

PICA Staff Report
on the
City of Philadelphia's
***Quarterly City Managers Report
for the Third Quarter of FY2010***

Submitted to PICA on May 17, 2010

May 25, 2010

Changes from Five-Year Plan Projections and Previous Quarterly Report

- General Fund revenues are projected at a level \$14.4 million higher than the projection in the Five-Year Plan, and obligations are projected to be \$25.6 million higher than the Plan.
- The operating surplus for FY10 is projected at \$61.8 million, \$11.2 million below Plan. The actual prior year (FY09) fund balance was \$42.7 million below the Plan's estimate.¹
- The net impact of these changes is that the QCMR for the third quarter of FY10 projects a deficit of \$50.9 million in FY10, compared to the \$3.0 surplus projected in the Plan.
- The projected \$50.9 million deficit in FY10 is \$86.3 million below the actual deficit of \$137.2 million in FY09, a reflection of the operating surplus projected for FY10, and anticipated prior year accounting adjustments.

¹The actual FY09 deficit of \$137.2 million was due in part to the delay in receipt of \$55 million in State reimbursements as a result of delayed passage of the FY10 State budget. Excluding those funds, the FY09 deficit would have been \$82 million, or \$12 million better than the original Plan estimate.

Changes from Five-Year Plan Projections and Previous Quarterly Reports

FY10 General Fund Revenues, Obligations, and Fund Balance Projections (\$ in Millions)					
Category	Five-Year Financial Plan	QCMR (FY10 Q1)	QCMR (FY10 Q2)	QCMR (FY10 Q3)	Change from Plan to Q3 QCMR
Revenues	\$3,769.5	\$3,783.0	\$3,791.9	\$3,783.9	\$14.4
Obligations	3,696.5	3,701.1	3,727.8	3,722.1	25.6
Operating Surplus/(Deficit)	73.0	81.9	64.1	61.8	(11.2)
Prior Year Adjustments	24.5	24.5	24.5	24.5	0.0
Prior Year Fund Balance/(Deficit)	(94.5)	(137.2)	(137.2)	(137.2)	(42.7)
Year-End Fund Balance	3.0	(30.8)	(48.6)	(50.9)	(53.9)

Revenues: Taxes

- The QCMR for the third quarter projects FY10 General Fund tax revenue at \$2,334.6 million, a reduction of \$3.5 million compared to the QCMR for the second quarter. The reduction reflects a \$7.5 million reduction in projected Sales Tax revenue, which is partially offset by a \$4.0 million increase in projected Real Estate Transfer Tax revenue.
- The adjustments to the Sales and Real Estate Transfer tax projections reflect recent collections trends.

FY10 General Fund Tax Revenue Projections					
(\$ in Millions)					
Tax	Five-Year Financial Plan	QCMR (FY10 Q1)	QCMR (FY10 Q2)	QCMR (FY10 Q3)	Change from Q2 to Q3 QCMR
Wage, Earnings, and Net Profits	\$1,172.4	\$1,131.4	\$1,131.4	\$1,131.4	\$0.0
Real Estate	412.7	412.7	413.4	413.4	0.0
Business Privilege	356.7	376.7	376.7	376.6	(0.1)
Sales	215.3	215.3	207.3	199.8	(7.5)
Real Estate Transfer	94.7	114.7	114.7	118.7	4.0
Parking	70.7	70.7	70.7	70.7	0.0
Amusement	20.9	20.9	20.9	20.9	0.0
Other	3.0	3.0	3.0	3.1	0.1
Total	2,346.5	2,345.5	2,338.1	2,334.6	(3.5)

Revenues: Locally-Generated Non-Tax Revenue

- General Fund FY10 locally-generated non-tax revenue projections in the QCMR for the third quarter are down by \$4.6 million compared to the second quarter QCMR, due to a reduction in projected license and permit revenue received by the Department of Licenses and Inspections.

