

FY08-FY12 Amended Five-Year Plan: PICA Staff Report

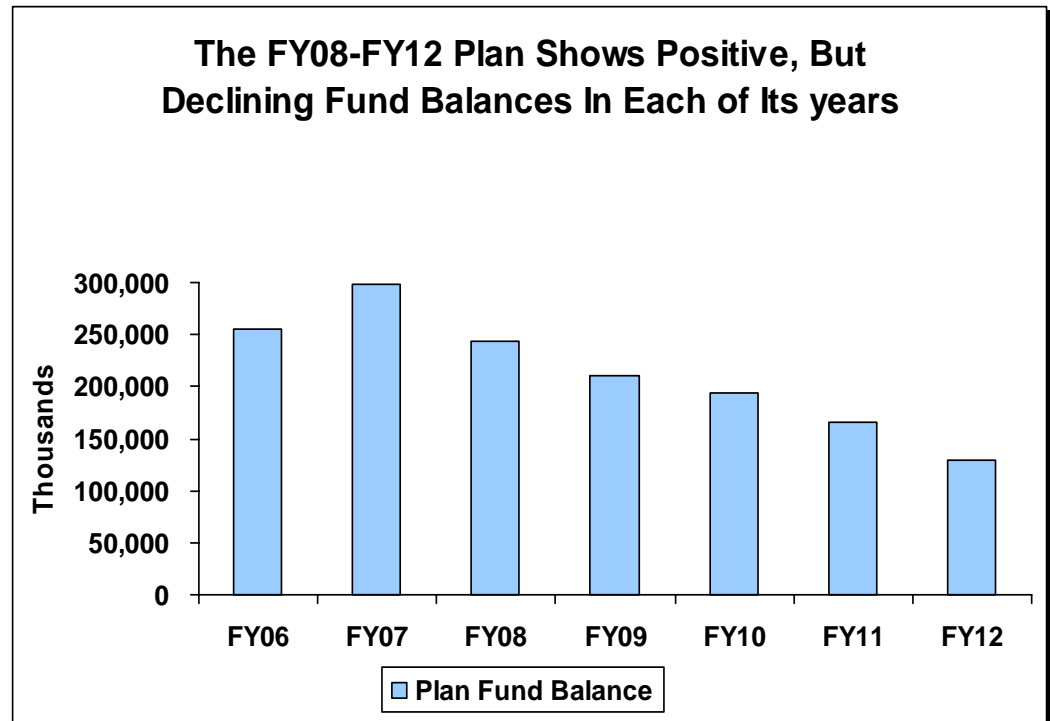
November 13, 2007

FY08-FY12 Five-Year Amended Plan: PICA Staff Report

Is The Plan Balanced?

The Plan is balanced, but fails to address the structural financial issues facing the City. While leaving the City with an FY12 fund balance that equals just over 3% of revenues, the Plan also leaves the City with:

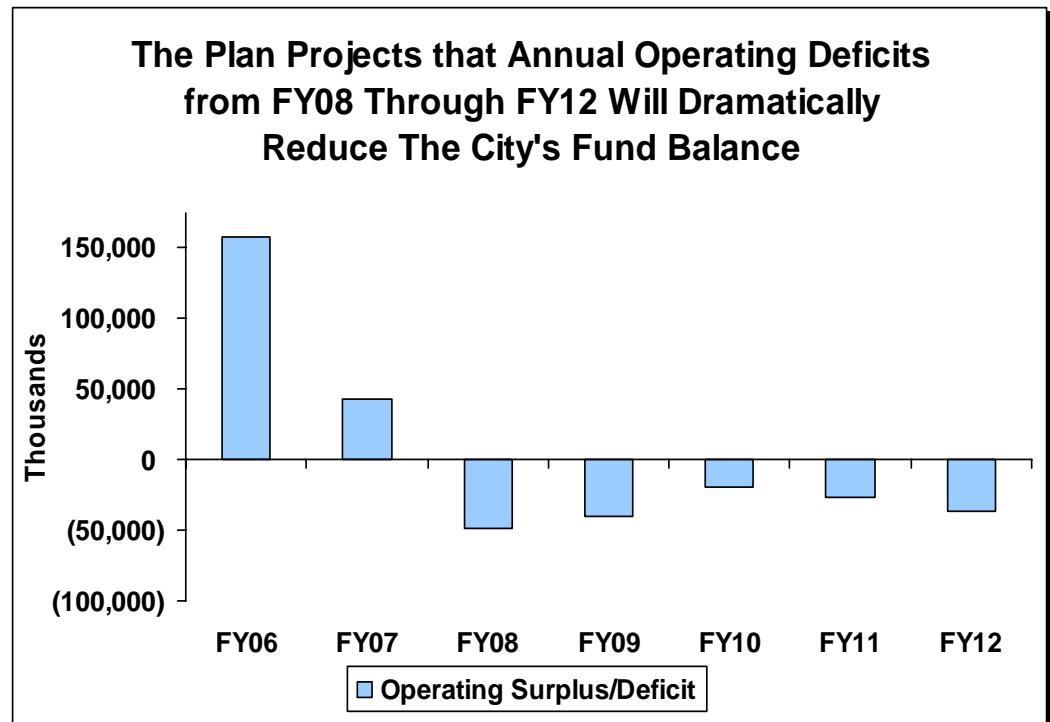
1. A crumbling core infrastructure;
2. An enormous unfunded pension liability;
3. An uncompetitive tax structure;
4. Skyrocketing health benefits and pensions costs;
5. A rapidly increasing prisons census;
6. A School District that faces its own financial challenges;
7. Collective bargaining agreements that expire at the end of the Plan's first fiscal year.



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What Are the Plan's Overall Trends?

- The Plan projects that the City will spend more than it will take in each year.
- Because of the imbalance between revenues and expenditures, the Plan is projected to have operating deficits each year from FY08 through FY12.



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Why Did the City Have to Revise the FY08-FY12 Plan?

- **The City was required to revise its FY08-FY12 Plan because it finalized labor agreements that were not consistent with the approved Plan.**
- **The Plan includes increased health insurance contributions to all four of the City's major unions – the ones representing police officers, firefighters, blue collar workers and white collar workers.**
- **The increased health insurance contributions translated into \$161 million in costs through FY12.**
- **Those new agreements are retroactive to FY05, FY06 and FY07, but all of the agreements are still set to expire at the end of this fiscal year.**

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How Did the City Bring the Plan into Balance?

The Plan includes costs for a series of items in addition to the labor costs. The largest of those items are:

- **\$8 million for the City to assume the costs of contracts that are now funded by the School District;**
- **\$7.5 million for IT projects;**
- **\$3.7 million in FY08 and \$18.5 million over the life of the Plan for homeless services;**
- **\$2.6 million in additional funding for the Youth Violence Reduction Program.**

Changes That Added Costs to the FY08-FY12 Plan	
	\$ Thousands
Additional Labor Costs	160,964
Assumption of School District Contract Costs	8,000
IT Projects	7,500
Homeless Services Costs	18,500
Youth Violence Reduction Program	2,600
All Other Costs	20,720
Total	218,284

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How Did the City Bring the Plan into Balance?

The City was able to capitalize on healthy tax revenues and two bond refundings to not only maintain a positive fund balance throughout the life of the Plan, but to show a larger fund balance (\$127.7 million) at the end of FY12 in the revised Plan than had been included in the initial Plan (\$53.1 million).

