

# **Pennsylvania Intergovernmental Cooperation Authority**



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

---

**July 7, 2004**

**PENNSYLVANIA INTERGOVERNMENTAL  
COOPERATION AUTHORITY**

1429 Walnut Street, 14<sup>th</sup> floor, Philadelphia, PA 19102  
Telephone: (215) 561-9160 – Fax: (215) 563-2570  
Email: [pica@picapa.org](mailto:pica@picapa.org)

**Board of Directors**

Chairperson

Lauri A. Kavulich, Esquire

Vice Chairperson

William J. Leonard, Esquire

Secretary/Treasurer

Gregg R. Melinson, Esquire

Member

Kenneth I. Trujillo, Esquire

Member

Michael A. Karp

Ex-Officio Members

Representative of the  
Commonwealth of Pennsylvania  
Michael Masch  
Secretary of the Budget

Representative of the  
City of Philadelphia  
Janice D. Davis  
Director of Finance

**Staff**

Joseph C. Vignola ..... Executive Director  
Uri Z. Monson..... Deputy Executive Director  
John J. Daly..... Director of Capital Analysis  
Lisa W. Gallagher ..... Executive Assistant  
Deidre A. Morgenstern ..... Special Assistant  
Kim Richardson ..... Secretary/Receptionist

**Professional Advisors**

Authority Counsel  
Reed Smith LLP

Independent Auditors  
Deloitte & Touche LLP

# TABLE OF CONTENTS

## PAGE

### **Section I: Introduction**

- A. Introduction ..... 1
- B. Executive Summary and Staff Recommendation..... 3

### **Section II: Significant Risks and Concerns**

- A. Labor Contracts, Pension Fund Liabilities, and the Municipal Work Force ..... 9  
*No contracts as FY2005 begins, ongoing concerns with the Pension Fund and the DROP*
- B. Philadelphia Gas Works..... 13  
*Renewed fiscal difficulties reduce City revenues and threaten City's fiscal health*
- C. Removing Flexibility in Tax Cut Programs..... 17  
*Long-term fixed tax rate reductions remove necessary flexibility in future years*
- D. The Crime of Inefficiency: The Cost of Policing Philadelphia ..... 19  
*The Philadelphia Police Department suffers from poor management and unproductive work rules*

### **Section III: Appendix**

- A. Appendix A..... 27  
*Statutory Background, Plan Review Methodology and Summary of Events*

**This page intentionally left blank**

**Pennsylvania Intergovernmental  
Cooperation Authority**

**STAFF REPORT  
ON  
FY2005-FY2009  
FIVE-YEAR FINANCIAL PLAN**

---

**SECTION I:**

**INTRODUCTION  
AND  
EXECUTIVE SUMMARY**

---

**This page intentionally left blank**

## INTRODUCTION

The debate over the City of Philadelphia's Fiscal Year 2005 budget and FY2005-FY2009 Five Year Plan was a debate that should inspire envy in other jurisdictions. The consideration of \$50 to \$370 million in tax cuts represented tax reductions *beyond* the approximately \$350 million initially proposed by Mayor Street in his preliminary Five-Year Financial Plan. While other State and local governments are calculating how to "enhance" their revenues through new taxes and tax increases, Philadelphia is focused on the degree of tax reform which will best assure fiscal stability in the short-term, and a long-term environment for growth.

Philadelphia's long-term environment for growth continues to hinge on becoming a competitive city which balances a fair system of taxation, a sensible regulatory system, and a high quality of life for citizens all while maintaining fiscal responsibility. The issues raised by the Tax Reform Commission should continue to be debated within that framework.

Unfortunately, interested parties blurred legitimate attempts by the City to address the changing needs of its populace, a blurring which demonstrated a key role of Pennsylvania Intergovernmental Cooperation Authority (PICA). PICA will continue to comment on opportunities to maximize taxpayer value through efficiencies and organizational changes as it did in its White Paper No. 10 "The Crime of Inefficiency: The Cost of Policing Philadelphia." Similar analyses and recommendations regarding issues such as Fire Department staffing, facility optimization, and inefficient spending, will continue to be a central role for PICA to play in its efforts to help the City maintain long-term fiscal stability while striving for a competitive economy.

As in every year since PICA's inception, there are numerous risks and concerns highlighted within this Staff Report which will continue to test the City's fiscal health. Though these problems, and other unforeseen challenges, are sure to raise concerns, the mechanism to handle these crises and inform the discussions over the City's fiscal health is in place. While no multi-year planning tool can anticipate every eventuality, and no oversight authority can one hundred percent accurately project the future economy, the fundamental tool of PICA, the Five-Year Plan, continues to demonstrate the advantage the City of Philadelphia has when facing fiscal challenges.

**This page intentionally left blank**

## **EXECUTIVE SUMMARY AND STAFF RECOMMENDATION**

The City of Philadelphia (City) submitted its *Five-Year Financial Plan, Fiscal Year 2005-Fiscal Year 2009* (the Plan) to the Pennsylvania Intergovernmental Cooperation Authority (PICA) on July 1, 2004. This marked the latest submission since PICA's inception, a result of the protracted dispute over balancing the City budget and Tax reform. As a result of PICA's desire to maintain the fiscal integrity of the City of Philadelphia, PICA Staff has expedited its review of the proposed Plan. Consequently although this Staff Report maintains PICA Staff's history of a rigorous review of the budget, it will not deal extensively with lesser risks or more general issues impacting the City's fiscal health.

