CITY OF PHILADELPHIA PENNSYLVANIA

OFFICE OF THE CONTROLLER

Promoting honest, efficient, and fully accountable government

FORECASTED GENERAL FUND STATEMENTS OF OPERATIONS UPDATED AS OF SEPTEMBER 10, 2013

CITY OF PHILADELPHIA

ACCOUNTANT'S REPORT

FISCAL YEARS 2014 – 2018

City Controller
ALAN BUTKOVITZ

CONTENTS

CITY OF PHILADELPHIA

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ALAN BUTKOVITZ
City Controller

GERALD V. MICCIULLA
Deputy City Controller

INDEPENDENT ACCOUNTANT'S REPORT

To the Chair and Board Members of the
Pennsylvania Intergovermental Cooperation Authority

We have examined the accompanying Forecasted General Fund Statements of Operations for the fiscal years ending June 30, 2014 through June 30, 2018, updated as of September 10, 2013 (the updated forecasted statements). The City of Philadelphia's management is responsible for the updated forecasted statements. Our responsibility is to express an opinion on the updated forecasted statements based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included such procedures as we considered necessary to evaluate both the assumptions used by the City of Philadelphia's management and the preparation and presentation of the updated forecasted statements. We believe that our examination provides a reasonable basis for our opinion.

As discussed in Note C.3.d and Note C.6.a. the updated forecasted statements take into account events and circumstances that were not anticipated at July 3, 2013, the date the previous forecasted statements were issued for the same periods, and those forecasted statements should no longer be relied on. We previously examined and, on July 19, 2013, reported on the previous forecasted statements. Our report on the previous forecasted statements is withdrawn and should no longer be relied on for any purpose.

As discussed in Note C.6.a under the caption "Labor Agreements" in the Summary of Significant Forecast Assumptions, the City is now expected to have additional funds due to the ongoing economic recovery. The revenue amounts in the updated forecasted statements do not reflect the favorable financial impact of this change, resulting in a steadily declining fund balance to a critically low amount of $8.5 million in fiscal year 2017.

In our opinion, the accompanying updated forecasted statements are not presented in conformity with guidelines for presentation of a financial forecast established by the American Institute of Certified Public Accountants because management's assumptions, as discussed in the preceding paragraph, do not provide a reasonable basis for management's forecast. We have no responsibility to update this report for events and circumstances occurring after the date of this report.

Gerald V. Micciulla

September 13, 2013

GERALD V. MICCIULLA, CPA
Deputy City Controller

Forecasted General Fund Statements of Operations

Fiscal Years Ending June 30, 2014 through June 30, 2018

Updated as of September 10, 2013

Prepared by:

Office of Budget and Program Evaluation
Office of the Director of Finance

City of Philadelphia - Office of the Director of Finance
Forecasted General Fund Statements of Operations
Fiscal Years Ending June 30, 2014 through June 30, 2018
(amounts in thousands)

NO.	ITEM	FY 2014 Estimate	FY 2015 Estimate	FY 2016 Estimate	FY 2017 Estimate	FY 2018 Estimate
(1)	(2)	(5)	(6)	(7)	(8)	(9)
	OPERATIONS OF FISCAL YEAR					
	REVENUES					
1	Taxes	2,760,798	2,715,898	2,769,903	2,830,157	2,884,115
2	Locally Generated Non-Tax Revenues	273,328	273,240	277,077	279,799	282,555
3	Revenue from Other Governments	628,570	638,780	652,347	666,540	688,498
4	Sub-Total (1)+(2)+(3)	**3,662,696**	**3,627,918**	**3,699,327**	**3,776,496**	**3,855,168**
5	Revenue from Other Funds of City	67,249	63,317	63,817	64,328	64,753
6	Total - Revenue (4)+(5)	**3,729,945**	**3,691,234**	**3,763,144**	**3,840,824**	**3,919,920**
7	Other	0	0	0	0	0
8	**Total Revenue and Other Sources (6)+(7)**	**3,729,945**	**3,691,234**	**3,763,144**	**3,840,824**	**3,919,920**
	OBLIGATIONS/APPROPRIATIONS					
9	Personal Services	1,401,330	1,398,761	1,399,298	1,400,789	1,407,204
10	Personal Services-Pensions	667,520	580,325	608,001	630,777	652,573
11	Personal Services-Other Employee Benefits	559,104	537,407	554,680	574,554	598,651
12	**Sub-Total Employee Compensation**	**2,627,954**	**2,516,493**	**2,561,979**	**2,606,120**	**2,658,428**
13	Purchase of Services	790,552	806,906	802,791	808,417	816,353
14	Materials, Supplies and Equipment	88,626	88,959	84,562	84,567	85,567
15	Contributions, Indemnities, and Taxes	141,709	138,744	140,055	139,366	140,179
16	Debt Service	129,530	142,388	146,399	158,369	165,113
17	Capital Budget Financing	0	0	0	0	0
18	Advances & Misc. Pmts. / Labor Obligations	84,708	35,209	29,455	28,822	28,822
19	Sub-Total (12 thru 18)	3,863,079	3,728,699	3,765,241	3,825,661	3,894,462
20	Payments to Other Funds	31,644	33,038	34,567	36,176	37,868
21	**Total - Obligations (19+20)**	**3,894,723**	**3,761,737**	**3,799,808**	**3,861,837**	**3,932,330**
22	Oper.Surplus (Deficit) for Fiscal Year (8-21)	(164,778)	(70,503)	(36,664)	(21,013)	(12,409)
23	**Prior Year Adjustments:**					
24	Revenue Adjustments	0	0	0	0	0
25	Other Adjustments	19,388	19,388	19,388	19,388	19,388
27	Total Prior Year Adjustments	19,388	19,388	19,388	19,388	19,388
28	**Adjusted Oper. Surplus/ (Deficit) (22+27)**	**(145,390)**	**(51,115)**	**(17,276)**	**(1,625)**	**6,979**
	OPERATIONS IN RESPECT TO					
	PRIOR FISCAL YEARS					
	Fund Balance Available for Appropriation					
29	June 30 of Prior Fiscal Year	223,851	78,461	27,346	10,070	8,445
30	Residual Equity Transfer	0	0	0	0	0
31	Fund Balance Available for Appropriation June 30 (28)+(29)+(30)	**78,461**	**27,346**	**10,070**	**8,445**	**15,424**

