

Pennsylvania Intergovernmental Cooperation Authority



**Staff Report
on the
City of Philadelphia's
Revised Five-Year Financial Plan
for
Fiscal Year 2005 - Fiscal Year 2009**

December 21, 2004

**PENNSYLVANIA INTERGOVERNMENTAL
COOPERATION AUTHORITY**

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PICA STAFF REPORT AND RECOMMENDATION ON THE CITY OF PHILADELPHIA'S REVISED FIVE-YEAR PLAN

The City of Philadelphia (City) submitted a preliminary Revised *Five-Year Financial Plan, Fiscal Year 2005-Fiscal Year 2009* (the Revised Plan) to the Pennsylvania Intergovernmental Cooperation Authority (PICA) on November 15, 2004. This submission was in response to the PICA Board's request for a Revised Plan which incorporated new expenditures resulting from agreements on several municipal union contracts, in accordance with Section 5.07 of the Cooperation Agreement between PICA and the City. The Revised Plan as submitted would not have constituted a reasonable prospect for balanced budgets over the life of the Revised Plan. In response to concerns raised by PICA Staff, the City further revised its Revised Plan; this final Revised Plan was submitted to PICA on December 20, 2004.

As a result of PICA's desire to maintain the fiscal integrity of the City of Philadelphia, and recognizing that the City will shortly propose its *Five-Year Financial Plan, Fiscal Year 2006-Fiscal Year 2010*, PICA Staff has expedited its review of the Revised Plan. Consequently although this Staff Report maintains PICA Staff's history of a rigorous review of the budget, it focuses primarily on the fiscal integrity of FY2005; a more extensive report will be issued on the FY2006-FY2010 Plan. An in-depth discussion of other PICA Staff concerns with the City's FY2005-FY2009 Financial Plan can be found in the Staff Report on the Plan for FY2005-FY2009 issued on July 7, 2004.¹

Expenditures and revenues are projected utilizing realistic assumptions except where noted in this Staff Report. The Revised Plan presents a reasonable prospect for balanced budgets over the life of the Revised Plan, although the first year of the Revised Plan is most tenuous with a projected surplus of just over \$11 million. The Revised Plan projects a surplus of over \$103 million by the end of FY2009.

As in the past, there are a number of risks and concerns which threaten the fiscal health of the City over the life of the Revised Plan. Many of these risks are ongoing issues previously documented by PICA Staff. While the Revised Plan at times acknowledges these risks, the City continues to fail to offer remedies.

The Revised Plan confronts three significant risks, including:

- Ongoing uncertainty surrounding labor wage and benefit costs.
- Fiscal uncertainty at the Philadelphia Gas Works (PGW).
- Continued reliance on long-term debt.

Other concerns include:

- Inconsistent and incomplete information regarding proposed City asset sales.
- Timely receipt of Luxury Box Revenues.

¹ A copy of the Staff Report can be found on the PICA website at www.picapa.org

- Growing expenditures in the Prison system resulting from a continuing high inmate population.
- The lack of support for logical service and productivity enhancements, savings from which are already assumed in the revised Plan.
- Payments by the Commonwealth for patrolling State Highways in Philadelphia.
- Assumption of savings from Reduction in Force efforts including lay-offs.
- Anticipated revenues resulting from the establishment of gaming facilities in Philadelphia.

Report Summary

As noted above, this report focuses primarily on significant risks to the Plan, with limited discussion of some department-specific and other issues that have a direct relationship to maintaining fiscal stability.

City's Revenue Assumptions

PICA Staff found the assumptions underlying the City's revenue projections to be reasonable with the following concerns noted.

- At this late stage of the Fiscal Year, PICA Staff had significant concerns about the City's ability to realize \$30 million in revenues from the sale of assets in FY2005. While the City does have surplus assets valued beyond that amount, the City failed to demonstrate that it would complete sufficient sales by the end of FY2005. In response to PICA Staff concerns, the Revised Plan now realizes \$10 million in asset sales revenues in FY2005 and the remaining \$20 million in FY2006.

The information and reports related to the asset sales that were provided to PICA Staff contained inconsistent and unverifiable data. As a result, PICA Staff will also require that the City continue to provide periodic reports on the progress of identified asset sales as well as the submission of key documentation including appraisals, letters of intent, and sale agreements. Should the City fail to provide this data, or fail to realize the \$10 million in asset sales during FY2005, PICA Staff will be forced to discount projected asset sale revenues when considering the next Plan.