Expenditures and revenues are projected utilizing realistic assumptions except where noted in this Staff Report. The Plan presents a reasonable prospect for balanced budgets over the life of the Plan, although the first year of the Plan is most tenuous with a projected surplus of just over \$100 thousand. The Plan anticipates ending FY2009 with a surplus of just over \$120 million.

As in the past, there are a number of risks which threaten the fiscal health of the City over the life of the Plan. Many of these risks are ongoing issues previously documented by PICA Staff. While the Plan often acknowledges these risks, few precautionary strategies are offered.

The Plan confronts four significant risks, including:

- No funding in the Plan for any costs associated with new labor contracts for employees beginning in FY2005.
- Uncertain Pension Plan liabilities.
- Fiscal uncertainty at the Philadelphia Gas Works (PGW).
- Enacted tax cuts with high revenue shortfalls beyond the Plan years, and reduced flexibility for adjusting rates as needed.

### ***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. A copy of White Paper No. 10 "The Crime of Inefficiency: The Cost of Policing Philadelphia" is contained in this report. PICA Staff continues to track departmental progress in numerous areas and will report on those areas as significant issues arise, as well as continuing to produce White Papers to provoke discussion on areas of concern to the fiscal health of the City.

## **City's Revenue Assumptions**

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

In its March 30, 2004 letter to the Mayor and City Council, PICA Staff raised 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.

The increase in fees for gun permits and for Police Accident and Incident reports would require State enabling legislation. No such bills were passed by the General Assembly. These new fees are counted on to provide over \$1.3 million in FY2005, and over \$7 million over the life of the Plan. Additionally, there have been no indications that the State will reimburse the City for the patrol of state highways. That proposal is expected to generate \$5.6 million for the City in FY2005 and \$28 million over the life of the Plan. The City has indicated that there may be other revenue sources to cover such a shortfall and will provide periodic reports on those revenues.

In its March 30, 2004 letter to the Mayor and City Council, PICA Staff raised concerns about the projected revenues from the Real Estate Transfer Tax. During the last quarter of FY2004, tax receipts maintained their strong pace diminishing PICA Staff concerns. In light of changing interest rates and other market conditions, PICA Staff will closely monitor these tax receipts in FY2005.

To the positive side, PICA Staff met with representatives from the Revenue and Law Departments and was encouraged by their renewed focus on increasing collection rates. While improved collection rates will obviously benefit the City's Fund Balance (as anticipated in the Plan), they will also result in a more equitable tax base. PICA Staff looks forward to periodic updates on both current collection rates and delinquent collections including property taxes and the approximately \$8 million in revenues from luxury box rentals at Veterans Stadium, which is due from the Philadelphia Eagles.

In addition to the PICA Staff review, PICA Staff convened a group of regional economists to comment on the revenue assumptions. The group's consensus was that the estimates used in the Plan were reasonable in light of the current economic outlook.

## **Significant Risks**

As mentioned earlier, the Plan confronts four significant risks to its successful implementation as well as a dependence on unspecified future reductions.

- As of the beginning of FY2005, the first year of this Plan, three of the four municipal collective bargaining agreements between the City and its unionized workers expired. As of this writing, negotiations continue though no agreement has been reached. The Plan contains no funding for any salary increases or benefit increases, other than an 8.5 percent increase in health care benefits. With a projected \$100 thousand surplus at the end of FY2005, there are simply no funds for increases in salary or benefits in the current year, and limited resources for increases in FY2006 and beyond. **Any contracts which increase General Fund costs will require a revision to the Plan. This revision must demonstrate that there are sufficient monies to cover these costs.**
- While improving investment returns should lessen the level of required Pension Fund payments, the amount of those payments is not yet known. The recent significant increases in the City's projected payments into the Pension Fund highlight the ongoing threat posed to the General Fund. While the City has reduced its annual contribution to the Minimum Municipal Obligation (MMO) required by law in order to meet short-term budgetary needs, the long-term Pension Fund liability continues to escalate. Despite an adverse material impact resulting from the Deferred Retirement Option Program (DROP), the Pension Board, over the objections of the Administration, chose to maintain the program with no changes. The potential costs of the ongoing DROP exacerbate the long-term Pension Fund liability.
- The Philadelphia Gas Works (PGW) continues to present a perplexing problem for the City. Just one year after appearing to make significant strides in improving its overall fiscal health, PGW was, for the first time, unable to make its \$18 million payment to the City. The long-term fiscal projection is clouded, and the factors for recovery being touted by PGW management are unlikely. While many management improvements have been made over the past few years, the inability to deal with strategic concerns in a timely fashion continues to plague PGW.
- One of the odd proposals to emerge from the debate over tax reform in Philadelphia was the insistence on fixing tax rate reduction programs in law for periods of ten years or more. Despite almost never fixing tax reductions into ordinance beyond one year, the tax reduction program had always met or exceeded the proposed cuts. In a year when tax changes by the Commonwealth threatened to fix tax rates currently enacted, this proposal threatened the City's ability to deal with unexpected fiscal changes. Additionally, over the Mayor's veto, City Council enacted a Wage Tax Reduction Bill for impoverished Philadelphians. While this tax cut does not begin until after the end of the Plan under review, it has expensive ramifications beginning in FY2010

### **Additional Concerns**

During the process of balancing the budget with proposed tax cuts, a number of cuts were passed which concern PICA Staff. First is a reduction of \$5 million over the life of the Plan in overtime at the Prisons. Given the history of high levels of overtime at the

prisons and the opening of a new correctional facility this summer, PICA Staff believes the Prisons Department will be hard pressed to achieve this goal. The City has phased in the reductions beginning in FY2006, which alleviates some concern, but PICA Staff will be looking for evidence of overtime reductions during FY2005.