FY10 General Fund Locally-Generated Non-Tax Revenue Projections (\$ in Millions)					
<u>Departmental Source</u>	<u>Five-Year Financial Plan</u>	<u>QCMR (FY10 Q1)</u>	<u>QCMR (FY10 Q2)</u>	<u>QCMR (FY10 Q3)</u>	<u>Change from Q2 to Q3 QCMR</u>
Division of Technology	\$16.9	\$16.9	\$18.0	\$18.0	\$0.0
Streets	13.9	12.4	13.5	13.5	0.0
Fire	37.2	37.2	37.2	37.2	0.0
Public Health	12.6	12.1	12.1	12.1	0.0
Public Property	9.4	9.4	8.4	8.4	0.0
Licenses and Inspections	45.4	45.4	45.4	40.8	(4.6)
Records	18.0	18.0	16.6	16.6	0.0
City Treasurer	11.8	11.8	9.8	9.8	0.0
Clerk of Quarter Sessions	8.0	8.0	7.0	7.0	0.0
Sheriff	10.6	10.6	9.6	9.6	0.0
First Judicial District	35.1	35.1	35.1	35.1	0.0
All Other	39.9	39.9	39.4	39.4	0.0
Total	258.7	256.7	251.9	247.3	(4.6)

Revenues: Revenue from Other Governments

- Projected General Fund FY10 revenue from other governments in the QCMR for the third quarter are unchanged from the previous quarter.
- Revenues from other governments are projected at \$1,168.9 million, \$32.8 million higher than the original Five-Year Plan estimate. The deviation from the Plan represents higher than expected revenues for the Department of Human Services (\$31.5 million) and the PICA City Account (\$15.9 million), offset by lower than projected revenues for Police (\$9.6 million), Finance (\$1.3 million), Commerce (\$1.9 million), and the First Judicial District (\$1.2 million).

Revenues: Revenue from Other Governments

FY10 General Fund Revenue from Other Governments Projections (\$ in Millions)					
<u>Departmental Source</u>	<u>Five-Year Financial Plan</u>	<u>QCMR (FY10 Q1)</u>	<u>QCMR (FY10 Q2)</u>	<u>QCMR (FY10 Q3)</u>	<u>Change from Q2 to Q3 QCMR</u>
PICA City Account	297.2	285.7	313.2	313.2	\$0.0
Police	17.3	7.3	7.7	7.7	0.0
Public Health	58.9	58.9	58.8	58.8	0.0
Public Property	18.0	18.0	18.0	18.0	0.0
Human Services	531.8	569.8	563.3	563.3	0.0
Finance	148.8	148.8	147.5	147.5	0.0
Revenue	30.0	30.0	30.0	30.0	0.0
Commerce – Convention Center	3.2	3.2	1.3	1.3	0.0
First Judicial District	16.6	16.6	15.4	15.4	0.0
All Other	14.4	14.4	13.8	13.8	0.0
Total	1,136.1	1,152.6	1,168.9	1,168.9	0.0

Obligations

- The QCMR for the third quarter projects FY10 General Fund obligations at \$3,722.1 million, a decline of \$5.8 million from the projection in the previous quarterly report. This reflects primarily a decline in projected obligations for the Department of Human Services, offset by a projected increase in obligations for employee benefits and the Streets Department.

FY10 General Fund Obligations Projections (\$ in Millions)					
<u>Agency or Cost Center</u>	<u>Five-Year Financial Plan</u>	<u>QCMR (FY10 Q1)</u>	<u>QCMR (FY10 Q2)</u>	<u>QCMR (FY10 Q3)</u>	<u>Change from Q2 to Q3 QCMR</u>
Employee Benefits	\$830.7	\$830.7	\$835.2	\$848.2	\$13.0
Human Services	590.9	590.9	590.9	563.5	(27.4)
Streets	114.1	114.1	125.6	134.1	8.5
All Other	2,160.8	2,165.4	2,176.2	2,176.3	0.1
Total	3,696.5	3,701.1	3,727.8	3,722.1	(5.8)

