PICA Staff Report

on the

City of Philadelphia's

Quarterly City Managers Report

for the Fourth Quarter of FY2010

Submitted to PICA on August 16, 2010

August 24, 2010

Introduction: PICA Staff Report on the City of Philadelphia's Quarterly City Managers Report for the Fourth Quarter of FY10

- The Pennsylvania Intergovernmental Cooperation Authority (PICA) Act (Act of June 5, 1991, P. L. 9, No. 6), Section 209(i), requires the City to submit to PICA within 45 days following the end of each fiscal quarter a report describing actual or estimated revenues and expenditures in relation to the budgeted level for the most recent quarter.
- Accordingly, the City submits a Quarterly City Managers Report (QCMR) to PICA 45 days after the end of each fiscal quarter. The QCMR contains extensive detail on actual and estimated General Fund revenues and expenditures for the current fiscal year, as well as information on personnel, performance, cash flow, and quarterly financial results for the Water Fund and Aviation Fund.
- This report is PICA staff's analysis of the most recent QCMR submitted by the City, covering the period ending June 30, 2010, the fourth quarter of FY10.
- Since the projections in the annual PICA-approved Five-Year Financial Plan establish the original budgetary baseline for each fiscal year, the analysis in this report compares projections in the fourth quarter QCMR to FY10 projections in the FY10-FY14 Five-Year Financial Plan approved by PICA in September 2009. The fourth quarter QCMR projections are also compared to projections in previously-issued QCMRs for FY10.
- The City's projections of FY10 revenue and obligations in the fourth quarter QCMR are the same as those in the FY11-FY15 Five-Year Financial Plan approved by PICA on August 10, 2010.

FY10 Projections in the Fourth Quarter QCMR: Changes from FY10-FY14 Five-Year Plan and Previous QCMR

- The FY10 revenue projections in the fourth quarter QCMR increased $4.7 million from the third quarter QCMR, while obligations increased $5.5 million. The FY10 operating surplus and projected year end fund balance declined by $800,000.
- Compared to the FY10 projections in the FY10-FY14 Five-Year Plan, the changes in the fourth quarter QCMR are more substantial. Revenues increased $19.2 million, while obligations increased $31.1 million. The FY10 operating surplus declined $11.9 million, and the projected end-of-year FY10 fund balance declined $54.6 million. The FY10-FY14 Plan projected a FY10 surplus of $3.0 million, while the fourth quarter QCMR projects a deficit of $51.7 million.
- The decline in projected FY10 fund balance between the FY10-FY14 Plan and the fourth quarter QCMR is the result of two factors: an $11.9 million decline in the FY10 operating surplus and an actual FY09 year-end fund balance $42.7 million below the FY10-FY14 Plan estimate.[1]

[1] The 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. If those funds had been received on time, the actual FY09 deficit would have been $82 million, $12 million better than the Plan estimate.

FY10 Revenues and Expenditures: Projections in the FY10-FY14 Five-Year Plan and FY10 QCMRs

FY10 General Fund Revenues, Obligations, and Fund Balance Projections ($ in Millions)							
Category	FY10-14 Five-Year Financial Plan	Q1 QCMR	Q2 QCMR	Q3 QCMR	Q4 QCMR	Change From Q3 to Q4 QCMR	Change From Plan to Q4 QCMR
Revenues	$3,769.5	$3,783.0	$3,791.9	$3,783.9	$3,788.6	$4.7	$19.2
Obligations	3,696.5	3,701.1	3,727.8	3,722.1	3,727.6	5.5	31.1
Operating Surplus/(Deficit)	73.0	81.9	64.1	61.8	61.0	(0.8)	(11.9)
Prior Year Adjustments	24.5	24.5	24.5	24.5	24.5	--	--
Prior Year Fund Balance/(Deficit)	(94.5)	(137.2)	(137.2)	(137.2)	(137.2)	--	(42.7)
Year-End Fund Balance	3.0	(30.8)	(48.6)	(50.9)	(51.7)	(0.8)	(54.6)

Revenues: Taxes

- FY10 tax revenue is projected at $2,335.1 million, an increase of $400,000 compared to the third quarter QCMR, and a reduction of $11.4 million from the FY10-14 Five-Year Plan.
- The $400,000 increase between the third and fourth quarter QCMR reflects reductions in real estate, real estate transfer, and business privilege tax collections, offset by increases in wage and sales tax revenues, and $27.0 million in collections from the tax amnesty program.
- The tax amnesty program collections played an important role in allowing the City to come close to meeting its Five-Year Plan tax revenue projections for FY10. Currently projected FY10 tax revenues are 0.5 percent below the FY10-14 Plan estimate made in September 2009.