The largest changes that increased projected fund balance were:

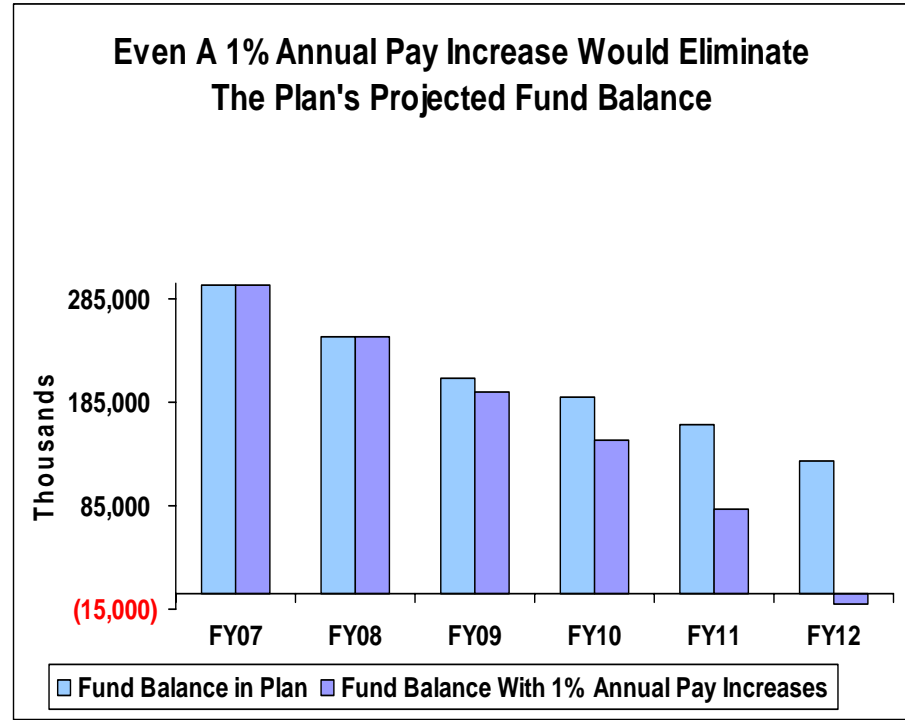
- \$72 million in additional business privilege tax revenues;
- \$102 million in additional wage tax revenues;
- \$36 million in increased PICA tax revenues; and
- \$29.5 million in savings from refundings.

Changes that Helped Bring the Plan Into Balance	
<u>Increased Projected Tax Revenues</u>	\$000
Wage Tax	101,928
PICA Tax	36,068
Delinquent Tax Collections	17,000
Business Privilege Tax	72,005
Other Taxes	(25,715)
Total Increased Projected Tax Revenues	201,286
<u>Increased Local Non-Tax Revenues</u>	
Increase Projected Garage Sale Proceeds to \$29 Million	15,000
Total Increased Local Non-Tax Revenues	15,000
<u>Expenditure Reductions</u>	
Refundings	29,500
Total Expenditure Reductions	29,500
Total Plan Balancing Proposals	245,786

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The Plan Contains a Number of Risks and Its Positive FY12 Fund Balance Could Be Obliterated By Even a 1% Annual Pay Increase

The Plan's \$127.7 million fund balance appears large, but even a one percent annual increase in employee salaries would wipe out that fund balance.



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In Addition to the Possibility That Pay Raises Could Eliminate the City's Fund Balance, the Plan Includes A Number of Other Risks

- **The Plan assumes that PGW will pay the City the remaining \$43 million of its \$45 million loan. The Plan assumes \$20 million will be repaid in FY08 and \$23 million in FY09.**
- **The Plan projects that real estate tax assessments will grow by at least 5% in 4 of its 5 years and by 6% in FY09 and FY10. Given the weakening of the real estate market, those projections appear to be aggressive. In addition, the Plan assumes \$17 million from an as yet unproven delinquent collection program.**
- **The Plan includes two actions that are inconsistent with promises made by the Mayor-elect: it ends the business privilege tax reduction program in FY10 and reduces the number of police officers by 63 in FY09 (when State Police assume full responsibility for patrolling state highways in Philadelphia).**