- PICA Staff continues to have some concerns about several funding assumptions which are dependent on new legislation and funds from the State and Federal governments. These proposals include increasing certain Department of Human Service (DHS) reimbursements from 80 percent to 100 percent, as well as Medicaid reimbursements for inmate costs. While many of the proposals concerning DHS are in various stages of the legislative process, DHS has

provided PICA Staff with a detailed contingency plan should those funds not materialize. While these contingencies are not ideal, they will not increase costs for the City in the short-term.

The increase in fees for gun permits and for Police Accident and Incident reports would require additional action at the State level. Additionally, there has been no action to date on the proposal that the State will reimburse the City for the patrol of state highways. In response to PICA Staff concerns, the Revised Plan no longer assumes any such revenues. Inclusion of these revenues in FY2006 and beyond will be the subject of discussions between the City, State and PICA Staff during review of the soon to be proposed *Five-Year Financial Plan, Fiscal Year 2006-Fiscal Year 2010*.

- PICA Staff has some concerns regarding the inclusion of receipts from gaming beginning with a projected \$12.5 million in FY2007. PICA Staff will continue to monitor the progress of the State's Gaming Commission as well as the proposals for gaming facilities in Philadelphia in order to determine a reasonable timeline for receipt of gaming revenues.

To the positive side, PICA Staff continues to be encouraged by the City's renewed focus on increasing collection rates. While improved collection rates will obviously benefit the City's Fund Balance (as anticipated in the Revised Plan), they will also result in a more equitable tax base. The City's Law Department has been accommodating in sharing its strategies and successes to date. PICA Staff looks forward to continued updates on both current collection rates and delinquent collections.

PICA Staff was also pleased to note that the City has filed suit in its efforts to collect revenues from luxury box rentals at Veterans Stadium, which is due from the Philadelphia Eagles. PICA Staff is concerned that protracted legal proceedings might prevent the City from collecting the money it is due within the current fiscal year. As requested by PICA Staff, the Revised Plan has a FY2005 surplus of over \$11 million to ensure that the Revised Plan is in balance even if the budgeted funds are not received in a timely fashion.

The City was also able to estimate an additional \$30 million in Revenue from Other Governments for FY2005. State officials overestimated the amount of Federal Title IV-E revenue and underestimated the amount of Act 148 revenue in developing the funding formula. State officials have indicated that they will work with the City to resolve issues related to the Title IV-E revenues. Department of Human Services officials will keep PICA Staff apprised as settlement language is completed.

Real Estate Transfer Tax receipts continue to grow at a steady rate. PICA Staff has been working with the Department of Revenue, the Records Department, and the Board of Revision of Taxes to try and identify the underlying reasons for this growth and achieve more reliable projections. With receipts continuing strong growth through November,

the City reasonably raised its projected Transfer Tax revenues an additional \$5 million in the Revised Plan.

Significant Risks

As mentioned earlier, the Plan confronts three significant risks.

- The recently completed contracts with the Cities municipal unions and the completed Act 111 Arbitration with the Fraternal Order of Police did not achieve many of the changes in benefits and work rules necessary for the City to control its overall labor costs. The unprecedented decision by the Act 111 arbitrators to set salary increases for four years but health benefit increases for one year greatly strains the City's ability to project its long term costs, in particular because of the recent deplorable history of dramatic and unwarranted health increases including one of 37 percent in one year. The City was derelict in not appealing this decision. PICA Staff has requested a meeting with the City Law Department to explore how the City utilizes the Act 111 regulations.
- The Philadelphia Gas Works (PGW) continues to present a perplexing problem for the City. As recent rule changes and management changes have taken hold, the utility has pushed its collection rate over 90 percent. While PGW is therefore generating a surplus, it is not earning enough to also cover all of its enormous debt. In FY2004 PGW was, for the first time, unable to make its \$18 million payment to the City. However, the Plan still assumes an \$18 million payment in FY2009 as well as repayment of the \$45 million loan. PICA Staff does not consider receipt of those revenues to be likely. The long-term fiscal projection is clouded, and the remedies being touted by PGW management are unrealistic.

Also to be noted in connection with PGW is the potential impact of the new PGW shut-off policies for non-payment. These policies are an important necessary step in allowing for the proper management of PGW. At the same time, these policies may result in a situation where residents left without heat are forced to access additional City resources, further straining a narrowly balanced City budget. PICA Staff will closely monitor the impact of these shut-offs on City agencies and overall expenditures.

- The City's approach to long-term debt is beginning to mirror that which got PGW into trouble in the first place. In effect, the City is attempting to use long-term debt to free up cash in the short-term, but saddling the next generation of Philadelphians with increasing amounts of debt. The decision to re-amortize the City's Pension Plan in accordance with the amendments to Act 205 will provide short term savings to the Pension Plan of approximately \$50 million. However, it will also reduce the percentage of Pension Plan funding, and increase future payments by over \$180 million.

A similar approach to long-term debt can be seen with the proposed plans to finance reconstruction of the Central Library, a new economic development fund, and the issuance of additional Neighborhood Transformation Initiative bonds. The City continues to utilize increasing percentages of locally-generated tax dollars to cover long-term spending commitments, despite warnings from PICA (in Staff Reports since 1999), the City Controller (recent report on “The Debt Threat”), and even the City’s own Budget Director (Quarterly City Manager’s Report). During the review of the next proposed Five-Year Plan, PICA Staff will expect a comprehensive City policy on long-term debt.

Additional Concerns

The inmate population in Philadelphia continues to run at a rate significantly higher than that projected in the Revised Plan. Combined with the recent opening of a new facility, PICA Staff does not believe the Prisons Department will be able to meet its target budget goals. Further, the Revised Plan assumes savings of \$5 million in Prisons overtime; a savings that is now questionable. PICA Staff has requested that the City provide periodic reports on the inmate population and Prisons Department expenditures.

The Revised Plan is in part balanced on a continuing effort to reduce the size of the City’s workforce through a combination of hiring freezes and lay-offs. While the City has demonstrated a sincere effort to achieve the stated reductions, PICA Staff will be closely monitoring the progress of these efforts throughout the end of FY2005. Savings from these reductions are assumed beginning in FY2006; failure to reach the workforce levels specified in the Revised Plan would result in an unbalanced Five-Year Plan.

As in the past, the Revised Plan anticipates a cumulative total of \$60 million in unspecified expenditure reductions over its final four years resulting from future government efficiencies. PICA Staff will continue to provide recommendations for greater savings and maximizing taxpayer value and believes many such opportunities exist. However, the recent impediments to the City in trying to properly manage its own Fire Department resources run counter to these efforts and threaten the realization of any benefits from increased efficiencies.

Since FY1995 the number of structural fires in the City has decreased dramatically, by over nineteen percent. This remarkable achievement came about through a combination of improved firefighting, stronger building codes, newer buildings, and new technology. At the same time, the Fire Department is increasingly being contacted in its role as a provider of emergency medical treatment. As a result, the Fire Commissioner determined that fewer resources were needed to fight fires, and that the needs of the citizens of Philadelphia would be better met with increased Emergency Medical Services personnel. The result of this change would be better delivery of services and a savings to the taxpayers of Philadelphia.

Despite the clear logic of this determination, many have successfully fought to preserve an outdated status quo. Part of any government's mission should be a constant striving to meet the ever changing needs of its citizenry in ever more effective means. Successes in these endeavors should be greeted with enthusiasm not derision. The "status quo approach" threatens PICA Staff's ability to rely on future unspecified savings when evaluating future Five-Year Plans.

Staff Recommendation

The submission of a Revised Plan provides an unprecedented opportunity for a mid-year reassessment of the revenues and expenditures of the City. In the event that revenues beyond those projected at the midpoint of the year materialize, the City will be able to more easily identify those funds and set them aside to further insure long-term fiscal health. Surplus revenues could be used to establish a "Rainy Day fund" long advocated by PICA as a means to proactively prepare for identified and unknown fiscal threats. These funds could also be utilized to address the growing long-term debt situation, discussed above, which unfairly burdens future generations of Philadelphians, or be utilized in further reforming the City's much maligned tax system. The opportunity cost of not utilizing excess revenues to address these needs is beyond calculation.

The identified potential risks to the General Fund in the Revised FY2005-FY2009 Plan constitute a real threat to the fiscal health of the City. PICA Staff will continue to closely monitor the City's fiscal situation throughout the coming year, and expects the City's *Five-Year Financial Plan, Fiscal Year 2006-Fiscal Year 2010* to respond to the issues raised in this Staff Report. Given the risks identified above, and the adjustments to the budget made by the City as requested by PICA Staff, the Revised FY2005-FY2009 Plan presents a reasonable prospect for balanced budgets in each year of its term.

PICA Staff recommends that the Board of the Pennsylvania Intergovernmental Cooperation Authority approve the Revised Plan as submitted to the Authority on December 20, 2004.