FY10 General Fund Tax Revenue Projections ($ in Millions)

Tax	FY10-14 Five-Year Plan	Q1 QCMR	Q2 QCMR	Q3 QCMR	Q4 QCMR	Change from Q3 to Q4 QCMR	Change from Plan to Q4 QCMR
Wage, Earnings, and Net Profits	$1,172.4	$1,131.4	$1,131.4	$1,131.4	$1,136.2	$4.8	($36.2)
Real Estate	412.7	412.7	413.4	413.4	398.9	(14.5)	(13.8)
Business Privilege	356.7	376.7	376.7	376.6	358.2	(18.4)	1.5
Sales	215.3	215.3	207.3	199.8	205.3	5.5	(10.0)
Real Estate Transfer	94.7	114.7	114.7	118.7	114.7	(4.0)	20.0
Parking	70.7	70.7	70.7	70.7	70.7	0.0	0.0
Amusement	20.9	20.9	20.9	20.9	20.9	0.0	0.0
Other	3.0	3.0	3.0	3.1	30.1	27.0	27.1
Total	2,346.5	2,345.5	2,338.1	2,334.6	2,335.1	0.4	(11.4)

Revenues: Locally-Generated Non-Tax Revenue

Locally-generated non-tax revenue is projected at $247.3 million, unchanged from the third quarter QCMR and $11.4 million below the projection in the FY10-FY14 Five-Year Plan. The $11.4 reduction from the Plan projection reflects slight reductions in various departments, with the largest reduction in the Department of Licenses and Inspections ($4.6 million).

FY10 General Fund Locally-Generated Non-Tax Revenue Projections ($ in Millions)							
Departmental Source	FY10-14 Five-Year Plan	Q1 QCMR	Q2 QCMR	Q3 QCMR	Q4 QCMR	Change from Q3 to Q4 QCMR	Change from Plan to Q4 QCMR
Division of Technology	$16.9	$16.9	$18.0	$18.0	$18.0	$0.0	$1.1
Streets	13.9	12.4	13.5	13.5	13.5	0.0	(0.4)
Fire	37.2	37.2	37.2	37.2	37.2	0.0	0.0
Public Health	12.6	12.1	12.1	12.1	12.1	0.0	(0.5)
Public Property	9.4	9.4	8.4	8.4	8.4	0.0	(1.0)
Licenses and Inspections	45.4	45.4	45.4	40.8	40.8	0.0	(4.6)
Records	18.0	18.0	16.6	16.6	16.6	0.0	(1.4)
City Treasurer	11.8	11.8	9.8	9.8	9.8	0.0	(2.0)
Clerk of Quarter Sessions	8.0	8.0	7.0	7.0	7.0	0.0	(1.0)
Sheriff	10.6	10.6	9.6	9.6	9.6	0.0	(1.0)
First Judicial District	35.1	35.1	35.1	35.1	35.1	0.0	0.0
All Other	39.9	39.9	39.4	39.4	39.4	0.0	(0.5)
Total	258.7	256.7	251.9	247.3	247.3	0.0	(11.4)

Revenues: Revenue from Other Governments

Revenues from other governments are projected at $1,169.7 million, an increase of $800,000 from the third quarter QCMR and $33.6 million over the Plan estimate. The $800,000 increase from the previous QCMR reflects higher PICA City Account revenue due to reduced PICA debt service. The increase over Plan estimate primarily reflects higher State reimbursements for Department of Human Services (DHS) costs and PICA City Account revenues, offset by a reduction in Police Department revenues. The higher DHS reimbursements are in part the result of a delay in receiving State payments due to the delay in passage of the FY10 State budget.

FY10 General Fund Revenue from Other Governments Projections ($ in Millions)							
Departmental Source	FY10-14 Five-Year Plan	Q1 QCMR	Q2 QCMR	Q3 QCMR	Q4 QCMR	Change from Q3 to Q4 QCMR	Change from Plan to Q4 QCMR
PICA City Account[1]	297.2	285.7	313.2	313.2	314.0	0.8	$16.7
Police	17.3	7.3	7.7	7.7	7.7	0.0	(9.6)
Public Health	58.9	58.9	58.8	58.8	58.8	0.0	(0.1)
Public Property	18.0	18.0	18.0	18.0	18.0	0.0	0.0
Human Services	531.8	569.8	563.3	563.3	563.3	0.0	31.5
Finance	148.8	148.8	147.5	147.5	147.5	0.0	(1.3)
Revenue	30.0	30.0	30.0	30.0	30.0	0.0	0.0
First Judicial District	16.6	16.6	15.4	15.4	15.4	0.0	(1.2)
All Other	17.6	17.6	15.1	15.1	15.1	0.0	(2.5)
Total	1,136.1	1,152.6	1,168.9	1,168.9	1,169.7	0.8	33.6

[1] Includes $25.0 million in PICA funds granted to the City for non-recurring public safety costs, a one-time payment not assumed in the FY10-14 Plan estimate. The fourth quarter QCMR projection is $16.7 million higher than the Plan estimate because the one-time $25 million payment offset projected recurring tax revenue that is $8.3 million below the Plan estimate.

Obligations

FY10 obligations are projected at $3,727.6 million, an increase of $5.5 million from the third quarter QCMR and an increase of $31.1 million from the FY10-14 Plan.

FY10 General Fund Obligations Projections ($ in Millions)							
Agency or Cost Center	FY10-14 Five-Year Plan	Q1 QCMR	Q2 QCMR	Q3 QCMR	Q4 QCMR	Change from Q3 to Q4 QCMR	Change from Plan to Q4 QCMR
Debt Service	$215.5	$210.8	$201.6	$201.6	$201.6	$0.0	($14.0)
Division of Technology[1]	31.3	36.3	41.6	41.6	41.6	0.0	10.3
Employee Benefits	830.7	830.7	835.2	848.2	848.2	0.0	17.5
Fire	188.7	188.7	190.5	190.5	190.5	0.0	1.9
First Judicial District	99.1	99.1	106.7	106.7	106.7	0.0	7.6
Human Services	590.9	590.9	590.9	563.5	563.5	0.0	(27.4)
Indemnities	24.5	24.5	34.5	34.5	34.5	0.0	10.0
Police	524.3	528.3	527.4	527.5	527.5	0.0	3.2
Prisons	248.8	248.8	239.8	239.8	239.8	0.0	(9.0)
Streets	114.1	114.1	125.6	134.1	137.1	3.0	23.0
All Other	838.2	838.4	834.0	834.0	836.5	2.5	(1.6)
Total	3,696.5	3,701.1	3,727.8	3,722.1	3,727.6	5.5	31.1

[1] Includes telecommunications costs originally budgeted under the Department of Public Property.

Changes in Obligations Projections

- The largest changes in obligations between the third and fourth quarter QCMR are as follows:
  - **Streets Department** ($3.0 million increase): The City was not able to achieve the projected level of savings in tipping fees.
  - **Department of Public Property** ($2.5 million increase): The City was not able to realize the projected level of savings through Department cost reduction initiatives.

- The largest changes in obligations between the FY10-14 Plan and the fourth quarter QCMR are as follows:
  - **Debt Service** ($14.0 million reduction): Savings were achieved through restructuring of variable rate debt.
  - **Division of Technology** ($10.3 million increase): Unanticipated costs associated with centralizing information technology functions within the agency and remediating City-wide IT infrastructure.
  - **Employee Benefits** ($17.5 million increase): Reflects a $4.5 million increase in unemployment compensation, due to costs associated with layoffs. Further, savings from restructuring health benefit programs were below the Plan estimate by $13 million. However, additional health benefits savings are expected in FY11 as the police and City-administered health plans are converted to a self-insured model, and as contracts with other unions are completed.
  - **Department of Human Services** ($27.4 million reduction): Savings resulted from fewer out-of-home placements and reductions in the average length of placement.
  - **Indemnities** ($10.0 million increase): Costs increased due to extraordinary settlements.
  - **Prisons** ($9.0 million reduction): A declining prison population resulted in savings for food and medical care.
  - **Streets Department** ($23.0 million increase): Unanticipated costs for snow removal.

Key Financial Issues

- Fund Balance
- Tax Collections
- Labor Contracts

Key Financial Issues: Fund Balance

- The projected FY10 fund balance declined with each successive QCMR for FY10. The FY10-14 Plan projected a surplus of $3.0 million. The QCMR for the fourth quarter projects a deficit of $51.7 million, $800,000 worse than the previous QCMR projection.

- FY10 marks the second consecutive fiscal year that the City has projected a current-year negative fund balance in the QCMR for the second, third, and fourth quarters of the fiscal year.