The other cut of concern is the elimination of the repayment of nearly \$5 million in Productivity Bank loans by the Police Department and the Records Department. The Productivity Bank is one of the most successful government innovations in Philadelphia and has become a national model, most recently adopted in San Diego, CA. It has generated savings many times its original investment. The Productivity Bank is predicated on funding worthy innovations whose cost savings allow for repayment of the loans. Without the good faith promise of repayment, the Productivity Bank is essentially worthless. PICA Staff strongly recommends that the Administration review and reconsider this budget action.

The decision to cut \$4 million from the Police Department was welcomed by PICA Staff. PICA White Paper No. 10 "The Crime of Inefficiency: The Cost of Policing Philadelphia," (a copy of which is found in the Staff Report) highlighted that the Philadelphia Police Department suffers from poor management, an organizational structure with too little oversight, and unproductive work rules. The result is a bloated Police force with higher expenditures than other peer cities, but no correlating increase in crime prevention.

Since the release of the PICA White Paper, the Police Department has been implementing reforms to reduce the command structure, improve the percentage of officers on the street, and better manage overtime usage. Additionally, some of the recommended work rule changes have been discussed during arbitration hearings with the Police. These initiatives follow directly from recommendations contained in the PICA White Paper. There is little doubt that the primary function of any government is to provide for the security of its citizens. However, that security should not be attained in such an inefficient manner as to place an undue fiscal burden on those same citizens. PICA Staff hopes that the other recommendations contained in the White Paper will be considered as well.

The Plan anticipates a cumulative total of \$60 million in unspecified expenditure reductions over its final four years resulting from future government efficiencies. In light of the over \$100 million in cuts already included in the final Plan as a result of the tax reform program, and other cost-cutting measures already included in the Plan, these unspecified reductions will be difficult to achieve. This risk is offset by the opportunity for the Administration and City Council to rescind the previously agreed upon tax cuts should these savings not be realized, under the new guidelines established by the Commonwealth of Pennsylvania.

***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 FY2005-FY2009 Five-Year Plan. The City Controller was unable to render a formal audit opinion prior to completion of the PICA Staff review. The City Controller will provide an opinion at a later date, in order to further inform PICA Staff's ongoing monitoring of the City's fiscal stability.

### ***Staff Recommendation***

The identified potential risks to the General Fund in the FY2005-FY2009 Plan constitute a real threat to the fiscal health of the City. However, the Plan is also predicated on a continuation of steady cuts to the Wage and Business Privilege taxes. Should the risks outlined in this Report be realized, rescinding the tax cuts would provide sufficient revenues to prevent a fiscal crisis. PICA Staff will work with City Officials to determine how the new Commonwealth gaming/tax legislation, Senate Bill 100, allows for such changes to be implemented.

PICA Staff will continue to closely monitor the City's fiscal situation throughout the coming year, paying particular attention to labor negotiations and the performance of the Pension Fund. **Any contracts which increase General Fund costs will require a revision to the Plan which demonstrates sufficient revenues to cover the increased costs.** With these caveats in mind, the 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 Plan as submitted to the Authority on July 1, 2004.

**This page intentionally left blank**

**Pennsylvania Intergovernmental  
Cooperation Authority**

**STAFF REPORT  
ON  
FY2005-FY2009  
FIVE-YEAR FINANCIAL PLAN**

---

**SECTION II:**

**SIGNIFICANT RISKS  
AND CONCERNS**

---

**This page intentionally left blank**

## **LABOR CONTRACTS, PENSION FUND LIABILITIES AND THE MUNICIPAL WORK FORCE**

As of the beginning of FY2005, the first year of the Plan, three of the four municipal collective bargaining agreements between the City and its unionized workers expired. As of this writing, negotiations continue though no agreement has been reached. The Plan contains no funding for any salary increases or benefit increases, other than an 8.5 percent increase in health care benefits. With a projected \$100 thousand surplus at the end of FY2005, there are simply no funds for increases in salary or benefits in the current year, and limited resources for increases in FY2006 and beyond. **Any contracts which increase General Fund costs will require a revision to the Plan which demonstrates sufficient revenues to cover the increased costs.** While it is impossible to assess the effect of any future wage and benefit related cost increases over the life of the Plan, recent arbitration awards and new legislation paint a dire picture for the City's budget over the next five years.

While improving investment returns should lessen the level of required Pension Fund payments, the amount of those payments is not yet known. The recent significant increases in the City's projected payments into the Pension Fund highlight the ongoing threat posed to the General Fund. While the City has reduced its annual contribution to the Minimum Municipal Obligation (MMO) required by law in order to meet short-term budgetary needs, the long-term Pension Fund liability continues to escalate.

Despite an adverse material impact resulting from the Deferred Retirement Option Program (DROP), the Pension Board, over the objections of the Administration, chose to maintain the program with no changes. While the program provides an opportunity for rightsizing the City's workforce, it is also subject to abuse by officials for whom it was never intended. The potential costs of the ongoing DROP exacerbate the long-term Pension Fund liability.