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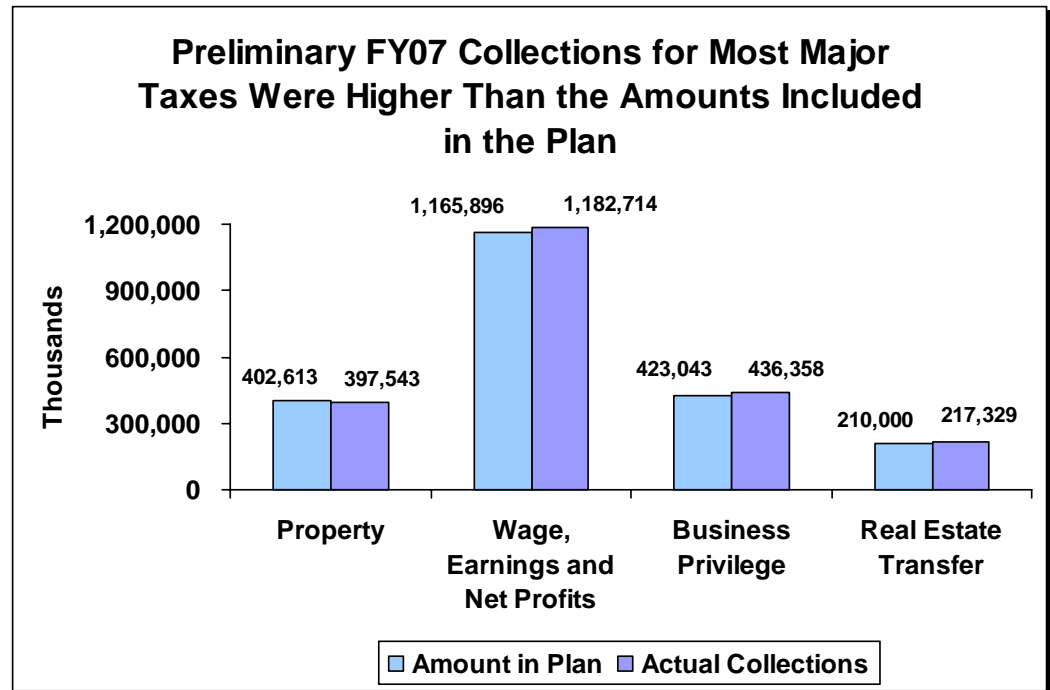
In Addition to the Possibility That Pay Raises Could Eliminate the City's Fund Balance, the Plan Includes A Number of Other Risks

- **The Plan assumes that the City will begin receiving casino revenues in FY09, but will not incur any costs associated with those casinos. In addition to facing a risk that the opening of the casinos may be delayed, the Plan faces the risk that, when they do open, the casinos will create costs for the City.**
- **The School District may have continuing financial issues and could seek additional funding from the City in the future. While the State, the City and the School District have taken steps to narrow the District's FY08 deficit, there is still an imbalance between the rate of growth in the District's expenditures and its revenues.**
- **The Plan assumes that the rate of growth in the prisons census and prisons costs will each slow down. If those rates do not slow, the City will incur additional costs.**

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The Plan's Tax Revenue Projections Are Appropriately Conservative

