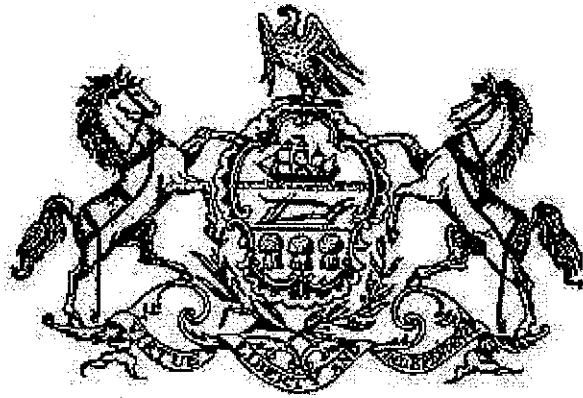


# **Pennsylvania Intergovernmental Cooperation Authority**



**Annual Report  
for  
Fiscal Year 2008**

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**October 28, 2008**

**PENNSYLVANIA INTERGOVERNMENTAL  
COOPERATION AUTHORITY**

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Telephone: (215) 561-9160 – Fax: (215) 563-2570  
Email: [pica@picapa.org](mailto:pica@picapa.org)

**Board of Directors**

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James Eisenhower, Esquire

Vice Chairperson

William J. Leonard, Esquire

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Varsovia Fernandez

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Commonwealth of Pennsylvania

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City of Philadelphia

Rob Dubow  
Director of Finance

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John J. Daly ..... Director of Capital Analysis  
Alik Bonarou ..... Director of Program Analysis  
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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Source: Pennsylvania Intergovernmental Cooperation Authority Act for Cities of the First Class (Act of June 5, 1991, P.L. 9, No. 6) (the "PICA Act") Section 102.

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Cooperation Authority**

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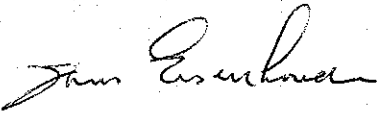
October, 2008

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

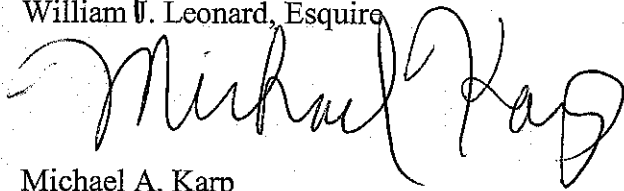
As the Pennsylvania Intergovernmental Cooperation Authority ("PICA") marks its seventeenth anniversary, we are pleased to provide you with this Annual Report for the fiscal year ended June 30, 2008 ("FY2008"). In 1991, the City of Philadelphia ("City") faced a deficit of \$137 million, and lacked a coherent fiscal planning mechanism. The City projects it will end FY2008 with a surplus of over \$119 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 which are being exacerbated by the struggling national economy we remain confident in PICA's ability to help the City maintain a positive fiscal outlook.

Even after seventeen years, PICA continues to have a significant role in the ongoing City financial recovery. FY2008 activity included: (1) the approval of a Five-Year Financial Plan for Fiscal Years 2009 through 2013 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; and (6) 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.

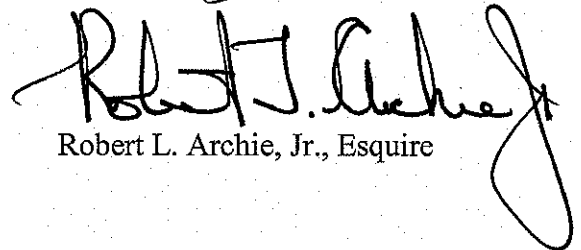
The PICA Board has been gratified by the recognition PICA regularly receives from the financial community and the media for its successful performance as the agency charged with the responsibility for oversight and monitoring of the City's finances. We would be remiss if we failed to acknowledge and 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

  
Michael A. Karp

  
Varsovia Fernandez

  
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 five, 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 \$1,191 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>384,300</u>
<b>TOTAL</b>	<b><u>\$1,191,303</u></b>

### **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 representatives 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 2008