### *Municipal Union Contracts*

The largest unknown variable in the Plan is personnel costs. The collective bargaining agreements between the City and its Police expired at the end of FY2004 and its Fire employees expire at the end of FY2005; the other municipal employee contracts expired at the end of FY2004. As is standard procedure, the Plan assumes no increases in wages or benefit costs after these expiration dates, excepting a baseline annual increase in health care costs of approximately nine percent. With a projected \$100 thousand surplus at the end of FY2005, there are simply no funds for increases in salary or benefits in the current year, and limited resources for increases in FY2006 and beyond. Personnel costs account for over 57 percent of the FY2004 budget; thus even a minimal increase in wages and benefit costs will have a significant impact on the City's expenditures throughout the life of the Plan. **Any contracts which increase General Fund costs will require a revision to the Plan which demonstrates sufficient revenues to cover the increased costs.**

While traditionally PICA Staff has been most concerned with the projected impact of wage increases, it is the recent health benefit increases which truly threaten the fiscal viability of the City. Although health care costs are increasing at nearly ten percent nationally, the most recent Act 111 Police and Fire Arbitration awards were deplorable, with a first year increase of over *thirty-seven percent*. The arbitration panel severely undermined their own practice by effectively nullifying the FY2002 arbitration award, and reestablishing the baseline for health care benefits. Their actions are unprecedented; the City was mistaken in its failure to appeal. PICA Staff awaits the results of the current Police Arbitration with some trepidation.

The Act 111 decision has serious consequences for the non-uniformed contracts to be negotiated for FY2005 and beyond. If these unions were to receive a health benefit increase in parity with the Act 111 awards for Police and Fire, the cost to the General Fund in just the first year is nearly *\$30 million dollars* over current Plan projections. As noted above, the funds to cover these additional costs will require additional spending cuts.

Employee wages also remain a concern. From FY1997–FY2002, represented employees average annual wage increase was over 3.5 percent, while over the same period inflation averaged just over 2.2 percent, private industry gains averaged just under 4 percent, and the State and Local government average was 3 percent. While the Philadelphia municipal average seems only slightly higher than the norm, it does not take into account automatic step and longevity pay increases included in municipal employee contracts which can add anywhere from 2 to 9 percent to the annual base salary of an employee.

### *Pension Fund Liabilities*

While improving investment returns should lessen the level of required Pension Fund payments, the amount of those payments is not yet known. When calculating its funding requirements, the Pension Fund assumes a nine percent rate of return; these calculations help determine the amount of the annual contribution from the City to the Pension Fund. In the years immediately prior to 2001, Pension Fund rates of return were well above ten percent. Like many pension funds nationally however, returns for the City's Pension Fund were negative for 2001 and 2002. Rising investment returns will be reflected in the next actuarial report, and should result in lesser MMO payment levels.

The recent significant increases in the City's projected payments into the Pension Fund highlight the ongoing threat posed to the General Fund. Should the national economy struggle, it is possible that the Pension Fund will continue to have years when its investment returns fall below its expected nine percent rate of return. According to some estimates, each percentage point below the expected rate of return would require an additional \$10 to 15 million City contribution. While the City has reduced its annual contribution to the MMO required by law in order to meet short-term budgetary needs, the long-term Pension Fund liability continues to escalate. This year's Plan made the first attempt to address these concerns by proposing a switch from a defined pension

benefit to a defined pension contribution. Such a step would eliminate the unpredictability of the current system and realize some savings for the City. PICA Staff will closely monitor the efforts to implement this change. Failure to achieve this modification preserves an unstable and costly system which jeopardizes the long-term financial health of the City.

*Deferred Retirement Option Program (DROP)*

Since the DROP began in October 1999, over 3,500 employees have enrolled in the program. In many cases, the Program has provided opportunities for City Departments to reorganize, reassess workflow, and rightsize in accordance with current demands. DROP has also provided an opportunity for improved succession planning, a feature put to particularly good use by the Police Department.

However, the original DROP was not revenue neutral with a cost estimated at \$12-14 million, funds the Pension Plan can ill afford to lose as indicated above. Simply modifying the guaranteed rate of return would have negated much of the risk cost to the Pension Fund. Despite this adverse material impact, the Pension Board, over the objections of the Administration, chose to maintain the program with no changes. The potential costs of the ongoing DROP exacerbate the long-term Pension Fund liability.

While the program provides an opportunity for rightsizing the City's workforce, it is also subject to abuse by officials for whom it was never intended. Elected officials whose positions cannot be terminated, and face no reorganization or succession planning issues were never the intended target of the DROP. While it is within the rules for these officials to enter the Program, it is clearly a violation of the spirit of the DROP.

**This page intentionally left blank**

## **PHILADELPHIA GAS WORKS**

The Philadelphia Gas Works (PGW) continues to present a perplexing problem for the City. Just one year after appearing to make significant strides in improving its overall fiscal health, PGW was, for the first time, unable to make its \$18 million payment to the City. The long-term fiscal projection is clouded, and the factors for recovery being touted by PGW management are unlikely.

While many management improvements have been made over the past few years, the inability to deal with strategic concerns in a timely fashion continues to plague PGW. Ironically, despite years of blaming fiscal woes on unusual mild winters, it was the extreme cold weather of this past winter which drove PGW back to fiscal instability.

### *PGW's \$18 Million Payment*

For the first time since the payment was first established, PGW missed its annual \$18 million payment to the City in FY2004. In its March 30, 2004 letter to the Mayor, PICA Staff noted that the payment could no longer be assumed given that failure as well as PGW's fiscal condition. In the final Plan transmitted to PICA on July 1, 2004, the City acknowledged it will not receive payments from PGW in years FY2005-FY2008.

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. As requested by PICA Staff, the City has achieved a projected surplus for FY2009 greater than \$63 million (\$120 million) to ensure that the Plan is in balance even if those funds are not received.