See accompanying summaries of significant accounting policies and assumptions and accountant's report.

A. Nature of the Forecast

The City of Philadelphia (City) Office of Budget and Program Evaluation (OBPE) is responsible for providing revenue and obligation estimates to the Director of Finance and the Mayor for discussion and inclusion in the FY2014 budget and the FY2014-2018 Five Year Financial Plan (FYP) submitted by the Mayor to the Pennsylvania Intergovernmental Cooperation Authority (PICA) on September 10, 2013. These financial forecasts present, to the best of management's knowledge and belief, the City's expected results of operations for the forecast periods. Accordingly, the forecasts reflect the City's judgment as of September 10, 2013, the date of these forecasts, of the expected conditions and its expected course of action. The assumptions disclosed herein are those that management believes are significant to the forecasts. There will usually be differences between the forecasted and actual results because events and circumstances frequently do not occur as forecasted or expected and those differences may be material.

B. Summary of Significant Accounting Policies

The Forecasted General Fund Statements of Operations are presented on the budgetary basis of accounting. The budgetary basis of accounting differs from the modified accrual (Generally Accepted Accounting Principles) basis used in the preparation of the City's governmental fund financial statements in that both expenditures and encumbrances are applied against the current budget, adjustments affecting activity budgeted in prior years are accounted for through fund balance or as a reduction of expenditures and certain interfund transfers and reimbursements are budgeted as revenues and expenditures.

C. Summary of Significant Forecast Assumptions

1. Approach to Revenue Forecasting

The City's estimated general fund revenues for FY14 total $3.730 billion. Approximately 74% of the City's budget comes from local taxes, and 17% comes from other governments. Locally generated non-tax revenues, which include fees, fines and permits, account for 7% of revenues.

OBPE provides forecasts of the six major taxes, totaling over $2.761 billion in the revised FY14 budget, as well as $276.3 million of Locally Generated Non-Tax revenues, and $628.6 million in Revenue from Other Governments. These three sources comprise 98% of the revenues anticipated for the FY14 budget.

OBPE employs a number of approaches to developing its forecasts of local revenues:

a. Forecasts of economic activity provided by several sources including the Congressional Budget Office and the Blue Chip Economic Indicators;

b. Continuous evaluation of national and local economic data on employment, inflation, interest rates, and economic growth;

c. Ongoing examination of the City's current tax receipts;

d. Economic forecasting of tax revenues provided by a revenue forecasting consultant;

e. Discussions with economists at the Federal Reserve Bank of Philadelphia; and

f. The extensive experience of its staff.

OPBE's tax estimates for the FYP were developed in conjunction with a revenue forecasting consultant, IHS Global Insight, Inc (IHS). IHS created econometric models which included variables such as wage and salary disbursements in the metropolitan statistical area (MSA) and the county, personal income in the county, the unemployment rate, home prices in the county, real estate transaction growth, and national corporate profits. These models, together with their forecast of the Philadelphia economy, were used by IHS to estimate tax revenues for the City. IHS focused on four taxes – Wage and Earnings Tax, Business Income and Receipts Tax, Real Estate Transfer Tax, and Sales Tax. These estimates were refined by OBPE after discussions with leading economists at the Federal Reserve Bank of Philadelphia.