Major Changes in Obligations Projections

- The largest projected increases in obligations in the third quarter QCMR, compared to the second quarter QCMR, are as follows:
 - Employee Benefits (\$13.0 million): The City had initially projected to receive \$25 million in annual savings in employee benefits cost due to new labor contracts. The actual savings from new contracts has been below this projection due to the delay in settlement of contracts for firefighters and non-uniformed employee unions. While the City expects to see savings as a result of the movement of the police health plan and City-administered health plan to a self-insured model, these savings will not be realized until FY11, and the City needs to provide initial funds to cover costs as the system comes on line. Benefits have also been impacted by a projected \$4.5 million increase in the cost of unemployment benefits for City workers who have been involuntarily separated from the workforce. Overall, employee benefits costs are projected to exceed the initial Five-Year Plan projection by \$17.5 million.
 - Streets Department (\$8.5 million): The increase in projected costs reflects unanticipated costs associated with snow removal. Primarily due to the cost of snow removal for this year's extraordinary level of snowfall, projected Streets Department obligations exceed the initial Plan projection by \$20.0 million.
- The largest projected decreases in obligations in the third quarter QCMR, compared to the second quarter QCMR, are as follows:
 - Department of Human Services (\$27.4 million): The City is projecting lower costs due to fewer placements in the DHS system. These reductions have a small impact on the fund balance, as the majority of these costs are reimbursed by the State.

Key Financial Issues

- ▶ Negative Fund Balance
- ▶ Tax Collections
- ▶ Labor Contracts

Key Financial Issues: Negative Fund Balance

- The QCMR for the third quarter projects a General Fund deficit of \$50.9 million in FY10, \$2.4 million worse than the previous QCMR projection. The Five-Year Plan (Plan) as initially proposed by the Mayor on March 4 projected an FY10 deficit of \$37.9 million.
- This marks the second consecutive year that the City has projected a current-year negative fund balance in the 2nd and 3rd quarter QCMR.
- The City identified a projected FY10 deficit of \$48.6 million in February (with the release of the second quarter QCMR), and was able to decrease its net projected obligation level by an additional \$5 million between the second and third quarter QCMR, while absorbing \$21 million in unexpected new obligations related to employee benefits and snow removal.
- The Plan as proposed on March 4 included fund balances ranging from \$64.6 million in FY11 to a high of \$206.7 million in FY12.
- The proposed Plan's projected fund balances in FY13-FY15 were close to 5 percent of projected FY15 revenues (\$204.9 million), the standard recommended by the Government Finance Officers Association as minimum level of reserves necessary to allow for a response to unanticipated events.

Key Financial Issues: Tax Collections

- Tax collections through April show signs of recovery, but the City’s ability to meet its overall projections for FY10 revenues is still unclear. The Wage Tax and Real Estate Transfer Tax bases have shown gradual recovery through the third quarter of FY10, while the Sales Tax base continued to decline. The impact of the City’s tax amnesty program on delinquent Real Estate and Business Privilege Taxes collections through June will be an important issue for the City’s ability to meet its FY10 tax revenue projections.
- The pace of recovery for the City’s major tax bases – earnings, real estate transactions, and retail sales – and the success of reforming the real estate assessment process will be important factors influencing tax revenues over the next five years.

**Tax Bases of Primary General Fund Taxes:
Year-over-Year Percentage Growth by Quarter¹**

Tax	FY09				FY10		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Wage, Earnings, and Net Profits ²	5.5	2.5	(0.8)	(2.2)	(4.6)	(1.1)	2.0
Real Estate Transfer	(24.0)	(43.1)	(41.2)	(47.2)	(31.0)	19.2	7.1
Sales ²	2.1	(5.8)	(5.3)	(7.1)	(8.5)	(8.6)	(13.9)
Parking ²	(5.4)	(4.3)	5.4	(23.5)	9.4	6.6	(6.3)
Amusement	(3.7)	54.6	20.4	17.5	6.6	(14.5)	(0.9)

¹ Negative amounts are shown in parentheses. Business Privilege Tax and Real Estate Tax trends are not shown since these taxes are collected primarily in the spring, and quarterly patterns are less meaningful.

² Growth rates adjusted for tax rate changes.

