year commencing July 1) before March 1 of each year and also stipulates the format thereof, and information to be provided therewith to the Governor and General Assembly of the Commonwealth of Pennsylvania. The Authority's annual General Fund budgets, since its inception, have all produced surpluses.

Details as to anticipated and actual fund balances as of June 30, 2007 and as to the fiscal year 2008 budget are as follows:

<u>Anticipated Residual Fund Balance:</u>	
Unreserved Fund Balance at June 30, 2006	\$6,457,802
Excess Revenues over Expenditures	0
Anticipated Unreserved Fund Balance at June 30, 2007	<u>\$6,457,802</u>

<u>Fund Balance at June 30, 2007 (Anticipated/Actual):</u>	
Anticipated Unreserved Fund Balance at June 30, 2007	\$6,457,802
Add: Net FY07 "Better than Budget" Operating Results	518,365
Actual Unreserved Fund Balance at June 30, 2007	<u>\$6,976,167</u>

<u>General Fund Budget for FY08:</u>	
Revenues - General Fund Interest Earnings	\$ 150,000
Other Financing Sources - Transfer from Bond Issue Investment Earnings ("Reserved for subsequent Authority Administration" in the Debt Service Reserve Fund at June 30, 2007)	1,558,986
Utilization of portion of FY07 fund balance	<u>1,200,000</u>
Total Estimated Expenditures	<u>\$2,908,986</u>

The Authority's fiscal year 2008 budget recognizes the possibility that the Authority may be requested to become involved in oversight matters as directed by the Pennsylvania General Assembly; and provides funding to study and/or implement such a role. The fiscal year 2008 budget also provides funding from previous operating fund surpluses to support special city projects including a City Facilities Assessment project. Absent these additional special use funds, the fiscal year 2008 budget reflects a decrease of 8 percent from the fiscal year 2007 budget.

The philosophy underlying the Authority's general fund operations remains that the Authority should maintain a personnel and expenditure level sufficient to permit it to respond to the demands placed upon it, but not so large as to present an opportunity either for the City of Philadelphia to use the Authority's resources to bypass the re-creation of its own management systems or to establish a permanent Authority structure that would develop its own reason for continued existence.

**Special Revenue Fund.** The Authority's Special Revenue Fund receives PICA taxes, interest earnings on such collections, and net interest earnings on bond issue funds other than Capital Projects Funds (the earnings on Capital Projects Funds are restricted to use for grants to the City of Philadelphia for PICA approved capital projects). The Special Revenue Fund receipts are utilized to provide, monthly, from the first available funds in that month, one-sixth of the next semi-annual interest requirement on PICA bonds outstanding and one-twelfth of the next annual principal requirement on PICA bonds outstanding, in a manner calculated to provide the total required semi-annual interest and the total required annual principal at the close of the month prior to such required date. After provision of monthly debt service requirements, the residual balances in PICA's Special Revenue Fund are paid to City of Philadelphia as grants to the City's General Fund.

PICA grants to the City of Philadelphia's General Fund during fiscal year 2007 exceeded the equation (PICA taxes minus provision for PICA Debt Service equals PICA grants to the City) by more than \$2.9 million.

**Debt Service Funds.** The Debt Service Funds account for the accumulation of financial resources for the payment of principal and interest on PICA's long-term debt.

**Debt Service Reserve Fund.** This fund is used to hold assets for debt service reserve purposes as required by the Trust Indenture. Current year investment earnings were transferred to pay current year debt service requirements and to aid in paying for the General Fund's administration expenditures.

**Rebate Fund.** This fund is maintained in order to fund future potential rebates and/or debt service requirements. The only activity that occurred during the current fiscal year was the increase from investment earnings.

At June 30, 2007, the Fund Balances held in the combined Debt Service Funds, by individual fund groups, consisted of:

