

# **Pennsylvania Intergovernmental Cooperation Authority**



**Staff Report  
on the  
City of Philadelphia's  
Five-Year Financial Plan for  
Fiscal Year 2007 - Fiscal Year 2011**

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**July 5, 2006**

**PENNSYLVANIA INTERGOVERNMENTAL  
COOPERATION AUTHORITY**

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**SECTION I:**

**EXECUTIVE SUMMARY AND  
STAFF RECOMMENDATION**

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## EXECUTIVE SUMMARY AND STAFF RECOMMENDATION

Soon after the City released its proposed FY07-FY11 Five Year Financial Plan, PICA Staff identified \$500 million worth of speculative items included in that Plan and made clear that the Plan as then constructed was not balanced. After a series of discussions with PICA Staff, the City has either removed from the Plan or satisfactorily addressed all but \$88.4 million of those speculative items. The City's changes, when combined with a second consecutive late surge in tax collections, have brought the Plan into a precarious balance.

While the Plan is balanced, it is not without risks and flaws. Its failure to address the destructive long-term financial challenges facing Philadelphia, particularly in light of the unexpected surge in revenues, is particularly troubling. This Plan represents another missed opportunity by the City to attack these issues. As the City delays addressing these challenges, a return to fiscal distress becomes increasingly possible.

The Plan compounds these problems by continuing to include improbable revenues, such as assuming PGW will repay its \$45 million loan to the City in FY09 and that the Commonwealth will assume financial responsibility for the Pennsylvania Convention Center's operations beginning in FY10. PICA Staff believes that both of those assumptions are speculative at best.

In addition, the Plan includes a number of risky assumptions and while it begins to address some of the long-term issues facing the City's finances, it does not make substantial enough progress in attacking those problems. PICA will be closely monitoring the City's progress in confronting these challenges.

Under the PICA Act, the Board is charged with determining whether: "the financial plan projects balanced budgets, based upon reasonable assumptions...for each year of the Plan." The Plan the Board is now considering narrowly meets that test.

### *Report Summary*

This report focuses primarily on six areas:

1. **Actions the City took to address issues raised by PICA:** The City removed over \$285 million worth of speculative items from the Plan, took steps to address almost \$138 million in additional speculative items and benefited from increased tax collections.
2. **Speculative items included in the Plan:** These are items for which the possibility that the City will achieve its projections is so small that it is not reasonable to include them in the Plan;

3. **Substantial risks in the Plan above and beyond the Plan's speculative items:** These are items for which a strong possibility exists that the City will not meet its projections, but the risk of the City's missing those projections is not so large that it is unreasonable for the City to include them in the Plan.
4. **Tax revenue projections included in the Plan:** The tax collection projections are a key determinant of the level of expenditures that can be included in the Plan.
5. **Long-term financial issues facing the City:** These are issues that the City must tackle to secure its long-term fiscal health, but that do not pose a threat to the City's ability to achieve balanced budgets over the next five years.
6. **Approaches other cities are taking to their budgets.** A look at how a number of cities are aggressively attacking their long-term financial issues.

### **Actions the City took to Address Issues Raised by PICA**

In response to concerns raised by PICA, the City removed or balanced with compensating cuts \$286.5 million in speculative items and addressed an additional \$137.9 million in concerns. The items that the City removed from the Plan included overly optimistic assumptions about increases in state reimbursements and unreasonable expectations about the City's ability to slow some of its fastest growing expenditures. Changes in laws (for example legislation to delay the implementation of the low income wage tax credit bill) or additional information provided by the City helped address other speculative items.

Removing those speculative items from the Plan created large deficits, requiring the City to make a number of changes to balance the Plan. Among the changes selected by the City were slowing the pace of business privilege tax cuts, delaying the implementation of the low income tax credit bill, increasing parking fines, delaying the issuance of debt and agreeing to reduce the number of police officers if the Commonwealth assumes patrol of state highways in Philadelphia. Some of these changes, such as the decision to slow the pace of reduction in the business privilege tax were not in the best long-term financial interest of the City, but they did help bring the Plan into balance.

### **Speculative Items Included in the Plan**

Only two of the many speculative items initially included in the Plan remained in the revised submission made to PICA on June 23, 2006. Those two items are:

1. **Reimbursements for the Convention Center:** The Plan assumes that the Commonwealth will relieve the City of all responsibility for funding the operations of the Pennsylvania Convention Center beginning in FY10. State legislation allows, but does not require, the state to assume that funding; additional state legislation would have to be enacted before the State assumes financial responsibility for the operations of the center.

2. **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.

## **Substantial Risks**

The Plan faces the following substantial risks in addition to the speculative items.

- **Personnel Costs:** The largest risk in the Plan is also the City's largest cost area – personnel costs. In addition to having police and fire awards that it has appealed or committed to appeal, the City is scheduled to renegotiate the health benefits of its unionized nonuniformed employees for the fiscal year that began on July 1<sup>st</sup>, 2006. On July 1, 2008, the start of the third year of this Plan and the middle of the first year of the next mayor's term, all of the City's major unions' contracts will expire. As with all earlier Plans, the FY07-FY11 Plan does not include any funding for salary increases beyond the term of existing contracts. The Plan does assume that health benefits cost will increase by between seven and nine percent annually in the years after the current contracts expires, but there is a considerable risk that the combined cost of salary and benefit increases for fiscal years FY09, FY10 and FY11 will be greater than the amounts included in the Plan. **Any contracts which increase General Fund costs beyond the City's ability to pay will require a revision to the Plan. This revision must demonstrate that there are sufficient funds to cover these costs;**
- **Revenues from largely unproven initiatives:** While the sale of city assets and a strategic marketing initiative are potentially good sources of revenues, the City has yet to demonstrate the ability to generate significant funds from these programs;
- **Prison Population:** The City's prison census has grown rapidly over the last three years, but the Plan includes virtually no increase in costs for food, healthcare or maintenance contracts at the prisons from FY07 through FY11. While the Administration is developing a number of plans designed to control population growth and the cost of healthcare, many of the causes of the increase in population are beyond the Administration's control. Unless all of the criminal justice system's entities work together to ensure that the prisons population is controlled, it is unlikely that the Administration will be successful in halting the rapid growth in the prisons census;
- **Cuts to Compensate for Speculative State Reimbursement Assumptions:** In an attempt to compensate for large reductions in federal funding, the Administration has inserted into the Plan some speculative assumptions about State reimbursements for services provided by the Department of Human Services. While the Administration

did remove some of those speculative revenues from the Plan submitted to PICA on June 1<sup>st</sup>, it did not remove \$44 million in revenues from FY08 through FY11 that would require a change in state law or in the Governor's budget. The Administration has provided a list of cuts it will make to programs if the projected revenue is not received. There was no information provided, however, on the ancillary costs of making those cuts;

- **Federal Budget Cuts:** The threat of additional federal budget cuts continues to hang over the City's finances. As the reductions in federal funding for the Department of Human Services demonstrates, those cuts can have a dramatic impact on the City's budget;
- **Homeless Shelter Census:** The City's homeless shelter census has grown 35 percent since FY03. The City is in the conceptual stages of developing a 10-year plan to end homelessness and the Plan projects that, as a result, the shelter census will not grow after FY07. Until the elements of that Plan show signs of success, however, the City will continue to face a real risk that its homeless costs will increase;
- **Real Estate Tax Collections:** The Plan assumes that growth in Real Estate tax collections will jump from one percent in FY06 to 3.3 percent in FY07, 2.7 percent in FY08 and 3.5 percent in FY09. While those projected increases are not unreasonable, they could be difficult to obtain in the later years of the Plan if the BRT's full value/equalization project is implemented and, as is likely, legislation is passed that will put some sort of limit on the growth of individual tax bills;
- **Future Fee Increases:** The Plan anticipates a cumulative total of \$36 million in future fee increases over its last three years. It is not unreasonable to project that, in FY09, after three years without an increase, the City's costs will have increased by a sufficient amount to justify the assumed six percent increase in fees. This Administration, however, will be out of office by the time the projected fee increases would be implemented and the fee increases will only go into effect if the next Administration and City Council are prepared to raise those fees.

### **Structural Issues Facing The Plan**

PICA has documented a series of long-term issues facing the City. The Administration has proposed to take steps to address some of these issues, but more needs to be done. Those issues are:

- **Establishing a Rainy Day Fund:** The Plan does not take any steps towards establishing a Rainy Day Fund, but the Administration is in the middle of discussions with City Council about the creation of such a fund;
- **Reducing the City's Long-Term Obligations:** Instead of reducing the City's long-term obligations, the Plan increases them. The Plan includes \$150 million for a bond

issue to fund improvements to cultural assets and commercial corridors. From FY07 through FY10, the Plan includes \$60 million more in debt service than did last year's plan;

- **Making the City's Tax Structure More Competitive:** The Plan slightly accelerates the business privilege tax cuts included in last year's Plan, though by a smaller amount than was proposed in the preliminary Plan presented in January. The total value over five years of the accelerated cuts is less than \$10 million;
- **Reducing the City's Unfunded Pension Liability:** As recommended in PICA's issues paper on pensions, the City lowered the fund's investment earnings assumption from 9 percent to 8.75 percent. That change reduces the risk that the City will miss its earnings assumption. In a letter accompanying the June 23rd submission of a revised Plan, the City also said that it would explore the implementation of a number of the PICA report's recommendations for restructuring pension benefits for new employees to help lower the city's long-term liabilities;
- **Investing in Infrastructure:** The Plan's proposed level of funding falls far short of the \$185 million the City Planning Commission said is required annually to keep the City's infrastructure in good condition;
- **Rapidly Increasing Healthcare Costs.** The rapid increase in healthcare costs threatens to force the City to make cuts in other areas to keep the Plan in balance;
- **Reducing the Size of the City Workforce.** The Street Administration has done an admirable job reducing the size of the city workforce. At the end of May 2006, there were 1,800 fewer filled full-time general fund positions than there had been at the end of 2001. Unfortunately, this Plan proposes to undo much of the progress that had been made in trimming the workforce. The Plan shows 23,737 positions in FY07, 881 more positions than were filled at the end of May and 717 positions more than were budgeted in FY06.

### **Tax Revenue Projections**

Some of PICA's concerns regarding the Plan were alleviated by the continued strength of tax collections. Growth in the real estate transfer tax has been particularly strong and the wage, business privilege and sales taxes have all exceeded budget.

While tax collections have been strong, the City is now using more aggressive tax projections than it used in the Plan as submitted in January and in earlier plans. PICA Staff is concerned that by using more optimistic assumptions, the Administration has eliminated its cushion for unbudgeted expenditures, such as increases in labor costs beyond those included in the Plan, the need for emergency funds to respond to an infrastructure failure, the cost of two moves for the youth study center or the impact of potential future cuts in federal funding.

### **Contrasting Municipal Management of Long-Term Fiscal Concerns**

While New York, San Diego, San Francisco and Boston find themselves in very different fiscal conditions, they are each using their budget processes to attack their long-term issues. Among other things, the cities are using reserve funds, pay-as-you-go financing for infrastructure and increased employer and employee pension fund contributions.

#### ***City Controller's Opinion***

As in past years, and per the PICA enabling legislation, PICA Staff requested of the City Controller an opinion or certification prepared in accordance with generally accepted auditing standards, with respect to the reasonableness of the assumptions and estimates in the City's proposed FY2007-FY2011 Five-Year Plan. The City Controller has opined that the Plan uses reasonable assumptions.

#### ***Staff Recommendation***

Based on the PICA statute which requires that at a minimum the Plan demonstrate balanced budgets for the life of the Plan, the strength of the City's revenues leaves PICA Staff little choice but to recommend that the Board approve the Plan. This recommendation should in no way be viewed as an endorsement of the Plan or its approach to fiscal policy. In addition to doing too little to address the long-term issues facing the City, the Plan commits to new spending that will drain the City's resources and diminishes the capacity of future mayors to improve the City's fiscal condition. As the section of this report comparing this Plan to the budgets of other large cities demonstrates, there are other options.

The opportunity to significantly improve the City's fiscal outlook is "here today and gone tomorrow." In this Plan, Philadelphia misses that opportunity.

PICA Staff reluctantly recommends that the Board of the Pennsylvania Intergovernmental Cooperation Authority approve the revised Plan as submitted to the Authority on June 23, 2006.

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**SECTION II:**

**ACTIONS THE CITY TOOK TO  
ADDRESS PICA's CONCERNS**

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The Plan as presented to Council in January was replete with speculative items. The items included a bevy of unreasonable assumptions about state reimbursements and the city's ability to control costs. PICA Staff made its concerns known through letters and testimony before City Council. In March, PICA Staff said that unless changes were made to the Plan, it would recommend to the PICA Board that it disapprove it. In response, the City has made a substantial number of changes to the Plan, such as:

- Eliminating an assumption worth \$58 million over the life of the Plan that the state and federal governments would pass legislation to increase reimbursements for social workers. PICA Staff did not believe it was reasonable to include revenue that would require new legislation from two levels of government;
- In response to a new study by the City's actuary, the City increased the amount that is budgeted for its pension fund contribution by \$85.2 million over the life of the Plan;
- Eliminating \$24 million in unspecified future government efficiencies from the Plan. While this item had been included in plans in earlier years, PICA had made clear during last year's Plan review process that after a dozen years of cuts, it was becoming less and less reasonable to project that the City could continue to find these unspecified efficiencies. The Plan itself said that recent budget reductions have made "further cost reductions without service impacts increasingly difficult;"
- Eliminating the assumption that the state would reimburse the City annually for the cost of patrolling state highways within the City's borders. The recently enacted state budget includes a reimbursement for the City's costs for FY06, but not for FY07. The State still assumes that the Pennsylvania State Police will begin patrolling state highways in Philadelphia in January 2007. The State has said repeatedly that the Pennsylvania State Police will take over responsibility for patrolling those highways, but that the City would not be reimbursed for its costs. In its June 23<sup>rd</sup> submission, the City showed a 63 officer reduction in the Police Department to be implemented when the state begins patrolling its highways within Philadelphia.

The following lists show the speculative items that were removed from the Plan and the items that originally appeared to be speculative, but that the Administration was able to demonstrate were reasonable.

<b>Speculative Items Removed from the Plan or Compensated for With Cuts (in \$ thousands)</b>	
Increased Reimbursement for Social Worker Salaries	57,954
State Funding for Prevention Services	36,780
Gaming Revenue	12,400
Reimbursement for State Highway Patrol	25,200
Future Government Efficiencies	24,000
Health Benefits Costs Increases	25,000
One Year of Convention Center Operating Costs	20,000
Pension Cost Increases Based on Actuary's Report	85,187
	<b>286,521</b>
<b>Speculative Items Addressed Through Analyses or Legislation (in \$ thousands)</b>	
Future Fee Increases	36,000
Health Benefits Costs	39,141
Increased Parking Fines	16,000
Delay Low Income Tax Bill	46,800
	<b>137,941</b>

Through passage of new legislation or by providing additional analysis, the City also addressed a series of other items that PICA questioned. New legislation, for example, made it likely that the City will get the amount of parking fine revenue the Plan projects. Other legislation enacted during the spring delayed the implementation of the low income wage tax bill by three years.

In addition, the City provided an analysis to justify its projected increase in fees. The City showed that it is reasonable to assume that costs will have risen by enough for the City to justify the Plan's assumed six percent fee increase. The next administration, however, will be in office by the time the fee increases are projected to be put in place and may decide that it does not want to pursue those increases.

After the City removed the roughly \$287 million worth of items, it had to replace them with other revenue enhancements or obligation reductions to balance the Plan. The changes included the following:

- Slowing the pace of business privilege tax reductions, which increased projected tax revenues by approximately \$18 million;
- Delaying implementation of the low income tax credit bill, which avoided the loss of a projected \$47 million in revenues;
- Agreeing, if necessary, to make cuts in programs in the Department of Human Services to offset \$37 million in speculative reimbursements for those costs that were included in the Plan;

- Reducing the projected size of the police force by 63 officers when the commonwealth assumes responsibility for patrolling state highways in Philadelphia. This change would reduce costs by \$25.2 million;
- Generating \$16 million in additional revenue by increasing parking fines;
- Increasing projected tax revenues by \$186.5million. The \$186.5 million included almost \$50 million in additional real estate transfer tax collections, almost \$70 million in business privilege tax collections, \$34 million in real estate tax collections, and \$19 million in sales tax collections. Even at the higher levels, the tax revenue projections are not unreasonable, but by adding \$186.5 million to its tax revenue projections, the City has eaten away at the cushion it had for unexpected costs; and
- Increasing projected revenues from other governments by \$51.6 million

The following table shows a full list of the adjustments that the City made to the Plan:

<b>City's Proposed Gap Closing Measures:</b>		
<u>Changes to Tax Policy</u>		
Delay Implementation of Low Income Tax Credit	46,800	
Slowdown BPT Gross Receipts Rate Reduction	17,753	
<b>Total Tax Policy Shifts</b>		<b>64,553</b>
<u>Increased Projected Tax Revenues</u>		
Real Estate Transfer Tax	49,281	
Sales Tax	18,963	
Wage Tax	10,000	
Business Privilege Tax	67,654	
Real Estate Tax	34,192	
Amusement Tax	6,388	
<b>Total Increased Projected Tax Revenues</b>		<b>186,478</b>
<u>Increased Revenues from Other Governments</u>		
Prior Year Adjustments	22,600	
Pension Cost Reimbursements	9,000	
State Revenue Appeal	20,000	
<b>Total Increased Revenues from Other Governments</b>		<b>51,600</b>
<u>Increased Local Non-Tax Revenues</u>		
Increased Parking Fines	16,000	
Increased Interest Earnings	10,000	
<b>Total Increased Local Non-Tax Revenues</b>		<b>26,000</b>
<u>Expenditure Reductions</u>		
Potential Cuts to Offset \$37 M in Speculative DHS Revenues	134,000	
Potential Reduction in Number of Police Officers	25,200	
Reduction in Projected Debt Service Payments	15,515	
<b>Total Expenditure Reductions</b>		<b>174,715</b>
<b>Total Plan Balancing Proposals</b>		<b>503,346</b>

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**SECTION III:**

**SPECULATIVE ITEMS**

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*“He that lives upon hope will die fasting.” – Benjamin Franklin*

## **OVERVIEW**

This section will discuss the City’s assumption that it will be relieved of its financial responsibility for the operations of the convention center and the financial risks posed by PGW.

### **REIMBURSEMENTS FOR THE PENNSYLVANIA CONVENTION CENTER**

The Plan assumes that the Commonwealth will relieve the City of all responsibility for funding the operations of the Pennsylvania Convention Center beginning in FY10. While legislation allows the state to assume this responsibility, it does not require that funding. In fact, additional legislation would be required before the State could appropriate the funding for the center’s operations. Convention Center officials project that the center will require approximately \$45 million in subsidies from FY10 to FY11 and, unless the state legislature takes additional action, those subsidies will remain the City’s responsibility.

Legislation also authorizes the Commonwealth to contribute up to \$700 million to expansion and requires a twenty five percent local funding match for \$400 million of that \$700 million. The local match, however, has not been identified and there is still no completed financing plan. Until that financing plan is in place and additional legislation is enacted that would require the State to assume financial responsibility for the center’s operations, PICA Staff will continue to view the Plan’s assumption to be speculative.

### **PHILADELPHIA GAS WORKS (PGW)**

PGW continues to present an enormous risk for the City and the entire region. The Plan assumes that PGW 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 and could even damage the entire region’s economy.

#### *PGW’s Fiscal Condition*

PGW continued to make significant strides this past year as it used newly available managerial tools to increase collection rates and overall revenues, despite a cold winter and increasing fuel costs. While the utility now has a narrow positive annual operating balance, the nearly \$1 billion debt load and other fiscal constraints make it unlikely it will ever be able to repay the loan from the City. As the utility’s capital demands continue to increase, even greater pressure will be exacted on the slender amount of funds available. Effectively, PGW is trading water financially until serious plans for its future can be determined.

#### *PGW’s Plan For Recovery*

During discussions with PICA last year, the management of PGW placed its hope of regaining fiscal stability on three factors:

- A dramatic increase in funding of the Low Income Home Energy Assistance Program (LIHEAP);
- An increase in PGW collection rates from eighty-seven percent to ninety-two percent; and,
- The further development of the proposed Liquefied Natural Gas (LNG) plant.

Thanks in large part to new tools given to PGW by the State Public Utility Commission, PGW was able to increase average collection rates to over ninety-four percent. This dramatic increase enabled PGW to stabilize its finances and continue to pay its long-term obligations. This new fiscal stability resulted in better coverage ratios and a positive fund balance for FY2006 and a similar projection for FY2007. In making its projections, PGW assumed that it would no longer make a rent payment to the City.

Unfortunately, the other fixes anticipated by PGW were either not forthcoming or less helpful than originally anticipated. Although federal funding of LIHEAP did not change dramatically, the State provided additional supplementary funding for LIHEAP in response to the dramatic increase in fuel prices this past year. Despite this increase in available funds, extensive marketing, and the pressure of higher fuel bills on household budgets, most of the additional monies went unclaimed. PGW saw little to no benefit from the increase in LIHEAP funding.

While the proposed LNG plant could help PGW's finances, its likelihood of ever coming to fruition continues to diminish. PGW does have the facilities available, and has identified a viable private sector business to run the facility. However, among the estimated fifty proposed LNG sites, experts estimate that only ten will be approved. Security, local zoning and environmental issues have significantly slowed the approval process for these plants. Local opposition to the proposal will make it extremely difficult to implement.

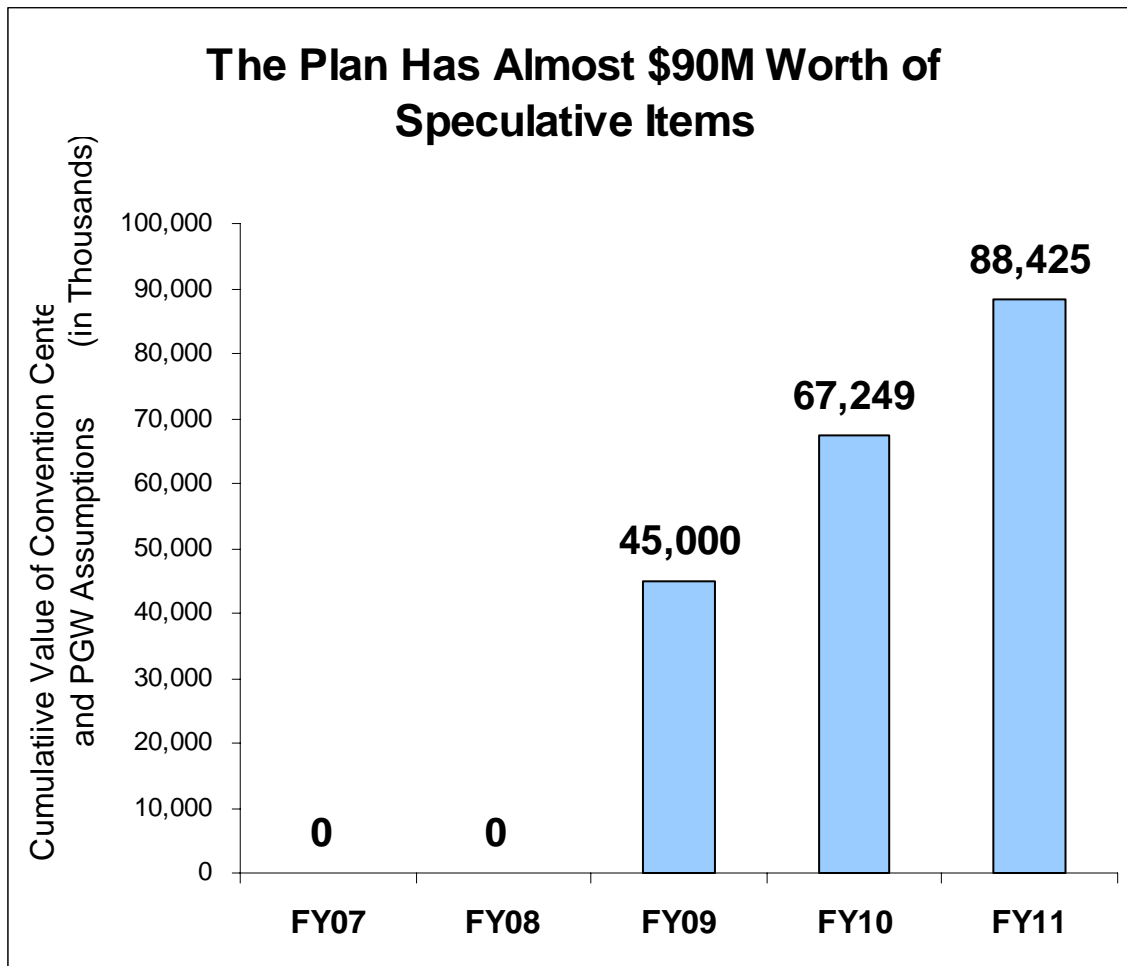
#### *Long-term Risk: The City's Liability for PGW Bonds*

PGW has restructured its capital program to meet pressing needs despite having over \$900 million in outstanding debt. The combination of increasing capital demands and a loss in revenue could render PGW unable to meet its debt obligations, forcing the City to either further subsidize the utility or allow it to default on its obligations. Either scenario would have dramatic implications on the fiscal stability of the City.

According to the City, there has been no official legal opinion on whether the City is contractually liable to repay PGW's debt should PGW be unable to meet those obligations. However, considering that nearly PGW serves nearly all of Philadelphia's commercial and residential gas users, the City would be forced to deal with the aftermath of a PGW default.

*Long-term Risk: Potential for Regional Impact*

Unlike many of the risks highlighted in this Staff Report, the impact of a PGW collapse could be both sudden and dramatic. An abrupt failure would be beyond the City's fiscal capability, and would require help from other governments, putting additional strain on surrounding state and local authorities. Regional businesses and employees who are dependent on the City's economy would be vulnerable, as the main economic driver for the Commonwealth was disrupted. In short, a PGW failure would have consequences far beyond the City's fiscal stability.



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**SECTION IV:  
ADDITIONAL RISKS TO THE PLAN**

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*“A small leak can sink a great ship.” – Benjamin Franklin*

## **OVERVIEW**

In addition to the speculative items listed above, there are a number of other areas of substantial risk for the Plan.

- Labor Contracts and the Municipal Workforce
- Gaming Revenues
- Growth in the City’s Shelter Bed Census
- Growth in the Number of Inmates in the City’s Prison System
- State Funding for Prevention Services
- The Impact of Federal Budget Cuts

## **LABOR CONTRACTS AND THE MUNICIPAL WORK FORCE**

By far the City’s largest cost is for personnel. Of every dollar City government spends, almost 60 cents goes to labor costs. Changes in labor costs can, as a result, have a major impact on the City’s finances.

All four of the City’s major employee unions are scheduled to have all or part of their contracts renegotiated by the beginning of FY07. In addition, they are scheduled to have their entire contracts renegotiated at the beginning of FY09 – the third year of the Five-Year Plan and half way through the first year of the next Mayor’s term. While the Plan has budgeted amounts for those new or modified contracts, the potential that the contracts will cost more than budgeted is one of the largest risks facing the Plan.

The risk of cost increases for the City’s police and fire unions is particularly high because their contracts are determined through an arbitration process. Just last week, an arbitration panel awarded firefighter health insurance benefits that the Administration projects will add \$24 million in costs through FY11 and set damaging precedents for other contracts. The panel gave the firefighters health insurance cost increases of 11 percent for the fiscal year that started July 1, 2005, 14 percent for the year that started July 1, 2006 and another 14 percent for the year that started July 1, 2007. The Administration intends to appeal that award.

The panel tasked with deciding the FOP award for health insurance benefits that was scheduled to be in place July 1<sup>st</sup> 2005 ruled over a year ago that the City’s contribution for police health benefits should increase 15.7 percent in FY06 and an additional ten percent in FY07. If it were implemented, the FOP arbitrator’s ruling would cost the City over \$45 million more than was included in the FY06-FY10 Plan. As a result of that additional cost, the City appealed the ruling. A Common Pleas Court vacated the ruling because it said the arbitrator did not adequately address the City’s ability to pay. The Court sent the award back to the arbitration panel, which then issued essentially the same award, but it added language that said it had considered the City’s ability to pay. The

Administration again appealed, but the Common Pleas Court denied the City's appeal, holding that the arbitrator had now sufficiently addressed the City's ability to pay. The City has appealed the Common Pleas Court's decision to Commonwealth Court. The possibility that the City will lose its appeals and eventually have to pay the full cost of the award is a substantial risk to the Plan.

The Administration has more control over nonuniformed employees' contracts, which are negotiated between the Administration and unions. As a result, the City is better able to keep those contracts consistent with the Plan. The renegotiation of the health and welfare portions of the collective bargaining agreements gives the Administration the opportunity to work with the unions on implementation measures that control health insurance costs.

While the Five-Year Plan includes projected growth rates for health insurance benefits of between seven and a quarter percent and nine percent for each year of the Plan, it does not include any assumed increases in wages beyond the end of current collective agreements at the end of FY08. The assumption that there will be no increase in salaries beyond FY08 is consistent with the approach taken in previous plans, but still represents a substantial risk. One percent annual increases in wages each year from FY09 through FY11 would add just over \$80 million in costs to the Plan. **Any contracts that increase General Fund costs will require a revision to the Plan that demonstrates sufficient revenues to cover the increased costs.**

### **GAMING REVENUES**

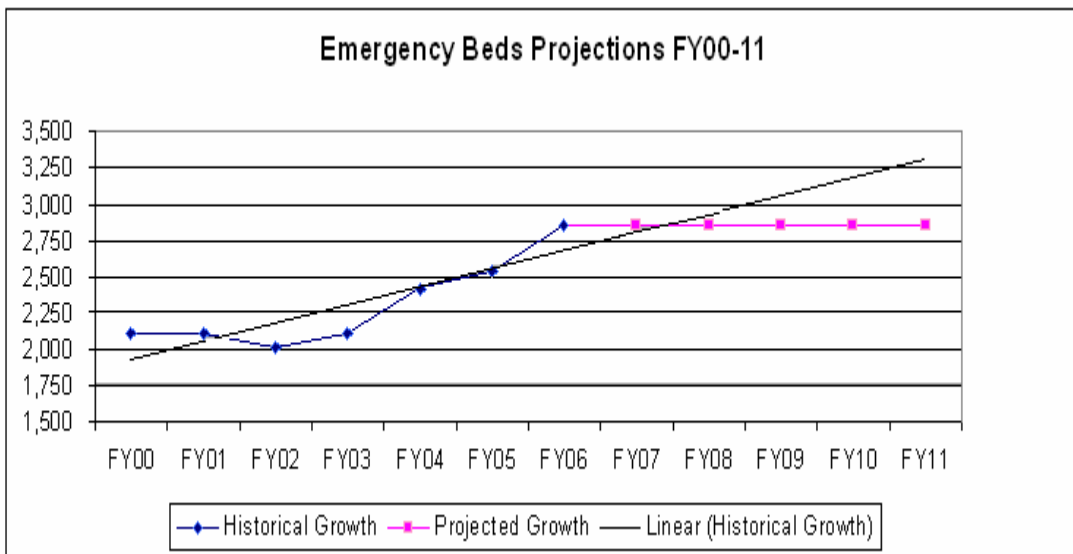
The Plan assumes that the City will receive \$62 million in gaming revenue from FY09 through FY11. Since state legislation is in place, it is not unreasonable for the City to include gaming revenue in the Plan. At the same time, there is substantial risk that gaming revenues will come in later or at lower amounts than the Plan projects. In a letter to PICA, for example, the State Budget Secretary projected slightly lower revenues in FY09 than does the Plan -- \$8 million as compared to the \$14 million included in the Plan. The \$14 million projection is not unreasonable as the Secretary's letter points out that his projections were conservative and could be exceeded if the companies granted licenses by the Control Board are able to bring their facilities on line earlier than the State projects. The Secretary did, however, add the following *caveat*: "Given the various factors that could delay construction and commencement of full-scale operation of these facilities, we believe a conservative forecast is prudent." PICA Staff agrees with the Secretary of the Budget and believes that there is a real risk that the City's revenues will fall short of the amounts projected in the Plan.

### **GROWTH IN THE CITY'S SHELTER BED CENSUS**

The City's homeless population has jumped 35 percent from 2,109 in FY03 to an estimated 2,853 in FY06. The Plan projects that that growth will stop because of the City's \$10 million 10-year plan to end homelessness, which was unveiled in October.

As part of the process of developing the plan to end homelessness, workgroups will construct targeted strategies to address the different types of individuals and families that require shelter. The Plan is projected to cost about \$10 million and that funding would include \$5 million of reinvestment funds from DBH/MRS over two years, for behavioral health services; \$1 million of NTI bond proceeds for prevention and housing subsidies for 25 families per month and \$1 million of private funding to support the plan's implementation.<sup>1</sup>

While the plan's concept is promising, the Office of Adult Services, which is responsible for homeless programs, has said that much of the planning, resource requirements and cost estimates for the plan will not be completed until the first quarter of FY2007. Until those strategies have been designed and implemented, the Plan's assumption that the growth in homelessness will stop remains risky. City officials have told PICA that without the successful implementation of a strategy to reduce homelessness, the shelter population could grow about 10 percent annually. Assuming that the census would grow at the same rate as it has since FY01, the number of shelter beds would increase from 2,853 to well over 3,200 by FY11.



**GROWTH IN THE NUMBER OF INMATES IN THE CITY'S PRISON SYSTEM**

Despite the City's ongoing efforts to control the growth in the prison system's population, the system's census has continued to increase rapidly. Since 1996, the average daily prisons census has grown 60 percent from 5,351 to a projected 8,548 at the end of FY06. Over the last decade, the City has attempted to deal with that growth in a number of ways:

- Implementing population management programs like drug and alcohol rehabilitation;

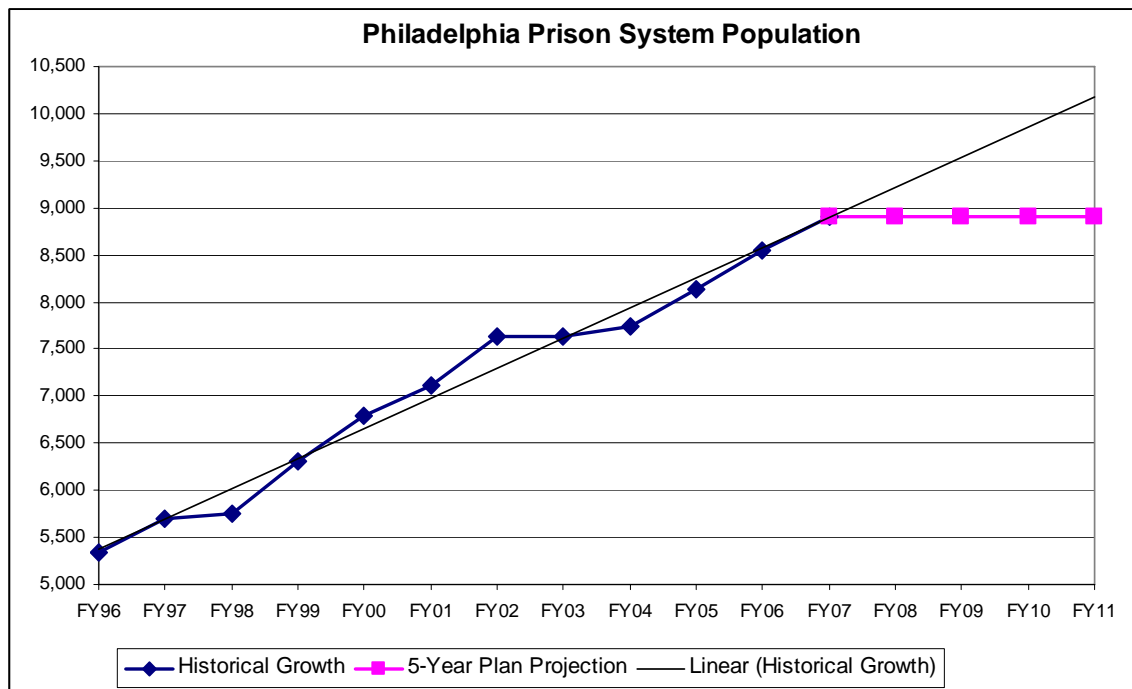
<sup>1</sup> Five Year Financial Plan, Fiscal Year 2007-Fiscal Year 2011, p.F-1 an dF-2

- Building new facilities like the women’s jail; and
- Sending inmates to correctional facilities outside of the City.

Those strategies, however, have yet to slow the surging population.

The increases in population have, not surprisingly, been accompanied by increases in costs. Since FY01, the prison budget grew by a third from \$143.4 million to a projected \$191 million in FY06. The current FY07-FY11 Five Year Plan, however, projects no annual growth in the prison population after FY07. In addition, the Plan projects that prisons contracts for food, physical health, mental health, maintenance and housing will essentially remain flat after FY07. These assumptions rely not only on the City’s ability to reverse the multi-year trend of a growing census, but also to avoid cost increases in healthcare and food among other contracted items.

The following chart shows how optimistic the City’s projection is. The chart compares the Plan’s projections to the trend of the last decade. If the City is unable to alter the trend and population continues to grow at the rate it has been growing, there could be 1,200 more inmates by 2011 than the Plan projects.



The City bases its optimistic projections on its ability to implement successfully a number of initiatives, including the following:

- Renegotiating the health contracts to achieve better rates;
- Developing an information technology system that will provide information that can be used to enhance population management;

- The work of the Mayor's Office for the Reentry of Ex-Offenders, which is tasked with reducing the likelihood that ex-offenders will be reincarcerated; and
- Working with a consultant who will submit a report to the prisons this summer that will detail ways in which the City can control its census.

While each of these initiatives may be effective, until they have shown results, there is a substantial risk in relying on them to mitigate the growing prison population. Even if the initiatives are successful, it is possible that the prisons census will grow because many of the causes of the population increase are beyond the Administration's control. The prisons are just one part of a multi-faceted system that includes, among others, the Police Department, the District Attorney's Office, the Defender Association and the courts. Unless all of the entities that are part of the criminal justice system work together to ensure that the growth in the prison population is controlled, it is unlikely that the Administration will be successful in halting the rapid growth in the prisons census and costs.

### **STATE FUNDING FOR PREVENTION SERVICES**

The Plan projects that the City will be reimbursed beginning in FY08 for the costs for prevention services above the amounts required under state law and that the state will pass legislation increasing the percent of adoption subsidy costs that are reimbursed. There is no reason to believe that either of these assumptions is accurate. Over the life of the Plan, the City assumes that reimbursements for these two items will total just under \$44 million.

The Administration, however, has pledged that if these reimbursements are not received, it will make cuts to the budget to offset the lost revenue. Since each city dollar budgeted for prevention services is matched by state and federal dollars, a reduction of \$11 million annually in City dollars will lead to much larger reductions in total funding. In fact, the Administration has said it will cut prevention funding by \$33.5 million annually or a total of \$134 million over four years. Unfortunately, cutting these programs will reduce the Department's ability to prevent children from entering the dependency or delinquency system. As a June 1<sup>st</sup> letter from the Acting Finance Director said, "None of these reductions would be desirable, as the programs have been carefully selected over the last five years for their effectiveness in supporting the well-being of children and families." The proposed cuts could have a particularly significant impact since a \$33.5 million cut would equal about 30 percent of the prevention division's FY07 budget. There are no estimates in the Plan of the increased long-term costs to the City overall of not funding these prevention programs. While the City has indicated that it would cut prevention programs if it did not receive the projected new funding from the Commonwealth, it also indicated that it may instead try to find other cuts or look for other revenue streams.

### **THE IMPACT OF FEDERAL BUDGET CUTS**

The Plan added speculative revenues in part because the City is trying to compensate for dramatic reductions in federal funding. In FY06 alone, the City is projecting that federal

funding for DHS will fall \$139 million short of budget. While state funding has increased, those increases have not been large enough to compensate for the federal cuts and part of the City's response has been to include speculative numbers in its Plan to avoid making draconian cuts.

Philadelphia is not alone in developing a response to federal cuts. Jurisdictions nationwide have been making adjustments in response to reductions in TANF revenues. A 2003 report by the Center on Budget and Policy Priorities<sup>2</sup> highlights 37 states that have cut programs, reduced human services or have planned to do so as they exhaust their TANF surpluses from prior years and need to fill budget gaps in other areas:

1. 15 states are scaling back Welfare-to-Work programs that assist TANF recipients in improving skills and finding jobs;
2. 11 states are cutting programs for disadvantaged families with serious problems, such as barriers to employment and substance abuse;
3. 8 states are reducing transportation assistance for TANF recipients;
4. Cash benefits for working families have been eliminated or are being considered for elimination in at least 10 states;
5. Teen pregnancy prevention as well as programs for responsible fatherhood and employment assistance for non-custodial parents have been reduced or eliminated in 4 states;
6. Childcare programs in 32 states have reduced income eligibility limits, created waiting lists, increased co-payments for child care, reduced provider payments, reduced funding to improve child care quality or have proposed to take such steps.

Counties in Pennsylvania, including Philadelphia, did not have to react to TANF reductions as quickly as did other jurisdictions because the State had built up a reserve of unspent TANF money from earlier years. The State used that reserve to continue funding programs even after the federal government had cut TANF dollars. That reserve, however, has now been exhausted and Pennsylvania is facing the same issue as other states.

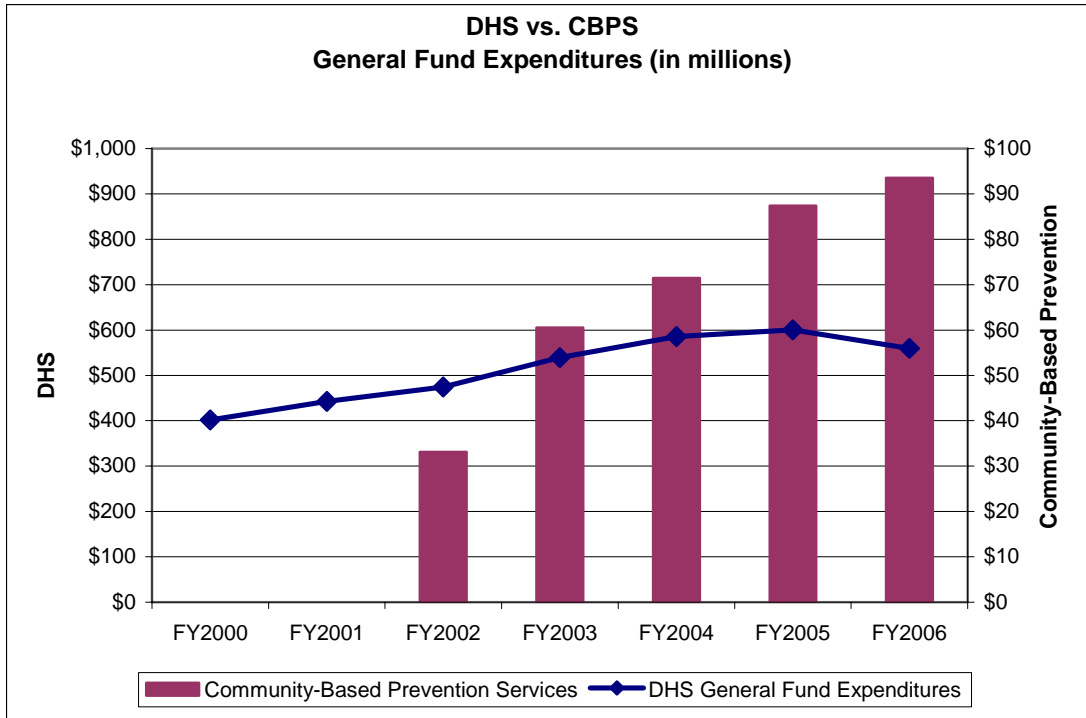
Philadelphia had used funding from other governments, including the TANF funding, to dramatically increase program funding. As a result, DHS saw its general fund budget expand by 47 percent from \$408 million in FY00 to \$601 million in FY05 before dropping seven percent to an estimated \$559 million in FY06 in responses to the cuts in TANF funding. The FY01 to FY05 growth rate would have been slightly larger if not for the FY05 transfer of the Riverview Home's \$5 million budget from DHS to the Office of Emergency Shelter and Services.

One of the biggest contributors to DHS' budget increase from FY01 to FY05 was the creation of the Community-Based Prevention Services Division (CBPS). Over 5 years of

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<sup>2</sup> Parrot, Sharon and Nina Wu. "States are Cutting TANF and Child Care Programs: Support for Low-Income Working Families and Welfare-to-Work Programs are Particularly Hit." Washington, D.C.: Center of Budget and Policy Priorities, 03 June 2003.

operation, CBPS' general fund expenditures have increased threefold to \$93 million. The division's expenditures are estimated to continue to increase rapidly in FY06 even as the rest of the Department's budget decreases in response to TANF cuts.



The increase in CBPS spending even while funding for the department is decreasing means that other divisions will see even larger decreases. In total, the department's FY06 expenditures are now estimated to be \$96 million lower than budgeted and \$41 million lower than FY05. Except for CBPS, all of DHS' divisions experienced a budget cut. The Children and Youth Division (CYD) took a cut of \$38.9 million and 52 employees. The Juvenile Justice Services Division (JJS) took a cut of over \$8.4 million and nine positions. The Department reported very different impacts from the cuts to the two divisions. CYD reported that despite the cuts it will still be able to handle 616 more abuse and neglect reports in FY06 than in FY05 when it handled a total of 15,788 reports. In addition, CYD estimates that it will provide 696 more children with services, provide non-placement services to 720 more children, reduce the number of children who were serviced in placement and institutional settings, finalize 700 adoptions, up from 618 in FY05 and continue to reduce the number of children in its care for more than two years. JJS, on the other hand, saw an increase of the average length of stay in YSC from 7.6 to 8.3 days.

<b>FY06 Estimated Obligations (in thousands)</b>		
	<u>FY06 Current Estimate Vs.</u> <u>Budget</u>	<u>FY06 Current Estimate Vs.</u> <u>FY05 Actual</u>
CBPS	(15,260)	6,100
Admin & Mgmt	(230)	(110)
CAPE	(1)	(140)
JJS	(14,760)	(8,370)
C&Y	(66,090)	(38,870)
<b>DHS Budget</b>	<b>(96,340)</b>	<b>(41,390)</b>

The Department projects that after FY06's cut, it will begin to see budget increases again – although those increases – 13.6 percent from FY06 to FY11 -- are not projected to be as large as the FY01 through FY05 increases. The City is able to assume that growth even though it projects no TANF funding in the Plan because it projects increases in other federal and state funding streams. Funding from the federal government's Title IV-E is projected to grow about seven percent and funding from the State through Act 148 is projected to grow about 19 percent. While these projections do not seem unreasonable, if federal funding is cut rather than increased, the City will be forced to provide additional funding, reduce services or attempt to secure additional funding from the State.

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**SECTION V:  
TAX REVENUE PROJECTIONS**

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## **OVERVIEW**

In each of the last two years, a late surge in tax collections has helped convince PICA that tax revenues would be strong enough so that Plans that included a number of speculative and risky items were balanced. FY06's collections appeared to be weak until the end of the year because of processing problems within the Revenue Department. Those processing problems not only make it difficult to analyze the City's revenues, but also mean that the City is losing interest on money until it is processed.

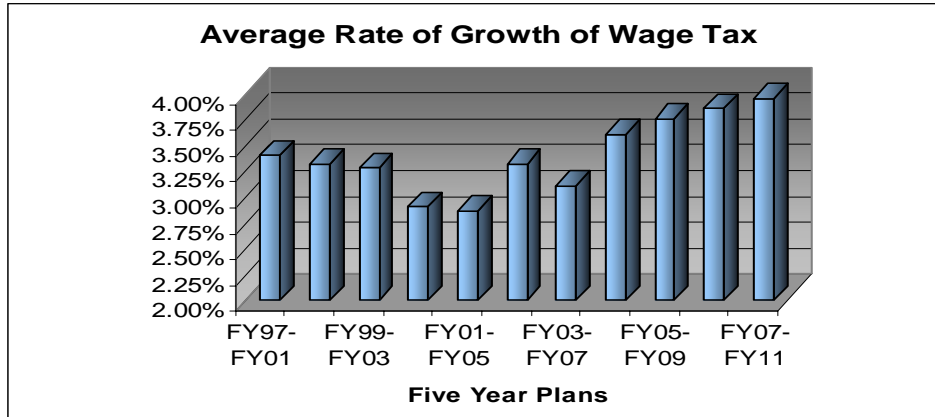
The City was able to enjoy the financial benefit of those late collections surges because it had used relatively conservative tax collections projections in its Plan. In fact, one of the strengths of the City's five-year plans has been their appropriately conservative tax revenue projections. By using those conservative projections, the City has been able to provide itself with a cushion to pay for unexpected costs or for the failure of speculative non-tax revenue items to materialize. The cushion has enabled the City avoid a recurrence of the financial crisis it suffered through in the early 1990s and to avoid making some of the draconian cuts that other cities have made.

While this year's Plan uses reasonable tax revenue assumptions, those assumptions are more aggressive than the projections used in the Plan the City originally proposed in January and earlier plans. As a result, the City will have less room for error than it has had in previous plans.

This section will discuss the City's projections for the taxes that generate the most revenue.

## **WAGE TAX**

The wage tax is by far the single largest source of revenue for the City. When combined with the PICA tax, it equals nearly 40 percent of all City revenue. As a result, projections for the wage tax are among the most important in the Plan. Over the last three Plans, wage tax projections have become more aggressive. Before the FY05-FY09 Five-Year Plan, there was only one time that a Plan had projected that any year would have growth of as much as four percent in the wage tax base. In that case, the FY97-FY01 Plan projected that there would be one year of four percent base growth – in the fifth year of the Plan. In contrast, the FY07-FY11 Plan projects that the wage tax base will grow by four percent each year from FY08 through FY11. The following graph shows the increasing aggressiveness of the Administration's wage tax projections.



The more aggressive projections meet the PICA Act’s test of reasonableness, but they do provide cause for some concern. By using the highest growth rates ever for the wage tax, the Administration makes it much more likely that wage tax revenues will come in below projection.

**PROPERTY TAX**

The Plan as submitted to PICA uses property tax projections that do not seem inconsistent with recent growth in property values. The Plan projects that property tax revenues will grow by 3.3 percent in FY07, 2.7 percent in FY08, 3.5 percent in FY09 and under 2.5 percent in each of FY10 and FY11.

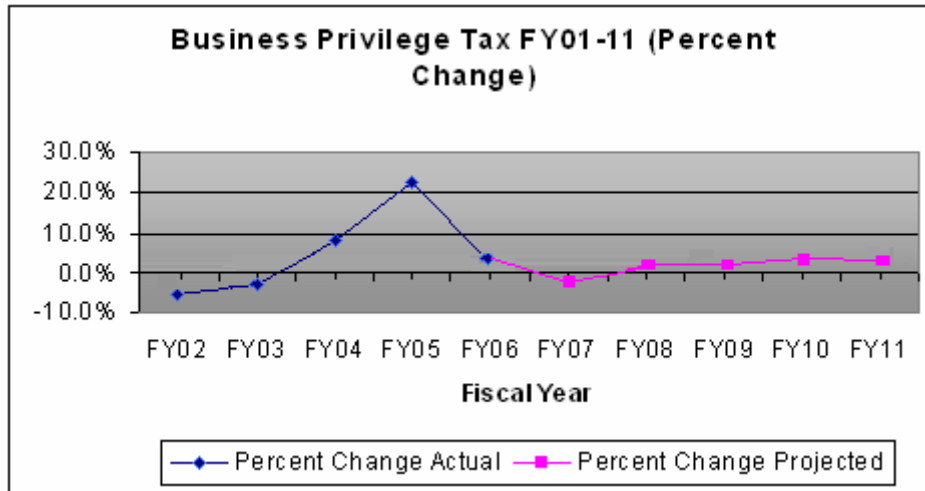
While these projections are slightly more aggressive than the assumptions used in recent plans, the strength of the City’s real estate market makes the Plan’s projections appear reasonable. At the same time, both City Council and the state legislature have held hearings about the possibility of enacting legislation that would cap the amount of tax increases for individual properties in the event that the Board of Revision of Taxes implements its proposed full valuation/equalization project. The full valuation/equalization project is essential for making the City’s property tax system fairer and more understandable (see PICA’s issues paper entitled “From Virtual Realty to Full Realty: Preparing for Reassessment”). It will, however, lead to substantial increases in property taxes for perhaps as many as ten percent of property owners.

Enacting legislation that slows the pace of the potential real estate tax increase for individuals is important for the successful implementation of the full value/reassessment project because it will help reduce some of the inevitable backlash against the new system. At the same time, by putting a constraint on the growth of individual’s taxes, the legislation may make it harder for the City to reach the projections included in the Plan.

**BUSINESS PRIVILEGE TAX**

The business privilege tax is perhaps the most difficult tax to project. It is received late in the year and is based on both income and sales. As the graph below shows, the tax has

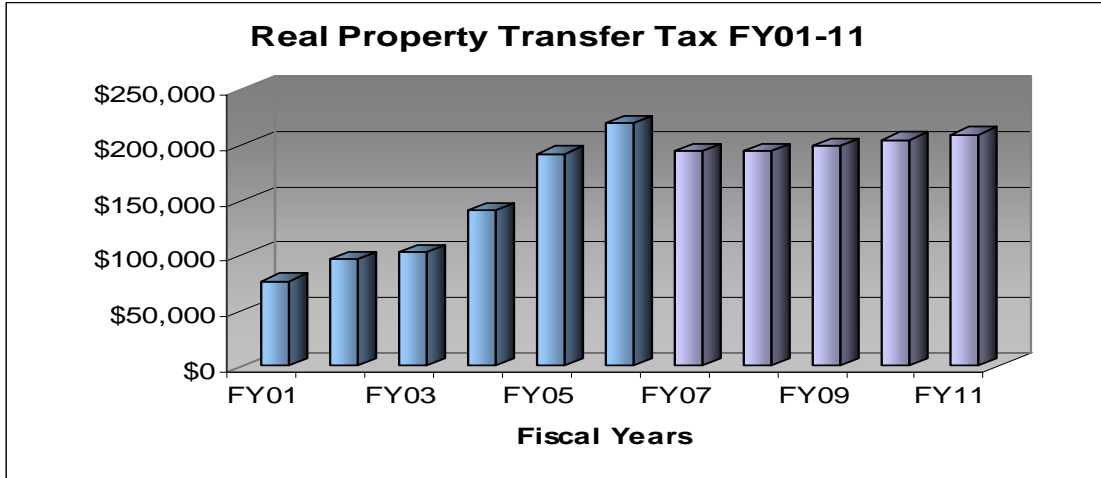
also been volatile over the last five years. It had two years during which it declined and one year during which it increased by over 20 percent.



In FY05, the surprising strength of the business privilege tax added \$80 million to the fund balance that had been projected in the FY06-FY10 Five-Year Plan. BPT collections are again much stronger than budgeted in FY06. In the budget as submitted to City Council, the Administration projected that the BPT would generate \$371 million in FY06. By the time the Administration submitted its initial Plan to PICA on June 1<sup>st</sup>, it had increased that projection to \$378 million. In late June, after seeing the strength of BPT collections, the Administration bumped its projection up to \$388 million. Given the level of collections through June, the Plan's FY06 projection appears to be reasonable. The Plan projects a drop to \$379 million in FY07 and steady growth in the tax's base through FY11, which is not unreasonable, but given the volatile nature of the tax, it is likely that there will be years during which growth will be weaker than the Plan projects.

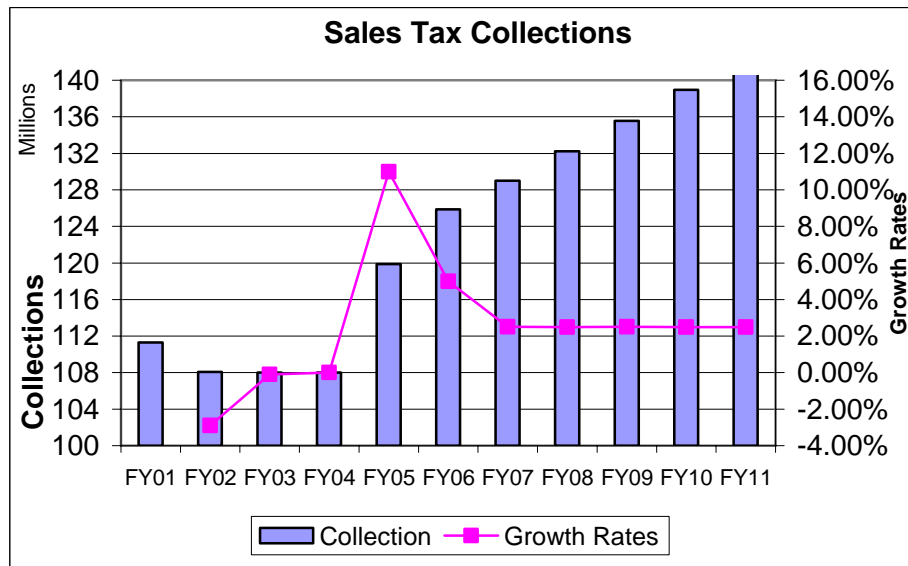
**REAL ESTATE TRANSFER TAX**

The Real Estate Transfer Tax has been the City's fastest growing source of tax revenues. As recently as FY01, this tax was generating under \$80 million. In FY06, the transfer tax is estimated to generate \$228 million – a 185 percent increase in just five years. The Plan appropriately conservatively projects that the growth in collections will slow – falling to \$195 million in FY07 and \$194.8 million in FY08 before growing by about 2.5 percent annually thereafter. The following graph shows how quickly the transfer tax has grown since FY01.



### SALES TAX

After being relatively stagnant from FY01 through FY04, the sales tax grew about 11 percent in FY05 and has grown at about five percent in FY06. The strong sales tax collections, when combined with the increases in the wage tax, the real estate transfer tax and the business privilege tax clearly indicate that the economy is strong. The Plan projects that the sales tax will grow at 2.5 annually through FY11.



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**SECTION VI:**

**LONG-TERM FINANCIAL ISSUES  
FACING THE CITY**

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*“Never leave that till tomorrow which you can do today.” – Benjamin Franklin*

## **OVERVIEW**

This section will discuss the city’s long-term financial issues that the city is facing and their status.

## **LONG-TERM OBLIGATIONS**

As detailed in PICA’s issues paper “Reversing the Trend of Doing Too Little With Too Much: Maintaining the City’s Infrastructure While Reducing Its Dangerously High Debt Load,” the City’s long-term obligations have grown much more quickly than its revenues and are putting an increasing burden on the City’s general fund. Instead of reducing the City’s long-term obligations, however, the Plan increases them. In addition to two new standard general obligation bond issues for basic infrastructure, the Plan includes a \$150 million bond issue to fund improvements to cultural assets and commercial corridors. From FY07 through FY10, the Plan includes almost \$60 million more in debt service than did last year’s plan. In addition, the Sinking Fund’s purchased service line, which consists primarily of repayments of debt issued through authorities, is projected to be at least \$92 million in each year of the Plan, more than double FY01’s \$42.6 million. This increase in long-term obligations will put a burden on future administrations as they attempt to improve the City’s fiscal condition.

## **RAINY DAY FUND**

As PICA recommended in “Philadelphia’s Fiscal Challenge: Finding a Way to Save”, the City should establish a rainy day fund. A rainy day fund would help the City build a contingency against the effects of downturns in the economy or other potential events that would have a negative impact on the general fund. While the FY07-FY11 Plan does not recommend the establishment of a rainy day fund, the City has been working with City Council to craft legislation that would establish such a fund.

## **THE CITY’S TAX STRUCTURE**

As documented in a number of analyses, the City’s tax structure puts it at a competitive disadvantage. For a variety of reasons, taxes in Philadelphia are substantially higher than those in other cities. In order to narrow the gap, the City must realign its tax rates so as to be in-line with those in other jurisdictions. The Plan slightly accelerates the business privilege tax cuts included in last year’s Plan, but not in a way that significantly narrows the competitive disadvantage. The total value over five years of the accelerated cuts is under \$10 million. The Plan as submitted to Council called for slightly more aggressive reductions (\$24 million over five years), but the Administration proposed slowing down the cuts in order to help balance the Plan when it eliminated some of the initial Plan’s speculative items. PICA Staff does not believe this was the best approach to balancing the Plan. By slowing down the rate of reductions, the proposed Plan makes it more difficult for the City to improve its competitive position. During the budget process,

Council and the Administration also agreed on legislation to delay the implementation of the low-income tax credit until after the years covered by the Plan.

### **UNFUNDED PENSION LIABILITY**

The City's unfunded pension liability is too large and is growing. As recommended in PICA's issues paper: "An Ounce of Prevention: Managing the Ballooning Liability of Philadelphia's Pension Fund," the City lowered the fund's investment earnings assumption from 9% to 8.75%, which reduces the risk that the City will miss its earnings assumption. Even at an 8.75%, the City's earnings assumption is well above the median of 8% in other cities PICA examined. Reducing the rate to 8%, however, would increase the City's annual contribution to the pension fund by over \$60 million. In addition to reducing the interest earnings assumption, in the letter accompanying the June 23<sup>rd</sup> revised Plan submission the City said that it would explore PICA's recommendations for restructuring pension fund benefits including increasing the minimum retirement age, decreasing the benefit multiplier, increasing the period to determine average final compensation and increasing the employee contribution. Making these changes would help lower the City's unfunded liability.

Finding ways to lower the City's unfunded pension liability is crucial for maintaining the City's fiscal balance as this year's Plan process demonstrated. One of the biggest changes from the Plan as submitted to City Council in January to the one submitted to PICA in June was an \$85 million increase over five years in the City's pension costs. The increase, which was based on a report prepared by the City's actuaries, illustrates the continuing threat the pension fund poses to the City's finances.

In FY07, the City's pension costs (its contribution to the pension fund plus its debt service payment on its pension obligation bonds) are budgeted to be just under \$420 million, a \$77 million or 22 percent increase in one year. That one-year increase in the City's pension payments is slightly larger than the combined budgets of the Free Library and the Recreation Department. The 22 percent increase is almost 10 times faster than the projected 2.4 percent increase in the City's revenues. Clearly, pension costs are consuming a larger and larger share of the budget and, unless growth rates are slowed, will force the City to make substantial cuts to other areas of the budget.

Unfortunately, even while the City is seeing its pension costs increase rapidly, it is not seeing an improvement in the pension fund's health. The City's latest actuarial report shows that the City's pension fund liability is only 53 percent funded down from 77 percent as recently as FY01 when the City was paying under \$200 million for pensions – less than half of what it will pay in FY07.

It is crucial that the City begin to take steps to both control the cost of its pension fund and to improve that fund's health. Exploring the recommendation included in the PICA report is an important first step in that process.

## **INFRASTRUCTURE**

The City is grossly under funding infrastructure maintenance and improvements (see the PICA issues paper “Reversing the Trend of Doing Too Little With Too Much: Maintaining the City’s Infrastructure While Reducing Its Dangerously High Debt Load”). Like the FY06-FY10 Plan, the FY07-FY11 Plan includes an insufficient level of funding for infrastructure. An analysis by the City Planning Commission said that the City needed to invest \$185 million annually to keep its infrastructure in good condition. Instead, the capital program includes only \$71 million in FY08 with slightly lower amounts in each other year of the FY07-FY12 capital program. It is likely that there will eventually be a substantial cost stemming from the Administration’s failure to invest in its infrastructure. The City will be faced with the choice of substantially increasing its borrowings, spending much more on maintenance, or closing facilities.

## **EMPLOYEE HEALTHCARE INSURANCE COSTS**

The FY07 budget includes \$323 million for health insurance costs, which is \$136 million or almost 75 percent more than the City spent in FY01. That increase is slightly larger than the combined FY07 budgets of the health and licenses and inspections departments. The rapid growth in health care costs has meant that health benefits have become one of the largest threats to the City’s five-year plan. Even with a projected additional increase of nearly \$125 million to \$446 million by FY11, the Plan may not have projected sufficient funding for the potential health insurance cost growth. At between 7.25 percent and nine percent, the Plan’s projections are more conservative than those made by the Hay Group, an independent management consulting group. Hay projected that rates would grow by 12 percent in FY08 before dropping to eight percent in FY09 and seven percent in FY10 and FY11. If the growth rates for health care costs grow as quickly as Hay projected, it will add costs beyond those included in the Plan.

The City’s ability to reach the Plan’s projections is particularly questionable because such a large portion of the health care costs are decided by arbitration panels. Those panels have provide awards that are so large that they have meant that health insurance costs have risen so rapidly that they are squeezing other expenditures out the budget. The FOP decision that is now under appeal, for example, would increase costs by 15.7 percent in its first year. The recently announced Fire award would increase costs by 14 percent for two consecutive years. It is not possible for the City’s revenues to grow as quickly as the costs of the awards and the only way the City can afford these awards is to reduce other costs.

## **REDUCING THE SIZE OF THE WORKFORCE**

At the end of FY01, the City’s workforce was 24,653. The City, facing potential budget deficits, embarked on a plan to slash the size of that workforce. Since personnel costs represent 60 percent of the budget, the City reasoned that it would be difficult to attack its deficits without cutting its number of employees. By not filling positions as they became vacant, particularly positions that had been held by employees who had been in the DROP, and through limited layoffs, the City was successful in reducing the number of

general fund employees. By the end of May 2006, the number of employees had dropped by 1,800. The FY07-FY11 Plan, however, threatens to reverse that progress. The FY07 budget proposes to include about 880 more positions than were filled at the end of May and 717 positions more than were budgeted in FY06.

The new positions are in a number of departments. The largest projected increases are 242 in prisons; 100 in Police; 91 in Streets; 83 in Fire; 68 in the Department of Public Health; 40 in the Department of Human Services; and 23 each in the departments of Recreation and Public Property. Many of these increases are in areas that provide crucial services, but adding this many positions will add a substantial amount of recurring costs that the city may not be able to reduce during future periods of fiscal distress without making painful cuts to services

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**SECTION VII:**

**A TALE OF FIVE CITIES:  
CONTRASTING MUNICIPAL MANAGEMENT  
OF LONG-TERM FISCAL CONCERNS**

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*“By failing to prepare, you are preparing to fail.” – Benjamin Franklin*

Many older cities are faced with a similar set of long-term fiscal concerns - under investment in core infrastructure; large amounts of outstanding debt; growing pension and benefit liabilities; a high tax burden; and, a lack of contingency funds. At the same time, municipal budgets have an increasing percentage of the budget dedicated to fixed or mission-critical costs (debt service, employee benefits, pension liability, funds reimbursed by other governments, public safety, etc), paradoxically making the need to address long-term fiscal concerns both exigent and politically unappetizing. It can be instructive to see how various cities, some with surpluses, others in challenging financial straits, attempt to deal with the same long-term fiscal challenges facing Philadelphia.

### **PHILADELPHIA**

As the City of Philadelphia planned its budget for FY07 and beyond, the City was projecting dramatically higher surpluses for the current fiscal year. The short-term financial situation was very optimistic. At the same time, as highlighted by PICA in a series of reports,<sup>3</sup> the City’s unfunded pension liability was over 40 percent, its long-term obligations were growing steadily, investment in core infrastructure was less than a third of that recommended by the City’s own Planning Commission, the City tax burden was among the highest in the nation, and there were no funds set aside for future fiscal emergencies.

Philadelphia had an ideal opportunity to realize the advice of most financial analysts: pay down debt, prepare for future emergencies, and invest in core infrastructure. Instead, the spending plan presented by the City either avoided, or in some case worsened, the long-term fiscal problems. Philadelphia’s Plan increases debt service in a new borrowing for non-critical infrastructure and proposes no increased investment in critical infrastructure. Philadelphia’s Plan proposes only a very minor quickening of the pace of efforts to reduce the City’s tax burden. Philadelphia’s Plan includes a substantial increase in the size of the City’s workforce. Philadelphia’s Plan includes an increase in spending on non-core initiatives such as marketing. Philadelphia’s Plan includes no contingency funds for fiscal emergencies. In short, despite having an unanticipated surplus, Philadelphia has a Plan that: allows core infrastructure to further deteriorate, increases the percentage of the budget consumed by fixed costs, speeds only very slowly efforts to ease the City’s tax burden, and ignores planning for future fiscal emergencies.

### **NEW YORK CITY**

New York City was in a situation similar to that of Philadelphia – long-term fiscal risks and an unanticipated surplus. While both cities faced similar long-term fiscal issues and similar revenue growth expectations, the leadership of each city chose drastically different approaches to “spending” the surplus.

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<sup>3</sup> All of the PICA issue reports can be found on the PICA website at [www.picapa.org](http://www.picapa.org)

New York's approach was best summed up by the Director of the City's Independent Budget Office: "The budget Plan largely seeks to use the surplus in ways that do not commit the city to recurring expenditures or tax reductions that could be difficult to sustain in future years." Instead, the City devoted the majority of its surplus to managing a series of long-term fiscal challenges:

1. establishing a health care trust fund for retirees;
2. using \$200 million of "pay-as-you-go" capital spending to alleviate an escalating debt burden and increase basic infrastructure spending;
3. paying-off early \$350 million of debt service; retiring other outstanding city debt; and
4. prepaying certain FY07 expenses, to ease pressures on limited discretionary resources in the future. In short, New York took a common sense approach— pay down debt, prepare for future emergencies, and invest in core infrastructure.

## **SAN DIEGO**

Unlike Philadelphia and New York, San Diego found itself in a much more precarious position as it prepared its spending plan for FY07. After a series of incidents resulted in a fiscal crisis and cost two mayors their jobs, San Diego was faced with rebuilding its short-term fiscal stability, while still facing many of the long-term structural issues facing other large cities.

Notwithstanding the immediate budget needs, the FY2007 budget proposes to address many of San Diego's structural problems. In addition to increasing funds for the Police and Fire Departments, the City increased its contribution to its rainy day reserves, beyond the statutory requirement. The unfunded pension liability, the portion of the budget which precipitated San Diego's fiscal crisis, was addressed through a combination of increased City contributions, the issuance of Pension Obligation Bonds, and an increase in employee contributions. The Mayor has stated a goal of achieving 85 percent funding levels in the pension system.

San Diego also identified the rising cost of retiree health care as generating significant financial pressure. The FY07 proposed budget increases the contribution to these costs, and the City has begun negotiations with employees regarding benefit changes. The City also dedicated \$5 million to begin funding a reserve against future costs of these benefits, in the event changes to the retiree benefits do not come to fruition.

Finally, as the City's budget message itself reads: "as in most organizations with severe financial pressures, the City has long neglected the maintenance of most of its assets." The proposed FY2007 budget includes \$20 million dedicated to addressing deferred maintenance – almost half of which will be funded on a pay-as-you-go basis. The City is also developing a complete inventory of needs in order to establish a proper infrastructure funding level. Despite the short-term pressures on San Diego's budget, the budget proposed for FY2007 increases funding for core-mission services and addresses many of the City's long-term risks.

## **SAN FRANCISCO**

The City of San Francisco ended its FY2006 budget with a fund balance of over \$95 million. After evaluating the sources of that surplus, the City determined that much of the savings could not be assumed to be recurring. Mayor Newsom summed up the approach to utilizing the surplus: “Because that savings can only be spent once, it should be spent on one-time expenses such as capital and equipment. Had I opted to apply the savings to new ongoing programs, the City’s structural imbalance between revenues and expenses would have grown, and a year from now we would be forced to make additional reductions. This budget takes the more fiscally prudent path of planning ahead.”

In the proposed budget for FY2007, San Francisco increases the funding level of its financial reserves beyond that required by its Charter, in part due to pending labor agreements. The City dedicated much of its surplus to capital spending with particular emphasis on road rebuilding and general maintenance. These commitments to long-term issues were made in conjunction with an increase in key city services, including the hiring of 250 new police officers. The City analyzed the nature of its surplus, and utilized that analysis to balance funding short-term core mission needs and attending to long-term challenges.

## **BOSTON**

Boston ended its 2005 fiscal year with a modest surplus of \$8 million. While such a surplus might not leave room for dramatically attacking long-term structural problems, Boston finds itself in better condition on many of these issues, due in large part to a series of established policies regarding debt management, pension management, and reserve funding. The result of these established policies and systems is that Boston faces less future risk in these areas.

Boston’s debt management system is a careful balancing of ensuring that actual capital needs are met while assuring ongoing debt affordability. Under the latter precept, the City maintains several guiding principals including:

1. combined net direct debt does not exceed three percent of taxable assessed value;
2. at least 40 percent of the overall debt is repaid within five years and 70 percent within ten years;
3. annual gross debt service costs do not exceed seven percent of general fund expenditures.

These guiding principals not only serve to ensure ongoing fiscal flexibility in the short-term, but also aim to prevent future City governments and citizens from a crushing debt burden.

Boston’s fiscal management also extends to its reserves, where it is mandated to maintain a reserve fund equal to 2.5 percent of the preceding year’s appropriation. The City

furthered its commitment to prudent fiscal management, by prepaying its anticipated FY06 Reserve Fund requirement in FY05, and is projecting to do the same for its FY07 requirement before the close of FY06. Boston's pension fund is struggling like those in many municipalities, dropping to a funded level of under 65 percent in FY05. However, it relies on an assumed investment return rate of 8 percent, and utilizes an aggressive funding schedule that aims to fully fund the system several years earlier than required by state law. Though Boston's prudent fiscal management policies do not immunize it from fiscal threat, their approach limits the degree of risk and ensures a level of fiscal flexibility for future governments.

## **CONCLUSION**

The lessons taken from the examples cited above are instructive. Whether planning from a position of unexpected fiscal strength, recovering from near disaster, or continuing to manage resources effectively, most of the cities above have found a way to balance current needs while taking steps to address long-term structural issues. Two years from now, most of the cities listed above can expect to be well prepared to face their fiscal future. Two years from now as a new Mayor faces the beginning of a new fiscal year, Philadelphia can only hope it can muster the resources to manage new labor contracts, increasing pension costs, a deteriorating infrastructure, a growing debt load, and one of the highest tax burdens in the country.

**Pennsylvania Intergovernmental  
Cooperation Authority**

**STAFF REPORT  
ON  
FY2007-FY2011  
FIVE-YEAR FINANCIAL PLAN**

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**SECTION VIII:**

**APPENDIX**

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## APPENDIX A

### Statutory Background, Plan Review Methodology and Summary of Events

#### *Overview*

The General Assembly created PICA in June of 1991 by its approval of The Pennsylvania Intergovernmental Cooperation Authority Act for Cities of the First Class (Act of June 5, 1991, P.L. 9, No. 6). As in previous PICA Staff reports concerning the City's prior five-year financial plans, rather than re-state in the body of this Staff Report the principal provisions of the PICA Act and the Intergovernmental Cooperation Agreement, PICA Staff has included such information in this Appendix.

A brief summary of events to date including comments as to PICA's future focus, a summary of PICA Staff's Plan review methodology and a compilation of required future City reporting to PICA is also included herein.

#### *Statutory Basis -- The PICA Act*

The mission of the Authority, as stated in the PICA Act (Section 102), 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;
- (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.

The PICA Act establishes requirements for the content of a five year financial plan, and Sections 209 (b)-(d) of the statute and the Cooperation Agreement provide:

(b) Elements of plan. -- The financial plan shall include:

(1) Projected revenues and expenditures of the principal operating fund or funds of the city for five fiscal years consisting of the current fiscal year and the next four fiscal years.

(2) Plan components that will:

(i) eliminate any projected deficit for the current fiscal year and for subsequent years;

(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 financial plan through sound budgetary practices, including, but not limited to, reductions in expenditures, improvements in productivity, increases in revenues, or a combination of these 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-term and long-term credit markets.

(c) Standards for formulation of plan:

(1) All projections of revenues and expenditures in a financial plan shall be based on reasonable and appropriate assumptions and methods of estimation, all such assumptions and methods to be consistently applied.