### *PGW's Plan For Recovery*

According to the management of PGW, any hope of regaining fiscal stability depends on three factors: a lowering and stabilization of gas prices; a dramatic increase in Federal funding of the Low Income Home Energy Assistance Program (LIHEAP); and, an increase in PGW collection rates from 87 percent to 92 percent.

According to US Department of Energy forecasts which are supported by numerous economic surveys as well as the pricing of oil and gas futures, residential natural gas prices are not expected to drop and stabilize until the middle of next winter, and then are expected to begin rising again in the Fall of 2006. There is no reasonable expectation of stabilization in the near future.

LIHEAP is currently funded at \$1.8 billion, with an additional discretionary contingency funding of \$200 million. The American Gas Association and other related associations have proposed a bill that would increase LIHEAP funding to \$3.4 billion. However, PICA Staff discussions with key Association lobbyists and senior officials at the US

Department of Health and Human Services, indicate that LIHEAP funding will remain at \$1.8 billion for FY2005 and is "capped out for the foreseeable future." President Bush's proposed budget maintained the \$1.8 billion funding level for LIHEAP.

While it is accurate that PGW's collection rates have historically approached 92 percent, the steady erosion of Philadelphia's population, particularly of those able to pay has significantly impacted PGW's ability to collect its bills. PGW has yet to obtain changes in the City's gas shut-off moratorium rules, or further adjustments to senior citizen discounts, nor has Philadelphia's City Council demonstrated a willingness to enact such changes. As long as PGW is forced to operate in part as a social service agency, it will be hard pressed to achieve 92 percent collection rates. As a result, PICA Staff considers it highly speculative that the City will receive the budgeted \$63 million from PGW in FY2009.

While collection rates have improved since April 2004, PGW has no demonstrable record for maintaining collections in the winter months, particularly if gas prices are high and the weather is extreme.

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

PGW has restructured its capital program to meet pressing needs despite the large amount of outstanding debt. PGW currently has well over \$900 million in outstanding debt. It is conceivable that the combination of increasing capital demands combined with a loss in revenue could render PGW unable to meet its debt obligations.

According to the City, there has been no official legal opinion on whether the City is contractually liable for repayment of PGW's debt should PGW be unable to meet those obligations. However, considering that nearly all Philadelphia commercial and residential gas users are served by PGW, and given the City's history of coming to the aid of its citizenry even when not legally liable, the likelihood of the City assuming such liability is strong.

#### *Administration Plans for PGW: A Long-Term Plan*

While many management improvements have been made over the past few years, the inability to deal with strategic concerns in a timely fashion continues to plague PGW. It appears that the approach to dealing with the overall issue of PGW has resorted to attention when it is in dire straits and ignoring PGW when the fire is out. FY2002-FY2003 provided an opportunity to deal with PGW's issues when not in crisis mode. Unfortunately that opportunity was ignored.

In the past, options have included selling the utility to the first serious bidder; improving the utility to make it more attractive to prospective buyers; or, improving the utility and maintaining City control. The City commissioned a study to look at the feasibility of

selling PGW originally due to be released in December 2001. The initial study was found to be incorrect however, and was sent back for revisions; no date has been set for release of the new study.

For the second consecutive year, Mayor Street did not address the notion of selling PGW in his Budget Address. PICA Staff questions regarding any sale of PGW went unanswered.

**This page intentionally left blank**

## REMOVING FLEXIBILITY IN TAX CUT PROGRAMS

One of the odd proposals to emerge from the debate over tax reform in Philadelphia was the insistence on fixing tax rate reduction programs in law for periods of ten years or more. Despite almost never fixing tax reductions into ordinance beyond one year, the tax reduction program had always met or exceeded the proposed cuts. In a year when tax changes by the Commonwealth threatened to fix tax rates currently enacted, this proposal threatened the City's ability to deal with unexpected fiscal changes.

Additionally, over the Mayor's veto, City Council enacted a Wage Tax Reduction Bill for impoverished Philadelphians. While this tax cut does not begin until after the end of the Plan under review, it has expensive ramifications beginning in FY2010.

### *Usefulness of Flexibility*

From the inception of the incremental tax reduction program in FY1995 through the FY2003-FY2007 Plan, rate reductions were fixed by ordinance for one year, and by resolution for the remainder of the Plan years. In the FY2004-FY2008 Plan, tax rate changes were included in ordinance through the first years of the Plan. Tax rate changes beyond that period were in resolution only.

The advantage of such an approach is to enable legislators to more easily change a tax reduction schedule should circumstances so dictate. Such changes can lead to slowing or halting the tax cuts, or increasing the amount of the cut. **Since the inception of the tax reduction program in FY1995, tax rate cuts always met or exceeded those originally proposed in resolution.**

As part of its debate over gaming and related tax reform, the Commonwealth enacted (Senate Bill #100) a legal requirement that all tax rate changes through FY2009 currently enacted stand without deviation. The new legislation does provide for changes if approved by at least ten members of City Council and PICA certifies to a fiscal threat to the City or disapproves the City's Five-Year Plan. While this language does provide some room for response to changing fiscal conditions, it does limit the ability of local officials dealing with unforeseen events. Despite warnings by PICA Staff, the Wage Tax rate proposals are contained in ordinance.

PICA Staff has consistently cited this flexibility as a means for the City to pay for unforeseen revenue shortfalls or expenditure demands. Without this flexibility, future Plans may face a greater chance of a recommendation of rejection.