2. The National and Local Economic Context

The strength of the economy is a key determinant of the fiscal health of the City since tax revenues, which are directly tied to the economy's strength, account for 74% of the City's General Fund revenue. The national economic recovery after the recession and related fiscal crisis continues to be slow. The Blue Chip consensus forecast for U.S. Real Gross Domestic Product (GDP) which provides a forecast based on combining multiple leading separate economic forecasts, shows estimated growth of 1.8% for 2013, slightly lower than the 2.2% growth in 2012. Growth is expected to accelerate in

2014 to 2.7%. The consensus forecast estimates pre-tax corporate profits to grow 3.1% in 2013 and 5.1% in 2014, compared to 6.8% in 2012.[1]

Households are starting to show more confidence through spending; personal consumption expenditures are estimated to grow 2.1% in 2013, slightly above the 1.9% growth in 2012, and increase further to 2.5% growth in 2014. Nevertheless, disposable personal income is expected to grow by only 0.8% in 2013 compared to 1.5% in 2012. Unemployment is expected to decline slightly from 8.1% in 2012 to 7.5% in 2013 and then to 7.1% in 2014. The brightest spot in the economic forecast is that the housing market appears to be recovering, with 27% more housing starts expected in 2013 than in 2012. [2]

Like the nation, Philadelphia's economy continues to recover from the deep recession of 2007-2009. The number of people employed dropped from 593,307 in April 2009 to a low of 566,693 in March 2010, rebounding to 589,793 in April 2013, a decline of 0.6% since 2009. Unemployment had a sizable increase, from 5.9% in November 2007 to a high of 11.1% in July 2010 and has improved somewhat to 9.6% in April 2013.[3] Employment levels are particularly important for Philadelphia's budget because it is heavily reliant on the Wage Tax.

3. The City's Major Taxes

The City receives revenue to fund its services and programs from six major taxes (contributing to 74% of the expected General Fund revenue in FY14). These include:

a. Wage and Earnings and Net Profit Tax (Wage),

b. Property Tax,

c. Business Income and Receipts Tax (BIRT),

d. Real Estate Transfer Tax (RTT),

e. Sales Tax, and

f. Parking Tax.

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[1] Blue Chip Economic Indicators July 10, 2013.
[2] Blue Chip Economic Indicators July 10, 2013.
[3] Bureau of Labor Statistics. Retrieved on July 11, 2013 from the bls.gov website.

The remaining taxes, including the amusement tax, provide less than 1% of General Fund revenue. Philadelphia's reliance on the Wage Tax (34% of the General Fund) and the BIRT (11%) places the City at risk from economic trends and employment fluctuations of the local economy. Other cities and counties that rely more heavily on property tax revenues are more susceptible to dramatic shifts in the housing market.

a. Wage Tax

The largest tax revenue source (comprising 47% of tax revenues) is the Wage, Earnings, and Net Profits (Wage) tax. The Wage Tax is collected from all employees working within city limits, and all city residents regardless of work location. In FY14, the Wage Tax rate has been reduced from 3.9280% to 3.9240% for residents and from 3.4985% to 3.4950% for non-residents. The resident rate includes 1.5% that is reserved for the Pennsylvania Intergovernmental Cooperation Authority (PICA). PICA has overseen the City's finances since 1992, when the State Oversight Board was first established. The PICA statute permits the Authority to a "first dollar" claim on its portion of Wage Tax proceeds, which is used to pay debt service on bonds issued by PICA for the benefit of the City. Excluding the PICA portion, the Wage Tax is estimated to bring in $1.287 billion in FY14. This estimate includes a 3.59% growth rate in the Wage and Earnings Tax and a 3.0% expected growth rate in the Net Profits Tax.[4]

The City resumed cuts to the wage tax in FY14 that were suspended in FY10 and plans to continue wage tax cuts in each year of the FYP assuming that the City's fund balances remains consistent with or higher than those in the FYP. The level of cuts to the Wage Tax rates increase over the course of the plan as the economy is projected to recover. By FY18, the Wage Tax rates in the FYP are 3.7568% for residents and 3.3460% for non-residents.

b. Property Tax

The Real Property Tax (Property) is the City's second largest source of tax revenue (19%), estimated to contribute $536.6 million of the FY14 tax revenues. This tax is levied on the assessed value of residential and commercial property in the City. The City's plan to implement the Actual Value Initiative (AVI) in FY 2014 has been adopted. The Adopted Fiscal Year 2014 Budget has a combined City/School District property tax rate for FY 2014 of 1.34%, down from

[4] Growth rates referenced throughout these notes are applied to the current portion of the tax base.

9.7710% in FY 2013. The City portion of the tax is 0.6018% (down from 4.4620% in FY 2013) and the School District portion is 0.7382% (down from 5.3090% in FY 2013). The adopted City tax rate of 0.6018% is lower than the City rate in the Mayor's proposed budget which results in FY14 Property Tax receipts being revised downward by $14.3 million and FY15-FY18 estimates being revised downward based on the approved tax rate. The Plan submitted to PICA also includes $14.8 million of additional revenues from increased current and delinquent property tax collections in each year from FY14-FY18. The Adopted FY14 Budget includes a homestead exemption of $30,000 for all eligible property owners and other relief measures equal to an additional $20 million. The property tax estimate takes into account these relief measures.

The estimate of $536.6 million of property tax revenue for FY 2014 ($2.8 billion for the five years) may not be fully realized, as historical data is insufficient to accurately estimate the extent of tax appeals that may occur because of the City's newly implemented AVI, and as a result of more aggressive tax collection efforts implemented by the City with respect to current and prior year property tax receivables. Accordingly, estimated amounts of property taxes associated with potential appeals ($14.9 million for FY14 and $55.5 million in total) and the collection of additional current and prior year tax receivables ($14.8 million for FY14 and $74.0 million in total) are considered particularly sensitive assumptions.

c. Business Income and Receipts Tax

The Business Income and Receipts Tax (BIRT, formerly the Business Privilege Tax) is estimated to produce $410.0 million in FY14, 15% of total tax revenue. The majority of the BIRT is derived from corporate profits which are volatile and dependent on economic conditions within the City. BIRT receipts are coming in significantly above estimates in FY13 which follows trends seen nationwide. While the FY13 estimates for BIRT were revised upward by $18 million in the August 15, 2013 Quarterly Financial Manager's Report, FY14-FY18 BIRT estimates have not been changed given the volatility in corporate profits.

In FY12, BIRT tax reform legislation was signed by the Mayor which incorporated several changes intended to help small and medium size businesses grow in Philadelphia. Under Bill 110548, business taxes for the first two years of operations for all new businesses that employ at least three employees in their first year and six in the second would be eliminated beginning in FY13. This legislation also provides for across the board exclusions on the gross receipts portion for all businesses scaled in over a three year period beginning in FY15 and reductions in the net income portion of the BIRT. When the exclusions are fully phased in, the first $100,000 of receipts will be excluded. Lastly, the bill calls for implementation of single sales factor apportionment. This enables businesses to pay BIRT solely on sales, not on property or payroll. By taxing property and payroll, the BIRT previously had provided disincentives to firms to locate in the City.

d. Sales Tax

Sales Tax revenues are estimated to generate $270.8 million in FY14, 10% of tax revenues. As part of its response to estimated budget deficits in 2009, the Commonwealth of Pennsylvania (the Commonwealth) provided authorization and the City passed legislation to temporarily increase the Sales Tax rate from 1% to 2%. This raised the total Sales Tax rate to 8%, with 6% going to the Commonwealth and 2% to the City. The FYP includes the additional 1% for the City's General Fund sunsetting on June 30, 2014 as is legally required. The Commonwealth has enacted legislation that would enable the City to extend the expiring 1% sales tax and use the proceeds of the tax to provide funds for the School District, pay debt service on a borrowing for the School District and provide funding for the City's pension fund. A portion of the additional sales tax would flow into the General Fund beginning in FY15 for debt service on the School District borrowing and for the pension fund. The revenues as well as related expenditures have been included in the revised Plan. This assumption has no net impact on the Plan's fund balances. The $120 million of sales tax funds that go to the School District flow directly from the Commonwealth to the School District and are therefore are not included in the revised Plan.

e. Real Estate Transfer Tax

While economic conditions negatively affected the Real Estate Transfer Tax (RTT) since the housing market decline began in 2007, the City is now seeing significant growth in this tax. The RTT is estimated to provide $157.6 million in FY14; a growth rate of 7.4% over FY13 anticipated collections. A growth rate of 10.0% is estimated for FY15 and lower growth rates of 8.0%, 5.0% and 3.0% are estimated for FY16, FY17 and FY18, respectively. Even with the estimated strong growth for transfer tax revenues, the $202 million the Plan includes for FY18 is more than $30 million below the $234 million in transfer tax revenues collected in FY06. The City imposes a 3% tax on real property sales and an additional 1% is charged by the Commonwealth for a 4% total RTT.

f. Parking Tax

The Parking Tax is levied on the gross receipts from all parking transactions. Parking Tax revenue is estimated to generate $75 million in FY14.

Major Taxes ($ in Millions) with Percentage Change from Previous Year

Tax	FY12 Actual	FY13 Estimate	FY14 Estimate	FY15 Estimate	FY16 Estimate	FY17 Estimate	FY18 Estimate
Wage & Net Profits - Current & Prior	1,211.4	1,244.2	1,286.9	1,326.1	1,347.8	1,364.5	1,377.1
% change from prior year	n.a.	2.70%	3.43%	3.05%	1.64%	1.24%	0.93%
Real Property - Current & Prior	500.7	540.1	536.6	547.0	559.4	572.1	585.0
% change from prior year	n.a.	7.87%	-0.66%	1.94%	2.26%	2.27%	2.25%
Bus. Inc. & Receipts - Current & Prior	389.4	453.0	410.0	403.1	392.1	400.8	411.6
% change from prior year	n.a.	16.33%	-9.48%	-1.67%	-2.74%	2.22%	2.71%
Sales	253.5	257.6	270.8	165.0	179.8	190.2	199.4
% change from prior year	n.a.	1.59%	5.13%	-39.06%	8.93%	5.79%	4.84%
Real Property Transfer	119.4	146.8	157.6	173.4	187.3	196.6	202.5
% change from prior year	n.a.	22.99%	7.38%	10.00%	8.00%	5.00%	3.00%
Parking	70.9	73.2	75.0	76.9	78.8	80.8	82.8
% change from prior year	n.a.	3.15%	2.50%	2.50%	2.50%	2.50%	2.50%
Other Taxes	25.1	22.0	23.9	24.3	24.8	25.3	25.7
% change from prior year	n.a.	-12.38%	8.79%	1.84%	1.84%	1.84%	1.85%
Total Taxes	2,570.4	2,736.8	2,760.8	2,715.9	2,769.9	2,830.2	2,884.1
% Change from prior year	n.a.	6.47%	0.88%	-1.63%	1.99%	2.18%	1.91%

Notes:

- Wage & Net Profits Taxes include rate reductions that take effect in FY14 and each year through FY18. Wage Tax does not include the PICA Tax.

- Business Income and Receipts Tax incorporate rate reductions and changes in recently passed legislation that began in FY13.

- Sales Tax has been adjusted to reflect the recent legislation extending the 1% with proceeds being used to provide funds for the School District, pay debt service on a borrowing for the School District and provide funding for the City's pension fund. A portion of the additional sales tax would flow into the General Fund beginning in FY15 for debt service on the School District borrowing and for the pension fund. This assumption has no net impact on the Plan's fund balances. The $120 million of sales tax funds that go to the School District flow directly from the Commonwealth to the School District and are therefore are not included in the revised Plan.

- Other Taxes include the Amusement Tax and miscellaneous taxes.

4. Locally Generated Non-Tax Revenues

Locally Generated Non-Tax revenues are estimated based on historical trends, rate changes, and current collection patterns. Certain revenues such as interest earnings, licenses and permits and recording fees are subject to economic contractions and are estimated accordingly.

5. Revenue from Other Governments

Revenue from Other Governments is estimated based on historical trends and state and federal budget information. The PICA city account, which represents 52% of Revenue from Other Governments, is estimated using Wage Tax variables.

6. Obligation Estimates

OBPE provided obligation estimates to the Director of Finance and the Mayor for discussion and inclusion in the revised annual FY2014 budget and FY2014-2018 Five-Year Financial Plan (FYP) submitted by the Mayor to the Pennsylvania Intergovernmental Cooperation Authority (PICA) on September 10, 2013. OBPE provides forecasts of all major expenditure categories. In the FY14 budget, total expenses increase $257 million from FY13 estimated expenditures. The budget increase includes $118 million for pension, debt service and employee benefit costs and $105 million which is for labor including $20 million for the Philadelphia Police Department award and $85 million of appropriations for potential labor obligations. The remaining $34 million represents a small (0.9%) increase over FY 13 estimated obligations.

FY 14 Expenditure Increases:

The largest single investment in the FY14 Adopted Budget is the appropriations for potential labor obligations. The $84.7 million of appropriations included as a line item in the Civil Service Commission's budget includes the following:

- $37.2 million to fund potential costs for future contracts with the International Association of Fire Fighters (IAFF), District Council (DC) 33 and DC 47; and
- $47.5 million for salary costs related to the IAFF 2012 arbitration award that is no longer under appeal. (see section on Labor Agreements).

The Adopted Budget also includes investments in the following:

- $4.7 million for the Fire Department to fund new Self Contained Breathing Apparatus equipment ($4.0 million) as well as air bottles and 35 new Jaws of Life.