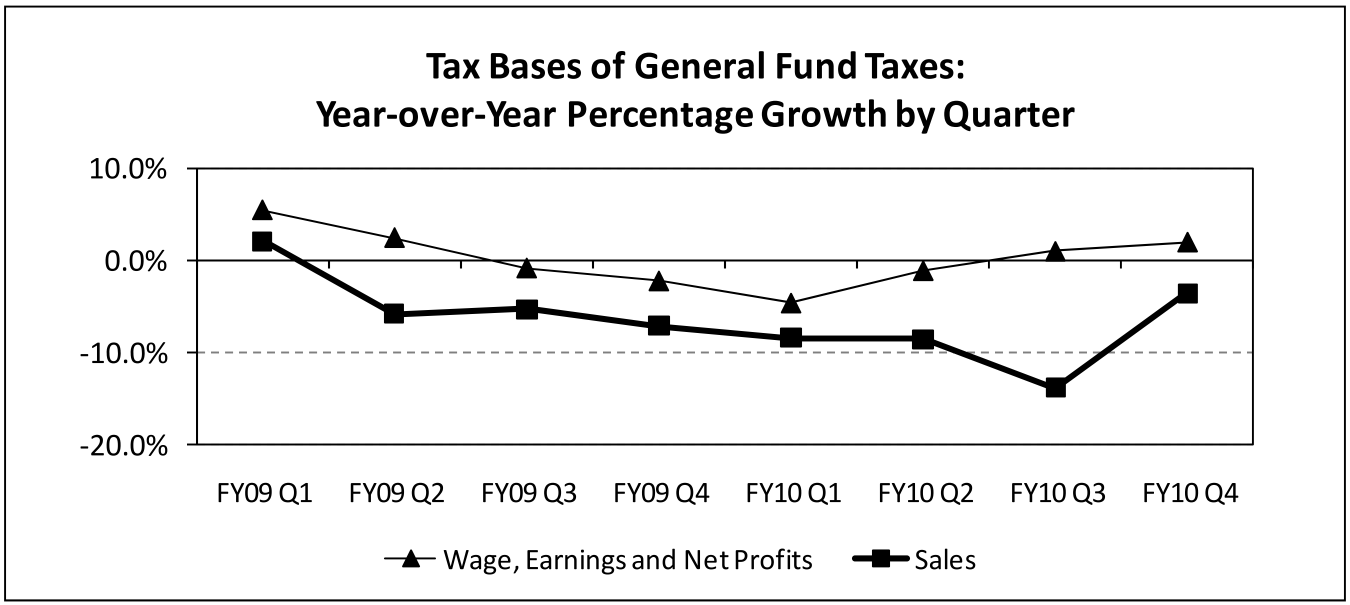
- The projected FY10 deficit reflects weakness in tax and locally-generated non-tax revenues ($22.8 million below the FY10-14 Plan estimate) and higher than anticipated obligations, including higher costs for the Division of Technology, employee benefits, indemnities, and the Streets Department. These changes generally reflected factors outside the City's control. The City was able to offset these changes through initiatives begun during FY10, but the impact of these initiatives was not sufficient to prevent the fund balance projection from deteriorating as the fiscal year progressed.

- A key challenge was the modest $3.0 million surplus projected in the FY10-14 Plan, which allowed little cushion for unexpected contingencies.

- The City continues to enjoy little margin for contingencies going forward, with a projected fund balance of $34.0 million in FY11 in the FY11-15 Five-Year Plan. Adverse events such as a downturn in tax collections, reduction in State or federal aid, or increased labor costs could result in future deficits.

Key Financial Issues: Tax Collections

- Estimated growth in the tax base through June suggests a generally improving trend for the wage, sales, and real estate transfer tax bases. In the fourth quarter of FY10, the tax base for the wage tax grew an estimated 2.0 percent, and the base of the real estate transfer tax grew 40.0 percent, a substantial improvement from prior quarters. The base of the sales tax declined 3.6 percent, but this was also an improvement from prior quarters.
- The FY11-15 Five-Year Plan assumes that the trend toward stability in tax bases will continue. In FY11, the wage tax base is estimated to grow 1.9 percent, and the sales tax base to grow 2.0 percent. The business privilege tax base is projected to increase 0.15 percent, and real estate tax assessments are projected to remain constant in 2011. Continuing the recent trend toward stabilization and growth in the city's major economic indicators is essential to meeting the new Plan's revenue projections in FY11 and later years.



Key Financial Issues: Labor Contracts

- A major outstanding issue for the City is the unresolved labor contracts with three of the four major municipal unions – the International Association of Firefighters (IAFF) and District Councils 33 and 47 of AFSCME.

- The FY10-14 Plan assumed $25 million in workforce savings in FY10 and later years that were anticipated to result from the new labor contracts. The City did achieve $18 million of this projected savings in FY10, through changes in the City-administered and Fraternal Order of Police health plans.

- Because of the delay in resolving the contracts for the IAFF and non-uniformed unions, and because of one-time start up costs associated with the shift to self-insured health plans, the City was not able to achieve all of its initially projected savings in FY10.