### *Wage Tax Cuts for Impoverished Working Philadelphians*

While there is no doubt that a Wage Tax cut for those Philadelphians at the bottom end of the economic ladder, who are also productive members of the community, is noble and should ultimately benefit the community socially and economically. This cut, passed by City Council over the Mayor's veto, was made with out any attempt to "pay" for the revenues that will be lost. The cuts begin in FY2010, the first year after the Plan, allowing City Council to reduce the revenues without finding corresponding expenditure cuts. Although next year's Five-Year Plan will be required to fund the revenue loss, it is this year's City Council which placed this burden on the next generation.

The cost of this tax cut is difficult to estimate due mainly to the fact that while the Wage Tax is remitted by the employer, the employee would be required to apply for the rebate. The City Revenue Department estimates that this cut will cost \$13 million in FY2010, and escalate thereafter.

## THE CRIME OF INEFFICIENCY: THE COST OF POLICING PHILADELPHIA

There is little doubt that the primary function of any government is to provide for the security of its citizens. However, that security should not be attained in such an inefficient manner as to place an undue fiscal burden on those same citizens. The Philadelphia Police Department suffers from poor management, an organizational structure with too little oversight, and unproductive work rules. The result is a bloated Police force with higher expenditures than other peer cities, but no correlating increase in crime prevention.

### Comparisons with Peer Cities

PICA Staff began by reviewing basic Police statistics for the ten largest cities in the United States. The goal was to establish whether or not the Philadelphia Police Department was normative or an outlier in staffing, deployment, and overtime. US Department of Justice (DOJ) statistics and discussions with Police and budget personnel in nine other cities, gives a quick snapshot of the Philadelphia Police Department's ranking relative to its peer cities.

The first example is the number of uniformed officers per 10,000 residents:

City	Uniformed Officers per 10,000 residents
San Diego	17.12
San Antonio	17.96
Phoenix	21.73
Los Angeles	24.15
Dallas	25.05
Houston	27.09
<b>Philadelphia</b>	<b>44.59</b>
New York	45.94
Detroit	46.09
Chicago	47.34
<b>AVERAGE:</b>	<b>31.71</b>

Numbers are based on 2000 census figures and FY2002 Police staffing complements provided by each of the cities.

While Philadelphia ranks seventh in this list, it is within the same range as the other Rustbelt cities which make up this list. This is not to say that such a status is acceptable, but that there are probably a number of historical, geographical, and political factors contributing to Philadelphia's position.

City statistics reported to the DOJ on the percent of uniformed officers in the field is a telling measure of efficient use of resources:

<b>CITY</b>	<b>Percent of Uniformed Officers in the Field</b>
Dallas	98.3
Chicago	98.2
Phoenix	94.7
Los Angeles	92.5
San Diego	91.7
New York	90.8
San Antonio	90.4
<b>Philadelphia</b>	<b>88.4</b>
Houston	87.5
Detroit	86.9
<b>AVERAGE:</b>	<b>91.94</b>

Not only is Philadelphia seventh among the top ten cities, and 3.5 percent below the average in the numbers reported to the DOJ in 1999, the percentage has fallen to 87.2 percent in FY2003, and is projected to reach 86.8 percent in FY2004, relegating Philadelphia to the bottom of its peer cities, relative to the 1999 statistics.

It is true that Philadelphia's field percentage is a vast improvement from the mid-1980's, when the Department averaged 77 percent of uniformed officers in the field. However, the City continues to rest on those old accomplishments, and lag the other large cities, by remaining at approximately 87 percent since FY1994.

The final statistic reviewed was overtime expenditures. While not every City was able to provide overtime expenditures broken down by civilian and uniformed usage, overall percentages across all cities were similar. As a result, PICA Staff used total overtime expenditures divided by the number of uniform officers as a proxy for average overtime spending for each Police Department.

FY2002 statistics were used, so as not to skew Philadelphia's numbers relative to Operation Safe Streets.<sup>1</sup> New York City's figures were left out of the comparison entirely. Although each City had some overtime increase relative to the events of September 11, 2001, New York City's overtime figures were so anomalous as to skew the entire table.