### Approval of the FY2009-FY2013 Plan

Review and recommendation for approval of the City's FY2009-FY2013 Five-Year Financial Plan was a major component of PICA Staff activities during FY2008. The Plan as presented to City Council in February contained a number of assumptions that needed adjustment before PICA Staff could recommend to the Board that the Plan be approved. During the course of discussions with City Council and PICA prior to completion of the submitted Plan, the City took several steps to bring the Plan into balance, and for the first time in several years took steps to create a structural balance between recurring expenditures and recurring revenues as the projected fund balance in the last four years of the Plan fluctuates only \$5 million. Another positive development was that for the first time in several years, City Council approved the entire Five-Year Plan as opposed to just approving the first year's budget.

As recommended in several previous PICA reports, the new Administration proposed several first steps in addressing the long-term fiscal challenges faced by the City, though the success of key initiatives will not be known until the end of the calendar year once labor contracts and the POB issuance are completed. Additionally, the worsening of the national economy may further delay some of these initiatives.

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

#### Speculative Items

1. **Casino-Related Revenues and the Absence of any Costs:** The Plan assumes that the City will begin receiving fees from casinos in FY11, but the longer that the start of construction is delayed, the less likely it is that those revenues will be received in accordance with Plan estimates. Further, the Plan does not assume that the opening of those casinos will result in any social, police or infrastructure costs to the City's general fund, beyond the payment amounts pledged by the casino operators.
2. **Skybox Payment from the Philadelphia Eagles:** Each year since FY04 the City has assumed that it will receive \$8 million in sky box rental payments from the Philadelphia Eagles. The City has asserted that the Eagles have owed those payments since they played at Veterans' Stadium, but those payments have not been made. Until an agreement has been reached with the Eagles on the timing and amount of these payments, there will continue to be a substantial risk that the City either will not receive the \$8 million that the budget includes or will receive a much smaller amount.

#### Significant Risks

1. **Labor Costs.** For the first time, the Plan includes a line-item for increases in wages and benefits – over \$400 million during the life of the Plan. While the identification of available funds is a positive step, it remains uncertain whether that amount will be sufficient to cover the cost of the new contracts, all of which expired at the beginning of this Plan.
2. **Pension Obligation Bonds:** The Plan assumes that the City will issue about \$3 billion worth of Pension Obligation Bonds (POBs) prior to the end of calendar year 2008. The resulting savings to the City's annual pension costs are expected to allow the General Fund to recognize a savings of \$50 million a year in each of the

last four years of the Plan. Issuing POBs of this magnitude is somewhat complex and will require the approval of City Council and others as well as appropriate market conditions. If the City is unable to issue the POBs, the Plan will be short \$200 million. Further, even though the POBs are being issued in part to address the City's most serious long-term fiscal threat, failure to realign pension fund contributions with pension benefits will ultimately leave the City's pension fund in a precarious state.

3. **Weak National Economy:** While the City has generally avoided significant losses in its revenue streams, ongoing uncertainty in the national economy poses significant risks to the Plan. Real Estate Transfer tax revenues were down about 15 percent for the current year (which is reflected in the Plan) but other revenues have remained stable or even grown slightly. If continuing increases in food and fuel costs, as well as uncertainty in the housing market continue to erode consumer spending and business activity, City revenues are likely to fall in the next few years.
4. **The School District of Philadelphia:** In April, the School District announced that it was facing a \$39 million FY08 deficit unless additional corrective actions were taken. While the City did not include any additional funds in its Plan and the School District did not include any additional funds from the City in its budget, operating deficits remain a concern. Additional funds from the State mitigate this risk.
5. **Prison Costs:** Though the Administration is focusing on addressing the various Prisons concerns that PICA has continually brought in the forefront, the Plan seems to include overly optimistic cost figures. While the Plan projects a 3 percent increase in the average daily inmate census to 9,371 in FY09, the introduction of the Crime Fighting Plan has seen admission numbers skyrocket. Additionally, the census grew by over five percent in FY07 and has not grown by less than 3.5 percent in any of the last three years. While the Plan does project a 5 percent increase in contracts costs each year, PICA Staff remains concerned that this projection may be too low given recent history.
6. **Philadelphia Gas Works (PGW):** While the rate increase granted by the Public Utility Commission last year will enable PGW to repay the \$45 million loan from the City, it was insufficient to allow the utility to emerge from its overall precarious fiscal status. Unless the utility is able to gain additional rate relief, or find other means to generate revenues, PGW's large debt load and narrow operating margins leave it susceptible to fiscal distress, particularly in light of the national economic downturn.
7. **Costs Related to the New 3-1-1 System:** One of the new Administration's main focuses has been to significantly improve operations, achieve government efficiency and lead a result-driven, customer-service oriented operation. In order to bring all these steps together, the Managing Director's office has implemented PhillyStat and is already setting up to bring a 3-1-1 system in Philadelphia. While 3-1-1 is a critical tool needed to achieve a high performing government and improve customer service, PICA staff is concerned that the upfront costs needed to set-up the 3-1-1 system are not reflected in the Five Year Plan. Currently there is \$1.5 million in FY09 for contract costs geared towards putting together this structure; however, other cities have reported spending between \$6 and \$10 million in upfront costs.