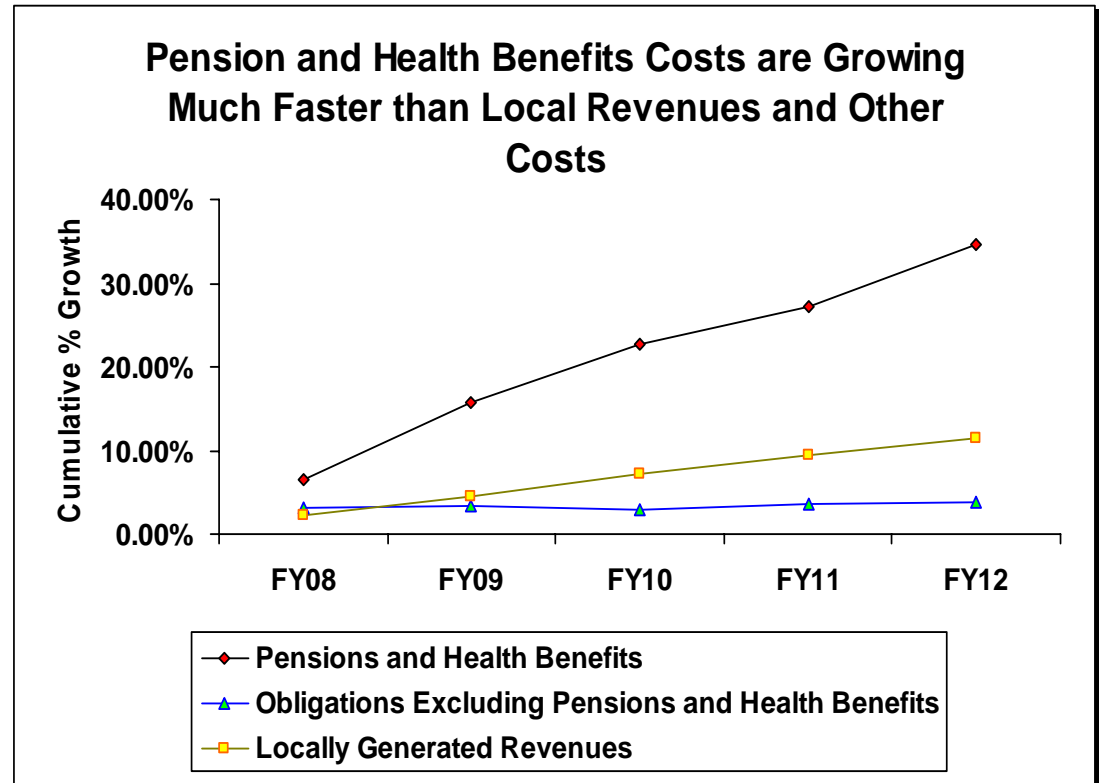
- The revised Plan uses the same growth rates for taxes as did the approved Plan, but has adjusted the FY07 base to reflect actual collections.
- With the exception of projected property tax collections, the City's tax projections appear to be appropriately conservative.



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Why Is It So Hard to Balance the Plan?

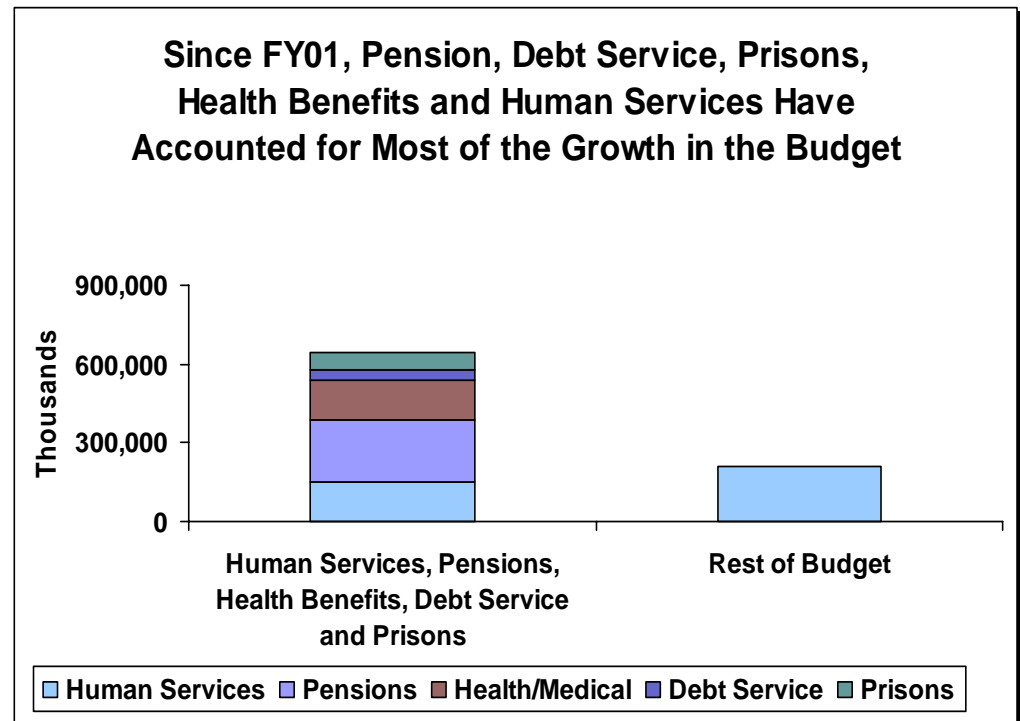
- Pensions and health benefits are projected to grow three times as fast as locally generated revenues and almost nine times faster than other obligations.
- Pensions and health benefits costs are projected to exceed \$1 billion in FY12.
- By the end of the Plan, pensions and health benefits will account for more than \$1 out of every \$4 the City spends up from \$1 out of every \$8 in FY01.