- Addressing health care and pensions costs through the remaining labor contracts is critical for the City's future fiscal stability. The FY11-15 Plan continues to project $25 million in annual savings from employee benefits. Reforms to the administration of health care benefits will be important to achieving this goal despite health care cost inflation. Restructuring of employee pensions will not likely result in dramatic short-term savings, but does have the potential for significant long-term savings.

[1] The Quarterly Report has a projected health benefit cost figure of 356.8 million which would equate to a savings of $12.2 million, however, as discussed in the FY11-15 Staff Report (http://www.picapa.org/Docs/FY11-FY15_5Yr_Plan_Report.pdf) , the actual figure is likely to be $351 million, equating to the savings of $18 million cited here.

Key Management Issues

- Agency Performance
- Staffing Levels
- Overtime
- Leave Usage

Key Management Issues: Agency Performance

The QCMR presents performance measures for major City agencies. Some key measures include:

- **Police Department**: The estimated number of homicides declined 2.2 percent from FY09 to FY10, while estimated Part 1 violent crime declined 8.7 percent. The homicide clearance rate declined from 80.0 percent in FY09 to 71.8 percent in FY10. The Department is generally continuing to make progress toward its goals, although actual crime figures are not yet available for all months of FY10.

- **Fire Department**: Fire response times increased from an average of 4:33 in FY09 to 4:56 in FY10, in part due to severe snow storms. Through April 16th, 2010, the number of FY10 structural fires was 1,091, a 19.4 percent decline from the same period in FY09. This continues the long-term trend toward fewer structural fires in the city. The Department has generally been able to maintain fire response times despite a 6.3 percent decline in uniformed personnel since the end of FY08, in part because the number of structural fires has declined.

- **Streets Department**: The recycling rate increased from 12 percent in FY09 to 16 percent in FY10. The on-time collection rate for recycling decreased from 97 percent in FY09 to 94 percent in FY10, and the on-time collection rate for trash decreased from 97 percent to 90 percent over the same period, in part due to severe snow storms in FY10. The increase in the recycling rate is a positive trend, and should result in long-term cost reductions if maintained.

Key Management Issues: Agency Performance

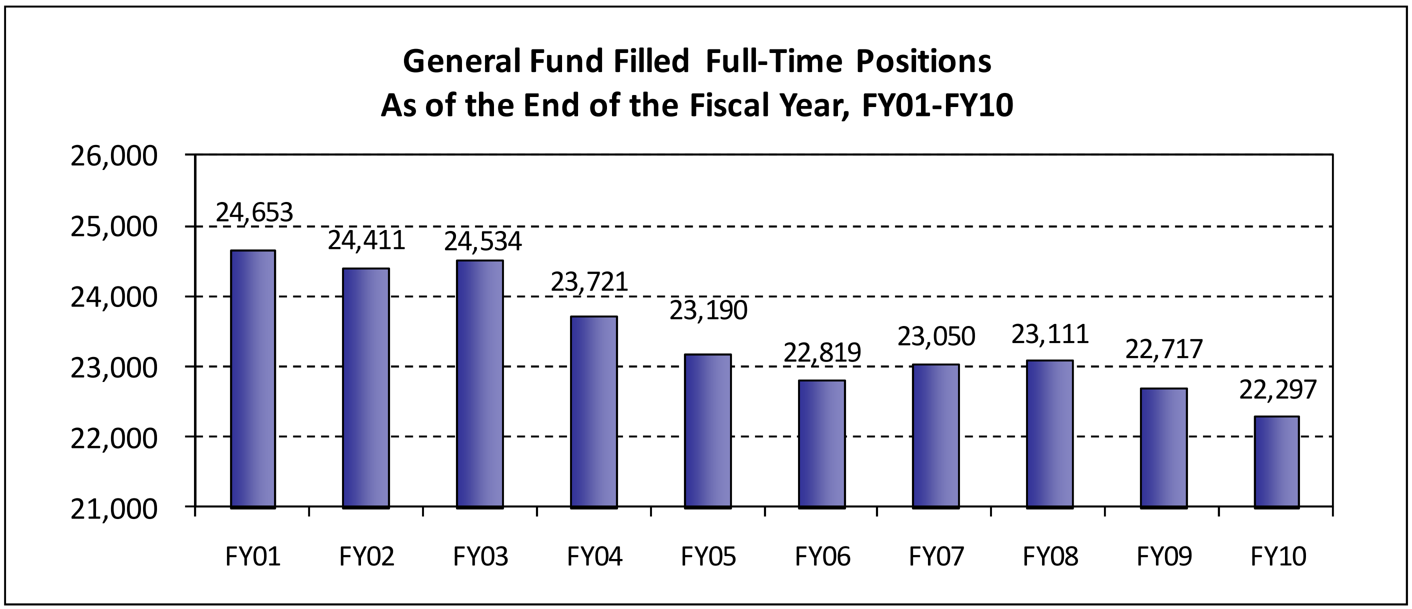
- **Prison System**: The proportion of sentenced inmates given the opportunity to participate in an education, training or treatment program increased from 65 percent in FY09 to 75 percent in FY10. This indicates progress toward increasing the ability of inmates to successfully transition to employment after release.