The Staff Report on the City of Philadelphia's Five-Year Financial Plan for Fiscal Year 2009-Fiscal Year 2013, dated June 17, 2008, 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 FY2008. 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 assessment team led by CDA&I was able to maintain the agreed upon schedule and provide the necessary tools for the City's capital assessment and maintenance needs. The project was completed and the final report released on October 31, 2007.

The report covered prison facilities, police stations, fire stations, health department facilities and the interior of historic City Hall. The report found that for the facilities assessed, the City should be investing \$143 million in capital dollars through fiscal year 2012. Instead, the City has programmed \$91 million. Of the needs identified in the report, only \$12.9 million were identified as being critical capital repairs, well below the \$73 million budgeted for FY08. In addition to the report, PICA provided the City with a database of all of the findings to help the City better manage its maintenance and repairs at these facilities.

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 FY2009-FY2013 Plan are a positive step toward addressing this problem, and the addition of cuts to the Net Profits portion of the Business Privilege Tax is significant. Additionally, the submission of gaming funds from the State aimed at further lowering the Wage Tax, brought the resident wage tax rate below 4% for the first time in decades. However, even with the implementation of the tax reductions, 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 FY2008, 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 one Issues Paper on long-term fiscal challenges facing the City:

1. Balancing a Budget on About \$10 Million A Day: The Fiscal Situation Facing the New Mayor. An analysis of the enormous short-term and long-term financial issues that faced Mayor Nutter upon taking office.

Copies of 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 FY2008, 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 2009**

### **Ongoing Goals**

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

- Work with the City to help it address the fiscal pressures being felt by the downturn in the national economy. PICA will assist the City in identifying the extent of balancing steps the City will need to take in order to maintain spending levels consistent with falling revenues.
- Encourage the City, when economic conditions allow, 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.
- Continue to review and analyze the City's proposed fixes to the underfunded Pension Fund and track the City's efforts to better align pension contribution levels with pension benefit levels.
- Undertake efforts to examine City departments and agencies structures and processes in order to make recommendations to the City on ways to improve efficiencies, service delivery, and achieve savings.
- Promote the further development and use of departmental performance measures that contribute to a better understanding of and capacity to manage departmental activities.
- Continue to evaluate the fiscal challenges of the Philadelphia Gas Works and determine ways to improve PGW's fiscal stability.
- 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.
- 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 FY2009 review of the City's Five-Year Financial Plan, Fiscal Year 2010-Fiscal Year 2014 (including Fiscal Year 2009) 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**

Although this goal is a challenge given the current economic conditions, PICA will continue to push the City toward annual balanced budgets. The FY2009-FY2013 Plan did make strides toward this goal, with projected annual surpluses in three of the five years. 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.

### **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. 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 2010-Fiscal Year 2014 (including Fiscal Year 2009) is thus anticipated to be received by PICA by March 20, 2009.