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What Do the Five Fastest Growing Areas of the Budget Mean for the Rest of the Budget?

- Since FY01, Pensions, health benefits, prisons and debt service have grown from under a quarter of the budget to almost a third of the budget.
- If the four areas were not consuming a larger percentage of the budget than they did in FY01, there would be an additional \$300 million to either spend on other areas of the budget like police or streets or to use for tax reduction.



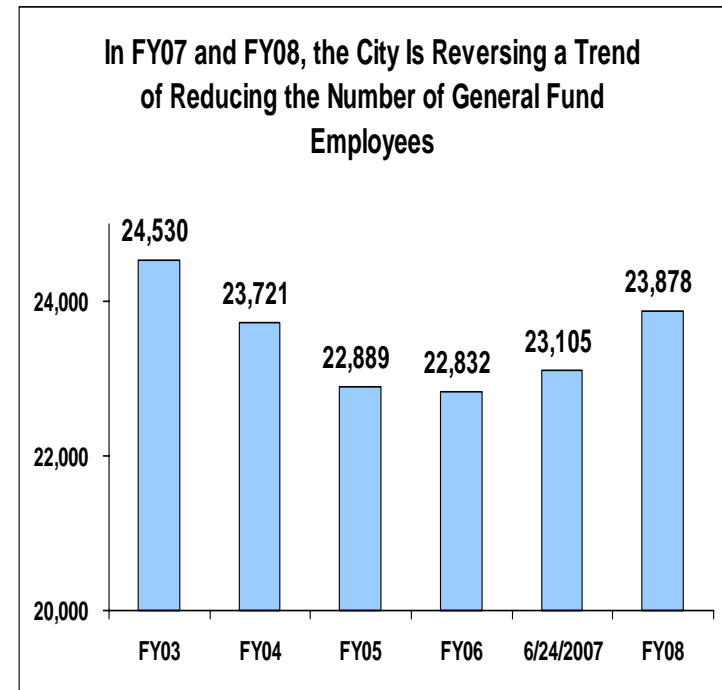
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What Changes in Staffing Does the Plan Propose?

The Administration has begun to reverse a recent trend of reducing staffing.

In total, the FY08 budget includes 773 positions more than were filled at the end of FY07. The largest components of that increase are:

- 224 in Prisons to handle a projected continued increase in the census;
- 88 in the Streets Department;
- 96 in the Department of Human Services;
- 84 in the Police Department;
- 57 in the Recreation Department ; and
- 41 in the Mayor's Office of Information Services to improve project management and to move 26 employees from Public Property's telecommunication division to MOIS as part of a shift of the function.