Key Financial Issues: Labor Contracts

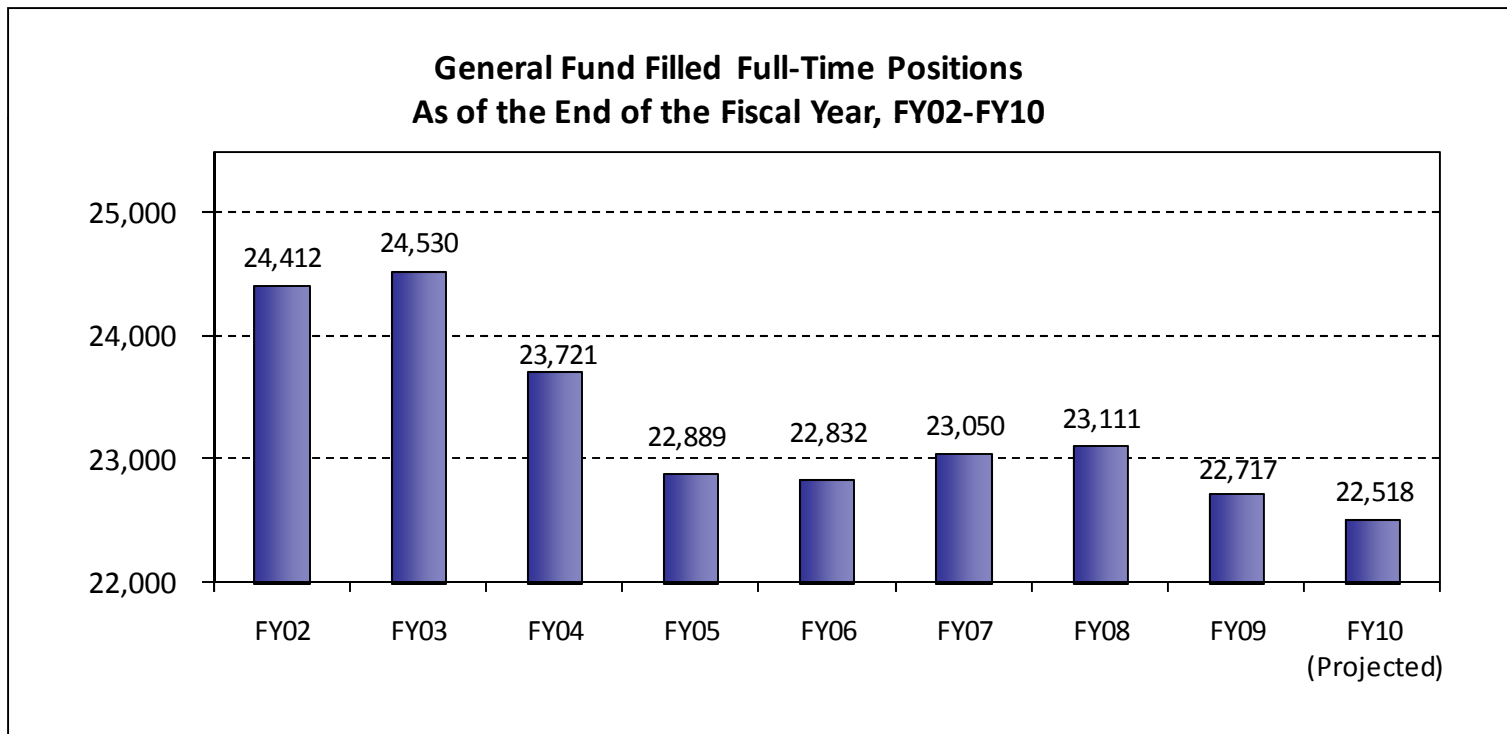
- The third quarter QCMR, as well as the City's proposed FY11-FY15 Five Year Plan, did incorporate the financial impact of the arbitration award for the City's police officers. This award resulted in an estimated \$80 million in additional costs over the FY10-FY14 period, while also resulting in long-run savings as a result of restructuring pensions and health care administration.
- Contracts with the remaining three major municipal unions – the International Association of Firefighters, and District Councils 33 and 47 of AFSCME – remain unresolved. The impact of these awards represents a major uncertainty for the City's fiscal stability.
- If these contracts follow the pattern of the police contract, the City would likely realize long-term cost savings from the restructuring of employee benefits, but would also be faced with significant short-term costs.