- **Department of Human Services (DHS)**: The number of dependent children in placement at the end of FY10 declined 13.8 percent from FY09, while the number of delinquent children in placement declined 13.1 percent over the same period. The number of adoptions finalized in FY10 increased 29.9 percent over FY09, and the number of permanent legal custodianships finalized increased 18.4 percent. These results suggest that DHS is making progress toward reducing out-of-home placements and expediting permanent caretaking.

- **Department of Licenses and Inspections**: The department's nine reported performance measures track the timeliness of serving walk-in customers and completing plan reviews and inspections. From FY09 to FY10, performance improved for five, and was constant for two, of the nine measures. The Department met its customer service standard for each measure over 90 percent of the time. This result indicates improving customer service.

Key Management Issues: Staffing Levels

- In FY10, City staffing continued the downward trend that has occurred generally over the past decade. The number of filled, full-time General Fund positions declined by 2,356 (9.6 percent) from the end of FY01 through the end of FY10. Between the end of FY08 and FY10, the number of positions declined 814 (3.5 percent).
- Employee wage and benefit costs make up nearly 60 percent of General Fund expenditures. Initiatives to increase productivity and adopt more efficient processes, such as information technology investments and better coordination among City agencies, could ultimately result in further staffing reductions, and free up resources for key economic and financial priorities such as establishing a rainy day fund, addressing the large pension liability, tax reduction, and investment in capital infrastructure.
- These types of initiatives are essential to the long-term fiscal health of the city, even though it would likely take time to realize savings.



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 fourth quarter QCMR projects total overtime costs of $140.2 million in FY10. This represents a reduction of 16.1 percent since FY08.

- Over the FY08-FY10 period, the largest overtime cost reductions are projected to occur in Police ($8.9 million or 12.6 percent), Prisons ($8.3 million or 26.0 percent), Human Services ($4.4 million or 38.4 percent), and Fire ($3.5 million or 14.7 percent). Fourteen other agencies are projecting overtime reductions of more than $100,000 over the period.

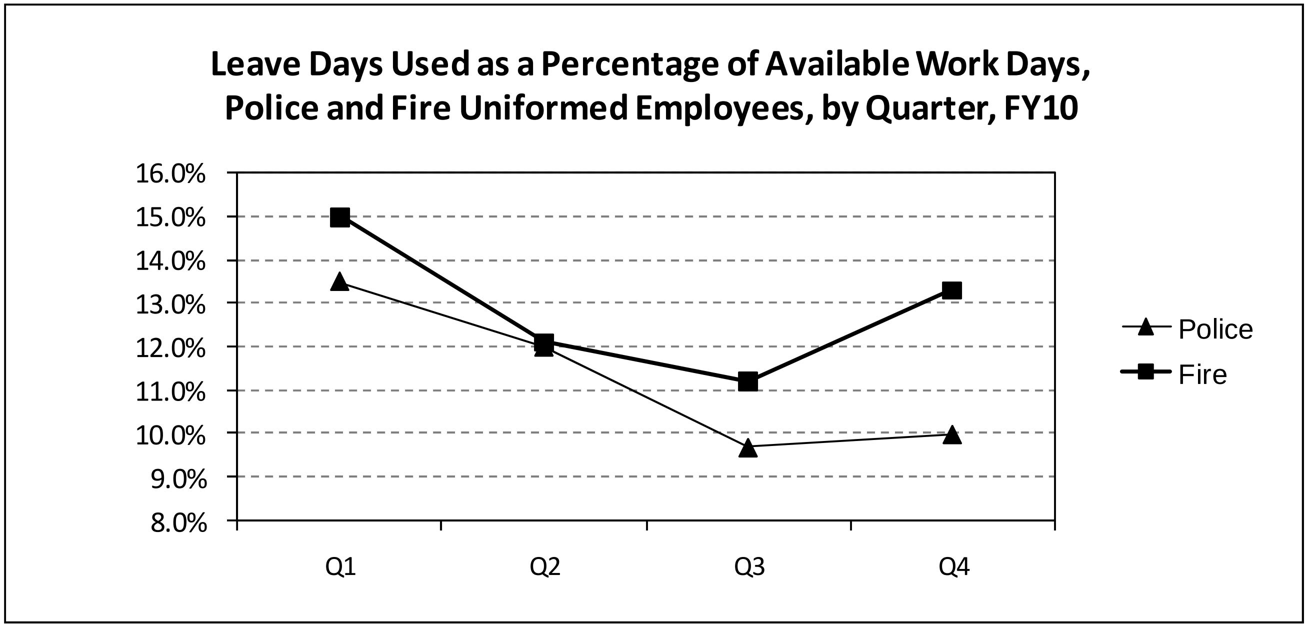
- Only four agencies are projecting overtime increases: Streets ($3.2 million or 36.5 percent), Managing Director's Office ($705,000 or 769.0 percent) , Division of Technology ($292,000 or 108.6 percent) , and Sheriff's Office ($217,000 or 6.8 percent).