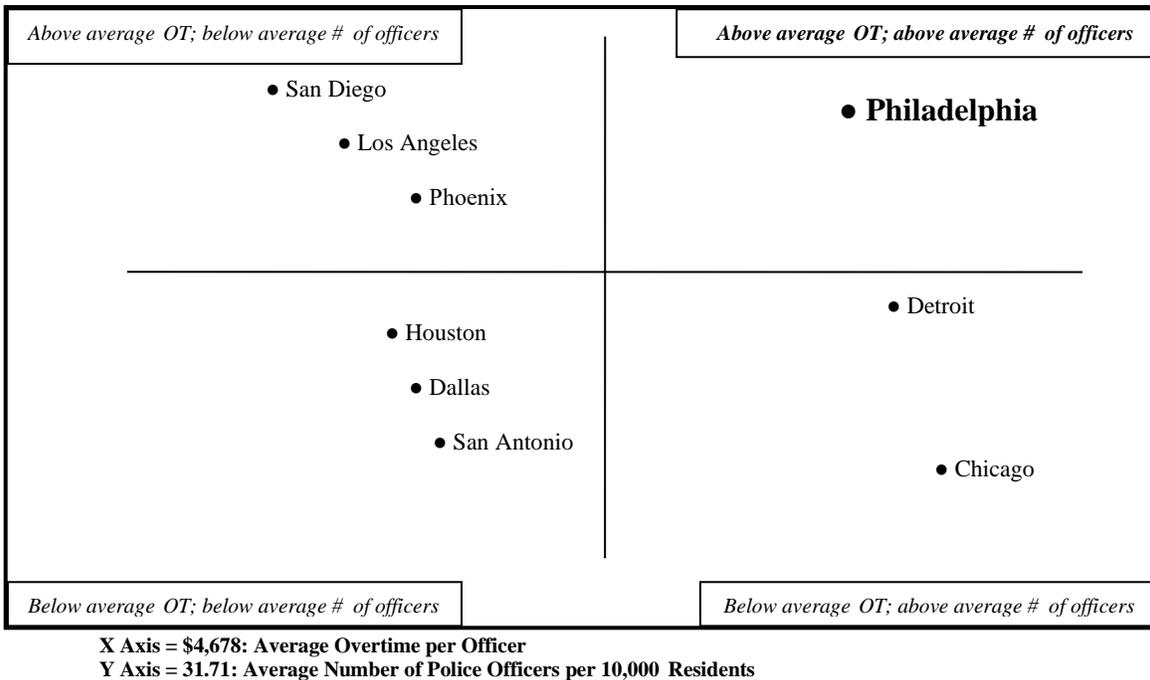
---

<sup>1</sup> In FY2003, the first full year of Operation Safe Streets, Police overtime jumped by over forty percent. Average overtime per uniformed officer rose from \$7,393 to almost \$10,400.

CITY	Average Overtime per Uniformed officer
Chicago	2,182
Houston	3,324
Dallas	3,679
San Antonio	3,795
Detroit	4,526
Phoenix	5,181
Los Angeles	5,582
San Diego	6,437
<b>Philadelphia</b>	<b>7,393</b>
<b>AVERAGE:</b>	<b>4,677.67</b>

Of the nine remaining cities, Philadelphia easily has the highest average overtime expenditures, nearly 60 percent higher than the average. Once again there appears to be some regional issues involved in Police overtime issues, although Philadelphia is notable as the exception. While Southern cities and Western cities tend to group with each other, Philadelphia is significantly higher than other similar cities.

When viewed graphically, Philadelphia's position as an outlier is glaring. The following graph combines average officers per ten thousand residents and average overtime per officer relative to the averages.



Philadelphia is the only city that manages to combine higher-than-average overtime costs with a higher-than-average number of police officers per resident.

## **Underlying Causes**

In order to understand the reasons for Philadelphia's anomalous statistics, PICA Staff engaged in discussions with current and former senior city managers, members of the Police Department, and similar officials in other cities surveyed. Although the frank conversations highlighted a number of serious concerns, most felt that a concerted effort to enact changes could increase departmental efficiency quickly.

Almost all of the conversations highlighted poor management within the department; a lack of oversight by the traditional city administrative structure; unnecessary personnel rules; overly permissive overtime rules; and, a lack of coordination across the criminal justice system.

### *Poor Management and Lack of Oversight*

The Philadelphia Police Department is adept at achieving its primary mission – reducing crime and maintaining public order. However, it fails to achieve that mission in an efficient and effective a means as possible. Insufficient training is given to newly promoted managers. There is an over-abundance of promotions, resulting in too many managers, and a too small percentage of uniformed officers on the street. Senior management fails to communicate internal priorities, and fails to encourage efficiency changes.

Many of the management problems were exacerbated when the Police Commissioner was given the added title of Secretary of Public Safety. The City's Managing Director has less control over Department operations, and the oversight role of the Finance Department has been reduced. While the Police Department has historically seen itself as a distinct unit of city government, this governance change has isolated the Department to the point of managerial ineffectiveness.

### *Unnecessary Personnel Rules*

In order to be a Police Sketch artist in Philadelphia, an individual must be a uniformed officer. In order to place decals on police cars, supervise 911 operators, or even post temporary "no parking" signs, an individual must be a uniformed officer. Officials in peer cities found these requirements "amusing" and "wasteful." These examples, and similar rules, need to be reviewed with an eye toward efficiency rather than preserving job slots for uniformed officers.

Another concern raised is the result of having one union representing all uniformed officers in the Police Department. Grievances pit union members against each other, and create awkward situations for mid-level Department supervisors. This reality affects the pace of internal management change and impedes the implementation of effective work rules.

### *Overtime and Criminal Justice Inefficiencies*

One of the most dramatic costs associated with the Police Department is its generous use of overtime dollars. As evidenced in the statistics above, Philadelphia's average overtime is nearly 60 percent higher than the average of its peer cities. These numbers are prior to the advent of Operation Safe Streets, which has nearly doubled the amount of funds spent on police overtime. Some of the problems with overtime result from poor managerial oversight – there is a Department culture which encourages a basic amount of overtime per officer, almost as a pay supplement. Overtime goals are established arbitrarily based on previous years usage rather than internal analysis. Managers are rarely held accountable for overruns in overtime usage.

Overtime is also often used by the Police Department as a “catch-all” funding line to cover the costs associated with new initiatives, such as the Operation Safe Streets program. Philadelphia should look to other departments within its own government, as well as other Police Departments across the Country, all of whom are able to use innovative approaches to increase services without increasing costs. For example, when the Police Superintendent in Chicago wanted to increase police presence recently, a new program was instituted whereby all officers, regardless of assignment, spent a minimum of one out of every five weeks on the street.