Key Management Issues

- ▶ Staffing Levels
- ▶ Overtime
- ▶ Prison Population

Key Management Issues: Staffing Levels

- The City reduced the number of filled General Fund positions by 1,813 or 7.4 percent from the end of FY03 to the end of FY09. As of March 31, 2010, the General Fund workforce had reached a low of 22,424.
- The proposed Five-Year Plan projects a continued workforce decline, with a year-over-year seasonally comparable reduction of 199 filled positions by the end of FY10.



Key Management Issues: Overtime

- Despite the reduction in filled General Fund positions from FY08 through FY10, the City has reduced overtime costs over this period.¹ In FY08, total General Fund overtime costs were \$167.2 million. Overtime costs dropped to \$147.4 million in FY09. The QCMR for the third quarter of FY10 projects total overtime costs of \$137.5 million in FY10. This represents a reduction of 17.8 percent since FY08.
- Over the FY08-FY10 period, the largest overtime cost reductions are projected to occur in Police (\$12.4 million or 17.6 percent), Prisons (\$7.9 million or 24.7 percent), Human Services (\$4.4 million or 38.6 percent), and Fire (\$3.3 million or 14.0 percent). Thirteen other agencies are projecting overtime reductions of more than \$100,000 over the period.
- Only five agencies are projecting overtime increases of more than \$100,000: the Sanitation Division of the Streets Department (\$2.4 million or 38.1 percent), other divisions in the Streets Department (\$589,000 or 22.8 percent), the Managing Director's Office (\$523,000 or 571.2 percent), Sheriff's Office (\$230,000 or 7.2 percent), and the Division of Technology (\$156,000 or 58.1 percent).
- The reduction in overtime costs that has occurred since FY08 – a period when personnel levels have declined substantially – indicates that the City has been successful in reducing unnecessary overtime expenses. For instance, the Police Department has worked with the First Judicial District to reduce court-related Police overtime through efficiencies in scheduling court appearances of police officers. Police court-related overtime is projected to be down by \$5 million in FY10 compared to FY08.

¹Prior to FY09, the City included within reported overtime expenditures certain disability payments to Police and Fire uniformed employees under the Heart and Lung Act. The exact amount of these payments is not currently available. Accordingly, to allow an accurate comparison of overtime cost over the FY08-FY10 period, all figures reported here as "overtime" costs include Heart and Lung Act disability payments as well as overtime. FY10 overtime cost excluding disability payments is projected at \$119.2 million in the quarterly report.

Key Management Issues: Prison Population

- Criminal justice system reforms taking place within the Philadelphia prisons system, the First Judicial District, and other criminal justice agencies have resulted in significant reductions in the prison population, with associated financial benefits for the City.
- Reversing a trend of increasing prison population over the past decade, the monthly average prisons census peaked at 9,787 in January 2009, and has generally declined since then. The monthly average census declined to 8,464 in March 2010, a decline of 1,323, or 13.5 percent, from the January 2009 peak.
- The declines have resulted from a variety of initiatives, including: 2008 State legislation that resulted in transferring inmates with sentences of 2 years or more to state correctional facilities; reduced arrests and admissions to prison; and court process reforms that have led to reductions in the number of prisoners held for violations of probation and parole.
- Compared to the FY10 Plan estimate, the City is currently projecting savings of \$9.0 million in Prisons System obligations. If the trend of declining Prisons System population continues, additional savings are possible.