- 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.

[1] Prior 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 $122.2 million in the quarterly report.

Key Management Issues: Leave Usage

- For the median City agency, employees were absent from work on 14.4 percent of available work days in FY10, due to sick, vacation, annual, funeral, or unpaid leave.
- Leave usage shows seasonal variation. For agencies that require consistent personnel availability over the year, variability in leave use has major cost implications. These departments incur overtime costs to assure consistent staffing during periods of high leave usage, often in the summer.
- Contractual restrictions on the City's ability to manage leave usage by its employees are therefore costly. Among uniformed Philadelphia Police Department (PPD) employees, for instance, leave use varied considerably over the year during FY10. While the 2009 Fraternal Order of Police arbitration award allows PPD to limit new hires to one week of vacation during the summer for the first five years of employment, PPD management cannot impose these limits for the majority of its current workforce.



Key City Budget Characteristics

Expenditure Categories Projected to Exceed $100 Million in FY10 ($ in Millions)				
Category	FY10-14 Five-Year Plan Projection	Percent of Total General Fund	Q4 QCMR Projection	Percent of Total General Fund
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%	137.1	3.7%
Public Property[2]	101.5	2.7%	102.0	2.7%
First Judicial District	99.1	2.7%	106.7	2.9%

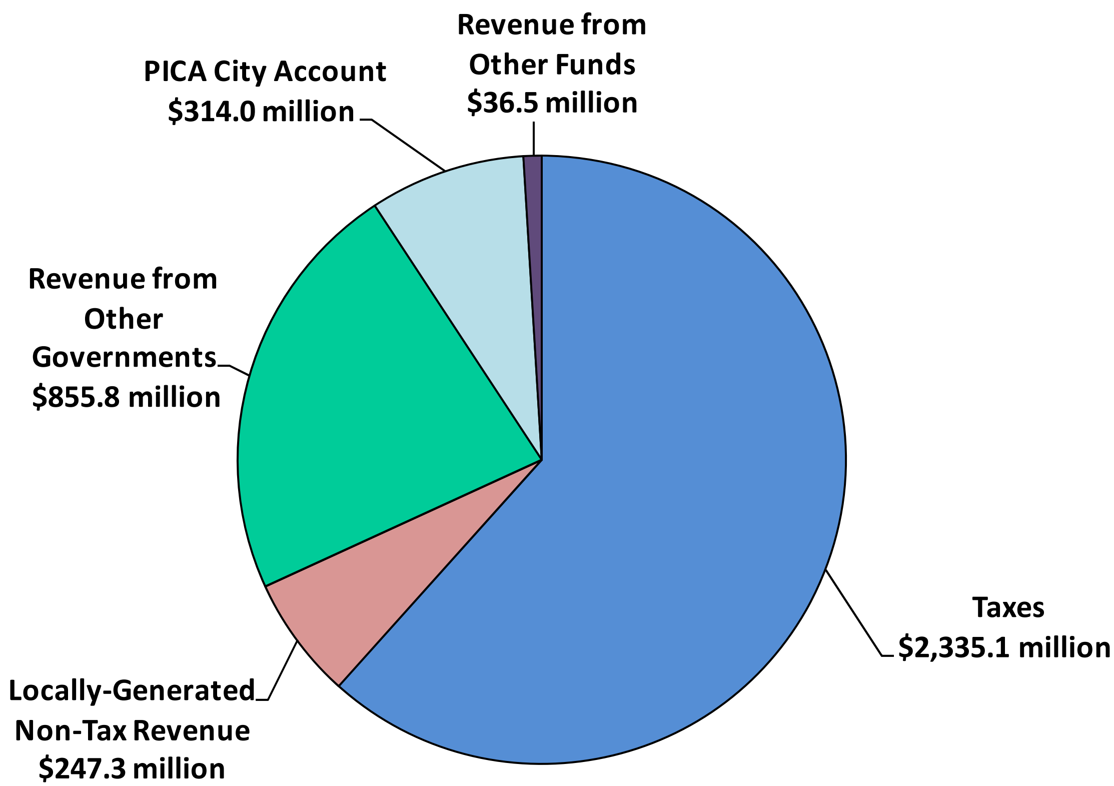
[1]Includes debt service on Pension Obligation Bonds.
[2]Excludes SEPTA subsidy and telecommunications.