- $1.7 million for the Office of Property Assessment to fully fund and maintain the department's complete overhaul of the City's property assessment function.

- $1.0 million for the Office of Supportive Housing's budget and $350,000 for Public Health's budget to fund larger than anticipated federal sequestration cuts.

- $1.1 million increase for the Managing Director's Office – Legal Services to fund two items: a $500,000 increase for Community Legal Services to partially offset cuts from other levels of government, and $590,000 for the Defender's Association to fund increased benefit and insurance costs.

- $1.2 million for the Revenue Department to improve tax collections.

- $1.0 million for the Free Library largely to expand hours at branches throughout the City.

- $1.0 million for Community College of Philadelphia to help offset tuition increases.

- $2.5 million for the Office of Innovation and Technology to fund several items including increased maintenance and departmental application costs, new positions necessary to implement court mandates related to public safety, and to fund positions previously funded through grants.

- $781,000 for Licenses and Inspections to hire additional code enforcement inspectors and building inspectors.

- $622,000 for Public Property to increase funding for the maintenance team to prevent deferring maintenance on city-owned facilities. This funding, in addition to the $734,000 added in FY13, brings the department's funding for this purpose up to industry standards.

- $624,000 to continue funding of the Keyspots program which was previously funded through American Recovery and Reinvestment Act and provides computer access to address the digital divide in underserved neighborhoods throughout the City.

- $570,000 for the Sheriff's Office to fund personnel costs related to 10 additional deputies and to fund the purchase of new bulletproof vests for all 210 deputy sheriffs.

- $500,000 for the Office of Housing and Community Development to expand a program for the rehabilitation of child care facilities.

- $447,000 to the District Attorney's Office largely for the costs related to the Fraternal Order of Police (FOP) arbitration award salary re-opener for uniform staff.

a. Labor Agreements

The City's labor agreements with its four major unions – FOP Lodge No. 5, IAFF Local 22, DC 33 and DC 47 – expired on June 30, 2009. An interest arbitration award to the FOP for police was made in FY10 and a Re-opener Award was issued in FY13. Contracts with DC 33 and DC 47 remain outstanding. The City issued a final offer to DC 33 in January 2013, which DC33 rejected. The Administration has asked the Courts for permission to impose the terms of this offer, citing the impasse between the two sides. Except for its pension provisions, the interest arbitration award granted to the IAFF on October 12, 2010 was appealed by the City. The Court of Common Pleas vacated the 2010 Award on November 16, 2010. On July 2, 2012, a new interest arbitration award was issued and the City appealed the award. The City decided to withdraw the appeal, leading to the Commonwealth Court closing the case on September 9th. The City decided to withdraw the appeal because the City now has the funds to cover the costs of the award due to the ongoing economic recovery.

<u>American Federation of State, County and Municipal Employees (AFSCME) DC 33, Local 159</u>

On March 16, 2012, a six year interest arbitration award with AFSCME DC 33, Local 159 was issued to cover FY 2009 through FY 2014. Local 159 includes approximately 2,000 employees who work as Correctional Officers, Youth Detention Counselors and Security Guards throughout facilities in the City's Prison System as well as in the Department of Human Services and the Police Administration Building. Important financial components of the award that affect FY 2013 through FY 2018 include:

- Two and one-half percent wage increases for covered employees on July 1, 2012 (FY 2013) and July 1, 2013 (FY 2014). Any wage increases negotiated with the larger DC 33 bargaining unit for FY 2010 through FY 2013 will automatically apply to Local 159.

- Prospective restoration of step and longevity increments that were frozen by the City in July 2009. Restoration was effective with the issuance of this award.
- No specific changes to the Health Plan. Any future changes agreed to with DC 33 will automatically apply to employees covered by the award.
- Any employee hired or rehired to a position covered under the award must participate in the new hybrid Pension Municipal Plan 10. Current employees may elect to make an irrevocable move to Plan 10.
- Effective July 1, 2013, current employees who are not participating in Plan 10 increase their contributions to the pension fund to no less than 50% of the normal cost of the plan in which they participate, without any offset.
- Effective, July 1, 2012 the uniform maintenance allowance for employees covered by the award is increased to $250 per year (previously paid at $175 per year).
- Only vacation leave (excluding holiday pay, sick time or annual leave days) will be considered hours worked for purposes of determining when overtime is due.

The FYP includes estimates for all of the above costs as well as savings related to FY 14 through FY 18.