Key City Budget Characteristics

Expenditure Categories Projected to Exceed \$100 Million in FY10 (\$ in Millions)				
<u>Category</u>	<u>Five-Year Financial Plan Projection</u>	<u>Percent of Total General Fund</u>	<u>QCMR Projection (FY10 Q3)</u>	<u>Percent of Total General Fund</u>
Employee Benefits ¹	\$830.7	22.5%	\$848.2	22.8%
Human Services	590.9	16.0%	563.5	15.1%
Police	524.3	14.2%	527.5	14.2%
Prisons	248.8	6.7%	239.8	6.4%
Debt Service	215.5	5.8%	201.6	5.4%
Fire	188.7	5.1%	190.5	5.1%
Public Health	116.9	3.2%	116.9	3.1%
Streets	114.1	3.1%	134.1	3.6%
Public Property ²	111.0	3.0%	99.5	2.7%
First Judicial District	99.1	2.7%	106.7	2.9%

¹Includes debt service on Pension Obligation Bonds.

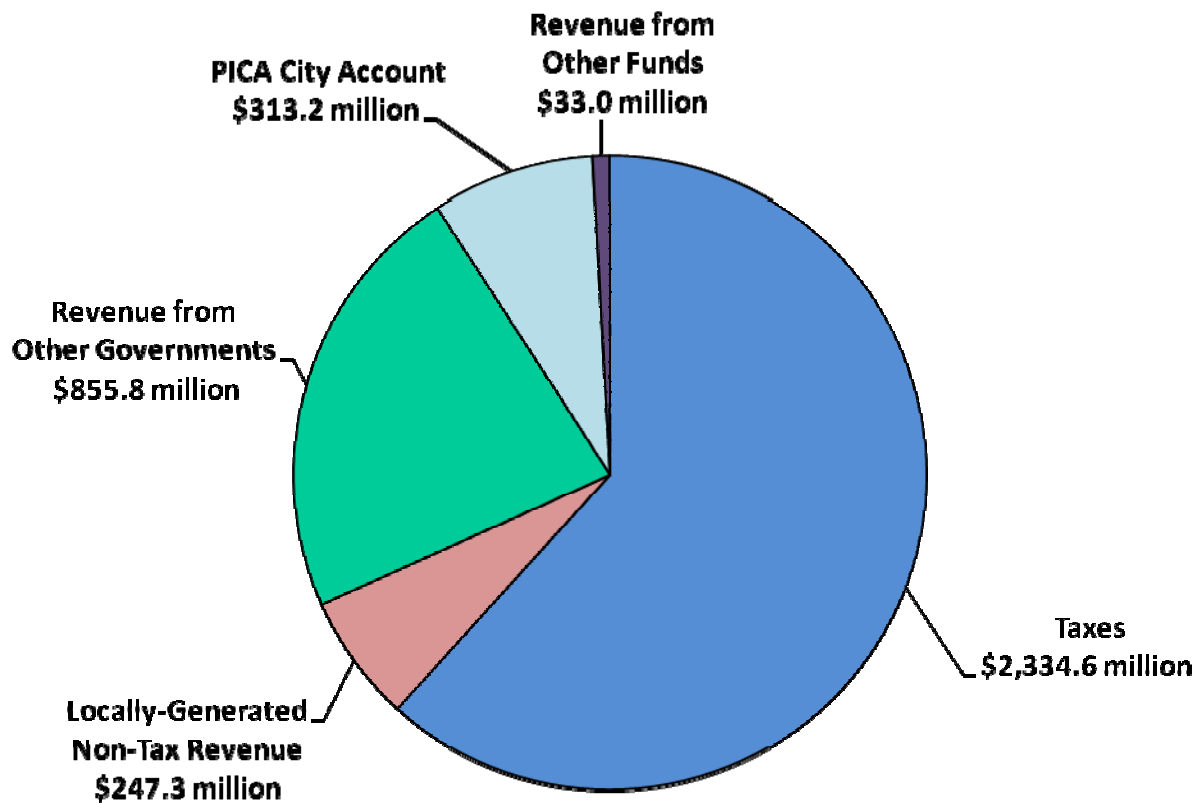
²Excludes SEPTA subsidy. The reduction from the Plan to the QCMR is due in part to the transfer of telecommunications costs to the Division of Technology.