Key City Budget Characteristics

Revenue Categories Projected to Exceed $100 Million in FY10 ($ in Millions)				
Category	FY10-14 Five-Year Plan Projection	Percent of Total General Fund	Q4 QCMR Projection	Percent of Total General Fund
Wage, Earnings, and Net Profits Tax	$1,172.4	31.1%	$1.136.2	30.0%
Human Services Reimbursement	536.3	14.2%	568.3	15.0%
Real Estate Tax	412.7	10.9%	398.9	10.5%
Business Privilege Tax	356.7	9.5%	358.2	9.5%
PICA City Account	297.2	7.9%	314.0	8.3%
Sales Tax	215.3	5.7%	205.3	5.4%
Real Estate Transfer Tax	94.7	2.5%	114.7	3.0%

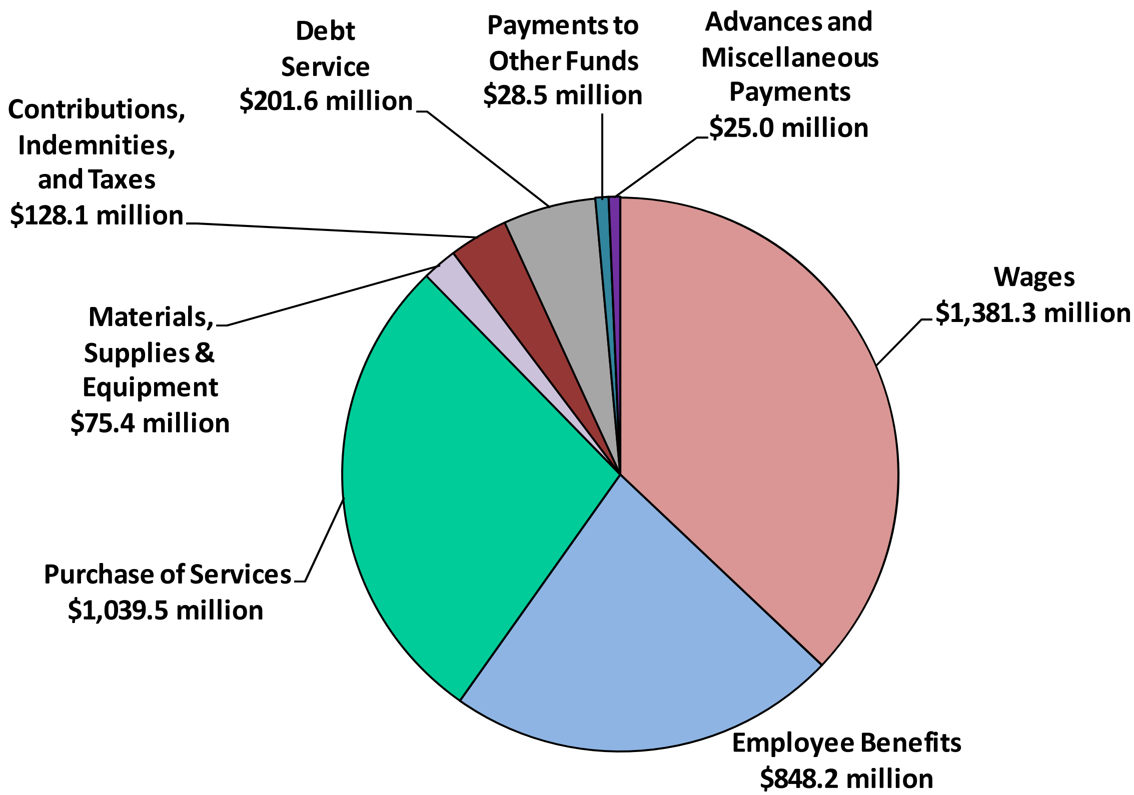
Key City Budget Characteristics

FY10 Sources of General Fund Revenues
Total Revenues: $3.789 Billion



Key City Budget Characteristics

Distribution of FY10 General Fund Obligations
Total FY10 Obligations: $3.728 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.