AFSCME DC 47, Local 810 Courts

On July 12, 2012, a five year interest arbitration award with AFSCME DC 47, Local 810 Courts was issued to cover FY 2010 through FY 2014. The Local 810 Courts bargaining unit titles include Probation Officers, Hearing Officers and Court Representatives. Important financial components of the award that affect FY 2014 through FY 2018 include:

- Two and one-half percent wage increases for covered employees on July 1, 2012 (FY 2013) and July 1, 2013 (FY 2014). Any wage increases negotiated with the larger DC 47 bargaining unit for FY 2010 through FY 2012 will automatically apply to Local 810.
- No specific changes to the Health Plan. Any future changes agreed to with the larger DC 47 will automatically apply to employees covered by the award.
- Any employee hired to a position covered under the award must participate in the new hybrid Pension Municipal Plan 10. Current employees may elect to make an irrevocable move to Plan 10.

- The award contains a reclassification of Probation Officer 2 from EP Range 21 to EP Range 22 effective July 1, 2012. The City dissented from this portion of the award, which it thinks went beyond the arbitration panel's authority. As a result, increased costs pertaining to this salary adjustment are not reflected in the FYP. The Courts have chosen not to implement this provision out of their allocated funds. The union has filed an unfair labor practice charge challenging the City's decision not to provide the Courts additional funds for this portion of the award.

The FYP includes estimates for the above costs except as noted as well as savings related to FY 2014 through FY 2018.

I.A.F.F.

On July 2, 2012, a four year interest arbitration award with the IAFF was issued to cover FY 2010 through FY 2013. This award would have cost more than $200 million over the Five Year Plan at the time resulting in negative fund balances. As a result, the City appealed the award on the basis of the lack of the ability to pay. On August 8th 2013, the Court of Common Pleas ordered the City to pay certain costs related to the IAFF 22 2012 award while the appeal of that award was pending. Specifically, the court ordered the City's health care contribution increased from $1,270 per employee per month (pepm) to $1,620 pepm. That increase is estimated to cost $11.5 million per year. This cost is included in each year of the revised Plan. The court also ordered the City to make a one-time $6.2 million payment to the health fund and a one-time $7.5 million payment to the retiree trust fund. These costs are included in the FY14 obligations in the revised Plan.

Because of ongoing economic recovery, the City is now able to cover the cost of the award so has withdrawn its appeal, leading Commonwealth Court to close the case on September 9th. The full costs of the 2012 award are included in the Plan, including a one-time $24.8 million retroactive payment to the health care fund and a $247,000 retroactive payment to the legal services fund.

The portion of the award that was never appealed and has already been implemented is the change to the IAFF members' pension plan. Similar to the pension changes made in the arbitration award with the FOP, new IAFF members as of October 15, 2010, must choose between increasing their pension contribution from 5% to 6% of pay or enrolling in a new hybrid pension plan.

Because the contract for which the City withdrew its appeal expired on June 30, 2013, negotiations are underway for a new contract to begin on July 1, 2013. A new interest arbitration panel has been established and hearing dates began in August 2013 and extend into the fall 2013.

F.O.P. Lodge 5

On December 18, 2009, a five year interest arbitration award with the Fraternal Order of Police (FOP), Lodge No. 5 for employees of the Police Department was issued to cover FY10 through FY14. Important financial components of the award that affect FY13 through FY18 include:

- The award contained a re-opener for FY13 and FY14 for the determination by the arbitration panel as to what salary changes, if any, would be awarded for those two years. On December 20, 2012 (FY 13), the re-opener award was issued and contains a 3% wage increase on July 1, 2012, a 3 % wage increase effective July 1, 2013 and a 1% increase to stress differential pay effective July 1, 2013.
- In FY11, the FOP's health plan moved to self-insurance. Instead of paying a carrier for insurance, the FOP began paying the actual cost of services provided to members. This health insurance change followed a similar change made by the City in FY10 to the plan it administers for non-union employees.
- Pension changes for new hires – FOP members will now choose between increasing their pension contribution from 5% to 6% of pay and enrolling in a new hybrid pension plan. The hybrid pension plan reduces the risk to the City of poor market returns and is unprecedented for uniformed employees in any major city in the country. Meanwhile, increased employee pension contributions provide General Fund savings for the City.
- Up to 30 furloughs (days off without pay) in a fiscal year.