Key City Budget Characteristics

Revenue Categories Projected to Exceed \$100 Million in FY10 (\$ in Millions)				
<u>Category</u>	<u>Five-Year Financial Plan Projection</u>	<u>Percent of Total General Fund</u>	<u>QCMR Projection (FY10 Q3)</u>	<u>Percent of Total General Fund</u>
Wage, Earnings, and Net Profits Tax	\$1,172.4	31.1%	\$1,131.4	29.9%
Human Services Reimbursement	536.3	14.2%	568.3	15.0%
Real Estate Tax	412.7	10.9%	413.4	10.9%
Business Privilege Tax	356.7	9.5%	376.6	10.0%
PICA City Account	297.2	7.9%	313.2	8.3%
Sales Tax	215.3	5.7%	199.8	5.3%
Real Estate Transfer Tax	94.7	2.5%	118.7	3.1%

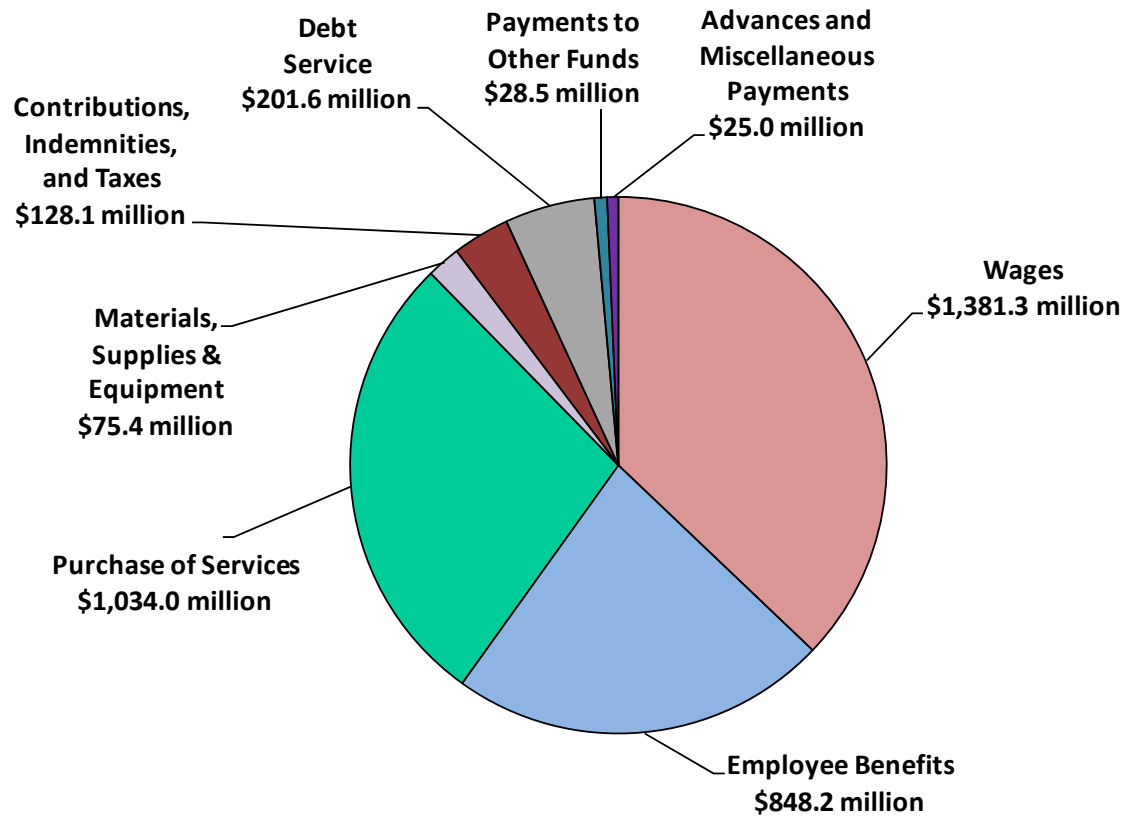
Key City Budget Characteristics

FY10 Sources of General Fund Revenues
Total Revenues: \$3.784 Billion



Key City Budget Characteristics

Distribution of FY10 General Fund Obligations
Total FY10 Obligations: \$3.722 Billion



Note: Debt Service includes \$93.7 million in debt service for lease-supported debt. This spending is classified in the Quarterly Report as purchase of services.