That is not to say that all of the overtime spending results from poor internal management. Work rules established by the contract with the Police union provide little room for managerial oversight regarding the taking of leave. A great deal of overtime is utilized simply providing for a full workforce when an unbalanced number of officers take leave during peak vacation periods. Then Commissioner Timoney required special authority to manage leave for the Millennium 2000 celebration, despite the throngs of visitors and the risks posed by the Y2K bug. It is simply untenable for managers to be stripped of the tools necessary to manage the workforce.

Additional overtime results from the inability of the other elements of the criminal justice system in Philadelphia to work with the Police Department. The Department of Prisons, District Attorney's Office, Defender's Association, Sheriff's Office, and the First Judicial District combined with the Police Department, make up nearly one-third of the City's non-reimbursed budget. Although some of these entities are elected independently, they all work for the citizens of Philadelphia and should provide the most coordinated and effective criminal justice system possible. Several million dollars in police overtime alone have been wasted by the inefficiencies resulting from an inability of these entities to work together.

## Recommendations

- ***Reduce the size of the uniform complement by at least 500 employees while increasing the percentage of officers on the street to 92 percent.***

It is clear from the comparative statistics that Philadelphia has too many uniformed officers per capita. It should be noted that there is no correlation between number of officers (within a reasonable range) and crime. The criminology field has demonstrated clearly that socioeconomic factors and demographics are the best predictors of crime rates.

Additionally, if the Department is able to achieve the average percentage of officers on the street, the total number of officers on the street will not change. There will simply be fewer, unnecessary administrative positions.

- ***Restore the position of Police Commissioner to reporting to the City's Managing Director.***

The Police Department needs to be a part of the City's overall public service program. Police Department policies, initiatives, spending and procedures can all benefit from better interaction with other City departments, particularly the Finance Department. Clear reporting lines need to exist to ensure that independent actions by the Department do not jeopardize the overall City budget.

- ***Negotiate with the Police Department Unions to eliminate costly, unnecessary job requirements.***

There is no viable reason that a uniformed employee is required to post temporary "No Parking" signs, or serve as a sketch artist, or put decals on police cars, or even supervise 911 operators. Few if any other peer cities have these rules; no other City has all of them. The excess funds spent for these positions, to provide extra jobs for uniformed employees, is tax-payer money wasted.

- ***Explore avenues for splitting the Police Union into at least two units – representing different organizational levels.***

Philadelphia remains the only peer city to have one union representing all of its officers. Some cities have more than four unions representing different administrative levels. The current system in Philadelphia blurs lines for grievances and inhibits discipline and management in the Police Department.

- ***Establish clear and reasonable goals for departmental overtime usage, including a strict justification and approval process for the use of overtime.***

The Police Department needs to be accountable for its overtime budget like any other City Department. Overtime goals, in line with those of other peer cities, need to be

clearly established and adhered to, barring a public safety emergency. Other City Departments are required to maintain their budgets when introducing new initiatives; the Police Department should be no different.

- ***Establish a system of leave usage which allows for proper workforce planning for the Police Department.***

It is impossible to do proper workforce planning without administrative control over granting leave. There is no other workforce where employees can all take-off at peak times requiring massive overtime to provide basic staffing. Some form of leave granting system based on seniority or rotating choice opportunities, with final approval in the hands of top administrators, is the only way to ensure efficient workforce deployment.

- ***Establish a Secretariat for Criminal Justice with oversight and budget approval authorities over the Police Department, Department of Prisons, District Attorney's Office, Defender's Association, Sheriff's Office, and the First Judicial District.***

Philadelphia's Criminal Justice System represents over one-third of the non-reimbursable City budget. Only a senior administrative official, reporting directly to the Mayor, with significant budget recommendation authority, will be able to ensure that the disparate entities involved in criminal justice in Philadelphia will work together to provide the most efficient and effective service to the citizens of Philadelphia.

## **Conclusion**

The recommendations presented in this White Paper are not the result of looking to close a budget gap. PICA Staff utilized a set of comparative data to highlight possible inefficiencies in government spending, investigated the reasons for those apparent inefficiencies, and made appropriate recommendations. These changes represent a better use of taxpayer funds whether the City enjoys a \$300 million surplus or faces a \$100 million deficit. We cannot afford to make efficiency decisions based solely on budgetary pressure.

The recommendations listed above could net savings for the City of at least \$35 million annually, and probably much more. Just as importantly, the result would be a more resourceful Police Department and Criminal Justice System, delivering a higher level of service at less cost to the taxpayers of Philadelphia.

The taxpayers deserve no less.

**This page intentionally left blank**

**Pennsylvania Intergovernmental  
Cooperation Authority**

**STAFF REPORT  
ON  
FY2005-FY2009  
FIVE-YEAR FINANCIAL PLAN**

---

**SECTION III:**

**APPENDIX**

---

**This page intentionally left blank**

## 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 July 1, 2004 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 March 18, 2004 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 July 7, 2004.

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, 2005 (100 days prior to the end of FY2005). At that time, the City is required to add its Fiscal Year 2010 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 \$1,178 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	508,603
Retirement of Certain High Interest City Debt	<u>381,300</u>
<b>TOTAL</b>	<b><u>\$1,178,903</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 2005. 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 FY2004 is August 16, 2004. Quarterly reporting deadlines for FY2005 are November 15, 2004, February 15, 2005, May 16, 2005 and August 15, 2005. 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 FY2004 is the report due June 21, 2004. For FY2005, the reporting dates are October 21, 2004, January 21, 2005, April 21, 2005 and July 21, 2005. 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 FY2005 are August 2, 2004, November 1, 2004, January 31, 2005 and May 2, 2005.