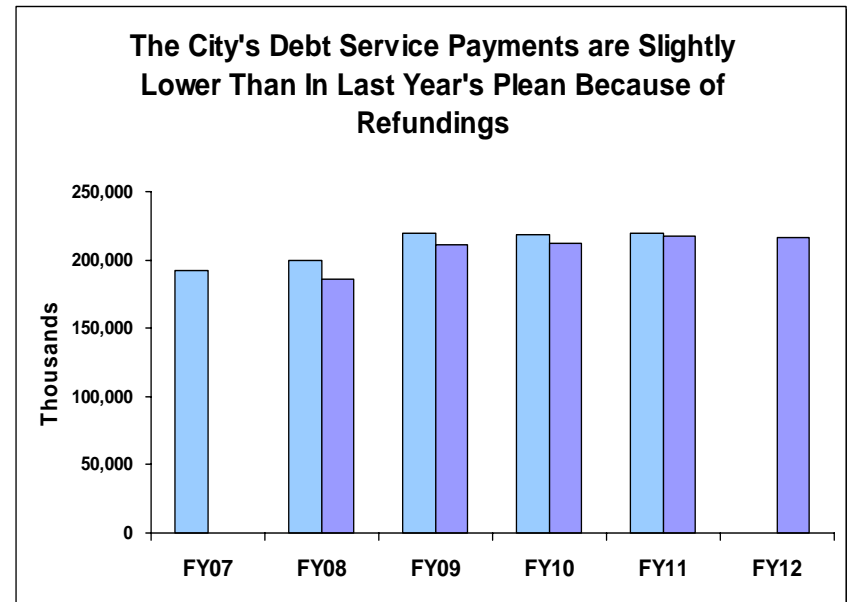


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How Does the Plan Deal With the Major Structural Issues Facing the City's Finances?

Rainy Day Fund: Potential progress. The Plan does not take any steps towards establishing a Rainy Day Fund, but Administration officials have been having productive discussions with Council representatives about establishing a fund.

Reducing the City's Debt Burden: Limited Progress. The Plan takes some step towards pay-as-you-go capital funding, which would help reduce the size of future borrowings. In FY08, the salaries of ten full-time and two temporary employees are shifted from the capital budget to the operating budget. In addition, refundings completed this year have helped reduce the City's debt service costs. The City did, however, miss an opportunity to increase its investment in its infrastructure without adding to its debt burden when it refused to spend money transferred by City Council from the operating budget to the capital budget to spend on Police, Fire and Recreation facilities.

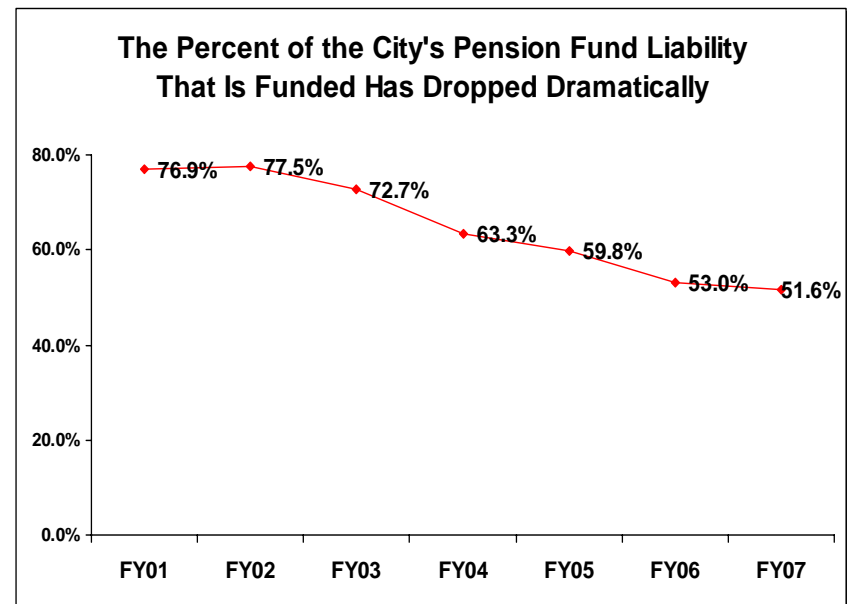


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Making the City's Tax Structure More Competitive: A Major Step Backwards. While the Plan maintains and extends by one year the wage tax reductions that were included in last year's plan, it proposes to end, after 14 years, the business privilege tax reduction program after FY09.

Reducing the City's Unfunded Pension Liability: No Progress. The Plan eliminates language included in the approved FY07-FY11 Plan that said the City would explore strategies to decrease pension obligations including increasing the minimum retirement age, decreasing the benefit multiplier, increasing the period to determine average final compensation, and increasing the employee contribution.



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Investing in Infrastructure: No Progress. The Plan includes lower levels of funding for City infrastructure spending than did last year's approved Plan. The funding levels included in the Plan are less than a third of the amount that the City Planning Commission says is necessary to keep City facilities in good condition.