(2) All revenue and appropriation estimates shall be on a modified accrual basis in accordance with generally accepted standards. Revenue estimates shall recognize revenues in the accounting period in which they become both measurable and available. Estimates of city-generated revenues shall be based on current or proposed tax rates, historical collection patterns, and generally recognized econometric models. Estimates of revenues to be received from the state government shall be based on historical patterns, currently available levels, or on levels proposed in a budget by the governor. Estimates of revenues to be received from the federal government shall be based on historical patterns, currently available levels, or on levels proposed in a budget by the

president or in a congressional budget resolution. Non-tax revenues shall be based on current or proposed rates, charges or fees, historical patterns and generally recognized econometric models. Appropriation estimates shall include, at a minimum, all obligations incurred during the fiscal years and estimated to be payable during the fiscal year or in the 24-month period following the close of the current fiscal year, and all obligations of prior fiscal years not covered by encumbered funds from prior fiscal years. Any deviations from these standards of estimating revenues and appropriations proposed to be used by a city shall be specifically disclosed and shall be approved by a qualified majority of the board.

(3) All cash flow projections shall be based upon reasonable and appropriate assumptions as to sources and uses of cash, including, but not limited to, reasonable and appropriate assumptions as to the timing of receipt and expenditure thereof and shall provide for operations of the assisted city to be conducted within the resources so projected. All estimates shall take due account of the past and anticipated collection, expenditure and service demand experience of the assisted city and of current and projected economic conditions.

(d) Form of plan. -- Each financial plan shall, consistent with the requirements of an assisted city's home rule charter or optional plan of government:

(1) be in such form and shall contain:

(i) for each of the first two fiscal years covered by the financial plan such information as shall reflect an assisted city's total expenditures by fund and by lump sum amount for each board, commission, department or office of an assisted city; and

(ii) for the remaining three fiscal years of the financial plan such information as shall reflect an assisted city's total expenditures by fund and by lump sum amount for major object classification;

(2) include projections of all revenues and expenditures for five fiscal years, including, but not limited to, projected capital expenditures and short-term and long-term debt incurrence and cash flow forecasts by fund for the first year of the financial plan;

(3) include a schedule of projected capital commitments of the assisted city and proposed sources of funding for such commitments; and

(4) be accompanied by a statement describing, in reasonable detail, the significant assumptions and methods of estimation used in arriving at the projections contained in such plan.

The Cooperation Agreement (at Section 4.04(a)-(h)), and similar provisions of the PICA Act, also require the following as supporting data for the Plan:

(a) a schedule of debt service payments due or projected to become due in respect of all indebtedness of the City and all indebtedness of others supported in any manner by the City (by guaranty, lease, service agreement, or otherwise) during each fiscal year of the City until the final scheduled maturity of such indebtedness, such schedule to set forth such debt service payments separately according to the general categories of direct general obligation debt, direct revenue debt, lease obligations, service agreement obligations and guaranty obligations.

(b) a schedule of payments for legally mandated services included in the Financial Plan and due or projected to be due during the fiscal years of the City covered by the Financial Plan;

(c) a statement describing, in reasonable detail, the significant assumptions and methods of estimation used in arriving at the projections contained in the Financial Plan;

(d) the Mayor's proposed operating budget and capital budget for each of the Covered Funds for the next (or in the case of the initial Financial Plan, the current) fiscal year of the City, which budgets shall be consistent with the first year of the Financial Plan and which budgets shall be prepared in accordance with the Home Rule Charter;

(e) a statement by the Mayor that the budgets described in section 4.04(d) hereof:

(i) are consistent with the Financial Plan;

(ii) contain funding adequate for debt service payments, legally mandated services and lease payments securing bonds of other government agencies or of any other entities; and

(iii) are based on reasonable and appropriate assumptions and methods of estimation.

(f) a cash flow forecast for the City's consolidated cash account for the first fiscal year of the City covered by the Financial Plan;

(g) an opinion or certification of the City Controller, prepared in accordance with generally accepted auditing standards, with respect to the reasonableness of the assumptions and estimates in the Financial Plan; and

(h) a schedule setting forth the number of authorized employee positions (filled and unfilled) for the first year covered by such Financial Plan for each board, commission, department or office of the City, and an estimate of this information for the later years covered by the Financial Plan. The schedule required under this paragraph (h) shall be accompanied by a report setting forth the City's estimates of wage and benefit levels for various groups of employees, such information to be presented in a manner which will allow the Authority to understand and effectively review the portions of the Financial Plan which reflect the results of the City's labor agreements with its employees, and an analysis of the financial effect on the City and its employees of changes in compensation and benefits, in collective bargaining agreements, and in other terms and conditions of employment, which changes may be appropriate in light of the City's current and forecast financial condition. The parties agree to cooperate such that the form of the report required under this paragraph (h), and the subjects covered, are reasonably satisfactory to the Authority.

### *City Reporting and Variances*

The PICA Act (Section 209) and the Cooperation Agreement (Section 409(b)) require submission of quarterly reports by the City on its compliance with the 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 four of its five appointed members declare the occurrence of a "variance", which is defined in Section 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 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 Section 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 statute mandates the submission of monthly reports to PICA by the City after determination by the Authority of the occurrence of a variance.

As provided in Section 210(e) of the PICA Act, there are legal consequences flowing from a determination by the Authority that a variance exists, and 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 it to deal with a continuing uncorrected variance are to direct the withholding of both specific Commonwealth funds due the City, and that portion of the 1.5 percent tax levied on the wages and income of residents of the City in excess of the amounts necessary to pay debt correction of the variance.

### *Plan Review Methodology*

Staff Report - The Plan was submitted to PICA by the Mayor on June 1, 2006 and resubmitted with substantial changes on June 23, 2006 and the PICA Act provides a 30 day period for review. Authority Staff has consulted with the City, both on the departmental level and otherwise, since the Plan was initially submitted to City Council by the Mayor on January 24, 2006 and has referred to material presented to City Council and the Controller's Office, as well as information included in reports submitted by the City to PICA and other data developed by PICA Staff. This report includes reference to materials received by the Authority through June 30, 2006.

Under Section 5.07 of the Cooperation Agreement, PICA agreed not to disclose information provided to it in confidence by the City with respect to negotiation of collective bargaining agreements and ongoing arbitration proceedings, and the Authority has consistently followed that requirement.

Relationship to Future Plan Revisions - The City is obligated under the both the Cooperation Agreement and the PICA Act to submit a revised Plan in the event it enters into a collective bargaining agreement, or receives a labor arbitration award, at variance with that which was assumed in the Plan. The Cooperation Agreement anticipates that the Plan must be revised to deal with such matters within 45 days after declaration of a "variance" by PICA.

Apart from labor-related revisions, or those required by declaration by PICA of a variance in the Plan in the future, the Plan is subject to mandatory revision on March 22, 2007 (100 days prior to the end of FY2007). At that time, the City is required to add its Fiscal Year 2012 to the Plan and make any other alterations necessary to reflect changed circumstances. Under the PICA Act, the City may determine to revise the Plan at any time and submit the revision to the Authority for its review.

### *Accounting Concerns*

The PICA Act requires that a modified accrual accounting system be used in preparation and administration of the Plan, in accordance with generally accepted accounting standards. Specifically, the Cooperation Agreement (at Sections 4.02(a) and (b)) provides:

Estimates of revenues shall recognize revenues in the accounting period in which they become both measurable and available....

Appropriation estimates shall include, at a minimum, all obligations incurred during the fiscal year and estimated to be payable during the fiscal year or in the twenty-four (24) month period following the close of the current fiscal year....

The Plan as submitted meets the requirements of the PICA Act and Cooperation Agreement.

### *Summary of Events to Date/Future Focus*

PICA's creation was an action taken by the Commonwealth of Pennsylvania in direct reaction to Philadelphia's financial crisis. Accordingly, PICA's primary focus during its initial years of existence has been to assist the City to avoid insolvency; to provide the funds directly required for that purpose and for essential capital programs; and to oversee the City's efforts to lay a sound foundation for its return to fiscal stability. The negotiation of the Cooperation Agreement to set out the basic terms of the City-PICA relationship, the PICA sponsored effort resulting in the establishing of the format and content of the Five-Year Financial Plan process, and the issuance of bonds to provide funds to assist the City to stabilize its finances were all major accomplishments. Successful defense against challenges to the constitutionality of the PICA Act was another vital PICA process component. PICA's annual assessment of Plan progress, successful challenges to overgenerous prior Plan revenue estimates and suspect methodologies, evaluations of City reporting, and analysis of City practices and programs have assisted in the ongoing City improvement as envisioned by the PICA Act.

PICA also provides continuing oversight as to the encumbrance by the City of PICA provided capital funds for capital projects deemed required to rectify emergency conditions or necessary for Plan operational success.

PICA has provided in excess of \$1,186 million in funding to 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	515,991
Retirement of Certain High Interest City Debt	<u>381,300</u>
<b>TOTAL</b>	<b><u>\$1,186,291</u></b>

PICA’s authority to issue new money debt has expired. PICA anticipates that its future activities with respect to the City will focus more closely on oversight on the City’s efforts to maintain financial balance, further institutionalize management reforms (both those initiated to date and those still to be made) and to implement ongoing operations changes in accordance with the City Strategic Plan.

The City had taken full advantage of the tools PICA made available to it. It is anticipated that the PICA/City relationship will continue to be a catalyst for further City operational improvements.

Whether PICA will also become involved in the financial oversight of the School District of the City Philadelphia is a matter that presently is in the hands of the Appellate Courts of the Commonwealth.

*Future City Reporting to PICA*

Absent the occurrence of a variance, receipt of an arbitration award which is at variance with the Plan or a determination by the City that further revisions to the Plan are necessary, the City will not submit a revised Plan to the Authority until March 2007. During future months, the Authority will receive quarterly reports on the City's performance under the Plan, together with other data.

The reporting system established in the Cooperation Agreement and the PICA Act anticipates a regular flow of data to PICA, and the reporting system which has been established by agreement between the City and PICA under the provisions of the PICA Act is divided into several groups, which are described below:

Quarterly Plan Reports The Authority receives reports from the City on a quarterly basis (45 days after the end of each fiscal quarter) concerning the status of compliance with the Plan and associated achievement of

initiatives. The remaining quarterly reporting deadline for FY2006 is August 15, 2006. Quarterly reporting deadlines for FY2007 are November 15, 2006, February 15, 2007, May 15, 2007 and August 15, 2007. The Cooperation Agreement 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 be prepared and submitted, by department, not later than 20 days after the close of each fiscal quarter, and still to be received relating to FY2006 is the report due July 20, 2006. For FY2007, the reporting dates are October 20, 2006, January 22, 2007, April 20, 2007 and July 20, 2007. Commonwealth funds by the City, as well as the eligibility for fund withholding by the Commonwealth at PICA's direction in the event the City cannot balance the Plan after an extended period of intensive reporting and PICA review of proposed corrective efforts.

Prospective Debt Service Requirements Reports 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. The dates for submission of such reports for FY2007 are August 1, 2006, November 1, 2006, January 31, 2007 and May 2, 2007.