**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 FY2008 Reporting Requirements

<b>Due Date</b>	<b>Description</b>
October 22, 2008	Receipt of 1st Quarter FY2009 Grants Revenue Fund Contingency Account Report
November 3, 2008	Receipt of 3rd Quarter FY2009 Prospective Debt Service Requirements Report
November 17, 2008	Receipt of 1st Quarter FY2009 Plan Report, Supplemental Funds Report and report concerning Commonwealth funds which may be withheld
January 21, 2009	Receipt of 2nd Quarter FY2009 Grants Revenue Fund Contingency Account Report
January 30, 2009	Receipt of 4th Quarter FY2009 Prospective Debt Service Requirements Report
February 16, 2009	Receipt of 2nd Quarter FY2009 Plan Report, Supplemental Funds Report and report concerning Commonwealth funds which may be withheld
March 20, 2009	Submission of proposed revision to Plan and addition of FY2014
April 20, 2009	Receipt of 3rd Quarter FY2009 Grants Revenue Fund Contingency Account Report
May 1, 2009	Receipt of 1st Quarter FY2010 Prospective Debt Service Requirements Report
May 15, 2009	Receipt of 3rd Quarter FY2009 Plan Report, Supplemental Funds Report and report concerning Commonwealth funds which may be withheld
July 20, 2009	Receipt of 4th Quarter FY2009 Grants Revenue Fund Contingency Account Report
August 3, 2009	Receipt of 2nd Quarter FY2010 Prospective Debt Service Requirements Report
August 17, 2009	Receipt of 4th Quarter FY2009 Plan Report, Supplemental Funds Report and report concerning Commonwealth funds which may be withheld

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

**PENNSYLVANIA INTERGOVERNMENTAL  
COOPERATION AUTHORITY**

**JUNE 30, 2008**

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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, 2008.

### Financial Highlights

- The total net assets (deficit) of the Authority at the close of the fiscal year were (\$438,666,841) representing a decrease in net deficit of \$46,900,627 over the prior year.
- At the close of the current fiscal year, the Authority's General Fund unreserved balance increased by over \$494,000 to \$7,470,168 from the prior fiscal year. All Administration costs during fiscal year 2008 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 \$50,440,000 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, 2008. 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 7-25 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 \$438,666,841 at the close of fiscal year 2008.

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, 2008 is summarized as follows:

	Amount (in thousands)
Outstanding Debt at July 1, 2007	\$622,535
Debt Retired	<u>(50,440)</u>
Outstanding Debt at June 30, 2008	<u>\$572,095</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 2008, the Authority granted approximately \$264 million to the City of Philadelphia.

Governmental activities decreased the Authority's net deficit by \$46,900,627, thereby accounting for the total decrease in net deficit during fiscal year 2008. 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 2008.

## 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 \$140.2 million, a decrease of approximately \$5.3 million in comparison with the prior year. Approximately 56 percent of this total amount (\$78.9 million) constitutes fund balances reserved for debt service. Approximately 23 percent of the total (\$31.8 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, \$20.4 million is designated for future swaption activity relating to various derivative transactions. Approximately \$7.4 million constitutes unreserved fund balance, which is available for spending at the Authority's discretion.

**General Fund.** All fiscal year 2008 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 2008, nor are any expected to be used in fiscal year 2009 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, 2008 and as to the fiscal year 2009 budget are as follows:

Anticipated Residual Fund Balance:

Unreserved Fund Balance at June 30, 2007	\$6,976,167
Excess Revenues over Expenditures	<u>0</u>
Anticipated Unreserved Fund Balance at June 30, 2008	<u>\$6,976,167</u>

Fund Balance at June 30, 2008 (Anticipated/Actual):

Anticipated Unreserved Fund Balance at June 30, 2008	\$6,976,167
Add: Net FY08 "Better than Budget" Operating Results	<u>494,001</u>
Actual Unreserved Fund Balance at June 30, 2008	<u>\$7,470,168</u>

General Fund Budget for FY09:

Revenues - General Fund Interest Earnings	\$ 150,000
Other Financing Sources - Transfer from Bond Issue Investment Earnings ("Reserved for subsequent Authority Administration" <u>in the Debt Service Reserve Fund at June 30, 2008)</u>	<u>1,565,500</u>
Total Estimated Expenditures	<u>\$1,715,500</u>