F.O.P. – Deputy Sheriffs and Register of Wills

On June 21, 2011, a five year interest arbitration award with the FOP, Lodge No. 5 concerning Deputy Sheriffs and Register of Wills employees was issued to cover FY10 through FY14. Important financial components of the award that affect FY14 through FY18 include:

- A 2.5% increase for Deputy Sheriffs in FY 11 and FY 12. The award will be reopened for FY13 and FY14 for a determination by the arbitration panel as to what salary changes, if any, will be awarded for those two years. Hearings have been held on the re-opener and an award is expected in the fall 2013.
- Register of Wills employee wage increases will be based on what is negotiated between DC 33 and the City.
- Restoration of step and longevity increments that were frozen by the City in July 2009. Increments were restored retroactively to July 1, 2009 for employees of the Sheriff's Office and restored as of the date of the award for Register of Wills' employees.
- The FOP's health plan, which includes Deputy Sheriffs, moved to self-insurance in FY11. This award continues that arrangement. It also reduced the City's monthly contribution from $1,165 per member to $965 per member for the period January 1, 2010 through June 30, 2010. The City received credit for contributions already made. Register of Wills employees will continue to participate in the City Administered plan.
- Pension changes for new hires. Deputy Sheriffs have to choose between going into the existing municipal Plan 87 and increasing their contribution from 30% of normal cost to 50% of normal cost, or going into the new hybrid plan. Register of Wills employees hired after the date of the award must enter the hybrid plan.

AFSCME DC 33

After having spent nearly four years in negotiations, the City has been unable to reach an agreement with DC 33.

On January 16, 2013, the City made a final offer to DC 33 for a contract to run July 1, 2009 through June 30, 2014. The City's offer includes wage increases of 2.5% following ratification and an additional 2% in January 2014 and restoration of step and longevity increments prospectively following ratification, along with $25 million in additional payments to the union managed health fund. Under the City's proposal, the City's per employee per month contribution to the union's health fund will remain at $975.76 for the term of the contract with the health fund using the lump sum payments to offset any cost increases it has experienced. The City also proposed two pension changes: (1) to require all new employees to enter Plan 10; and (2) increased pension contributions from current employees as was ordered for corrections officers represented by DC 33. Additionally, the City proposed changes in overtime rules based on the changes made in FY 2013 for non-represented employees and those represented by Local 2186 of DC 47 and the right to furlough employees when economic circumstances warrant, similar to the FOP award. The City estimates the Five-Year Plan cost of its final offer at more than $36 million. When DC 33 rejected this offer, the Mayor gave DC 33 two weeks to reconsider its refusal, but subsequent discussions were unproductive.

On February 1, 2013, the City filed an action in the Court of Common Pleas of Philadelphia County, asking the court for a declaration that the City has the right to implement its final offer for the currently-expired contract. The case continues in the Court of Common Pleas with the parties expected to file cross motions for summary judgment in fall 2013. During the period of litigation, the City is maintaining the status quo on the issues that separate the parties. The FY14-FY18 FYP includes the cost to implement the final offer to DC 33.

The forecasted statements do not include any additional potential changes above the estimated $36 million final offer referred to above because management expects to prevail in the City's filed action in the Court of Common Pleas. Accordingly, this assumption is considered particularly sensitive.

AFSCME DC 47

Negotiations continue with DC 47. The City's most recent offer to DC 47 is similar, but not identical to, the City's final offer to DC 33. The City seeks changes in overtime rules and other changes as part of an overall contract package that the City can afford.

The City also seeks to incorporate the new hybrid pension plan put in place by the award covering the employees of the Sheriff's Office, Register of Wills, Correctional Officers and Local 810 Courts and seeks increased pension contributions from employees.

The City has proposed multiple wage increases, prospective restoration of step and longevity increments that were frozen in 2009 and more than $20 million in lump sum payments to the union-controlled health fund.

The FYP includes a reserve of $21 million for DC 47 for future labor obligations.

In September 2012, the City announced that it was implementing a package of changes for exempt and non-represented employees that are similar to those being proposed to DC 33 and DC 47 effective October 2, 2013. The City applied these changes to DC 47 Local 2186 as well, providing a 2.5% wage increase in October 2012 and restoring step and longevity increments, along with implementing changes to the overtime rules and enacting regulations that permit the City to impose furloughs when economic circumstances warrant. The forecasted statements do not include any additional potential changes above the estimated $21 million recent offer referred to above because negotiations continue. Accordingly, this assumption is considered particularly sensitive.

b. Health / Medical

The Administration implemented a self-insured group health plan in 2010 for medical benefits for non-union employees. In FY 2011, coverage for members of the FOP, Lodge No. 5 also switched to self-insurance. For non-union employees, FY 2012 actual expenditures were used to determine cost estimates in the FYP. No increases were built in for the life of the plan as the City can change the design of the health plan (increase co-pays and employee contributions for example) to keep costs level. For the FOP, FY 2012 actual expenditures were used to estimate the annual cost. However, because the City has no control over the design of the FOP health plan, an increase of 10% per year based on medical cost trends has been included.

Cost estimates for DC 33 and DC 47 are based on FY 2012 actual expenditures under the provisions of the expired contracts ($975.76 per employee per month) to estimate the annual cost. Because there are no new contracts for these groups and therefore no change in the per member, per month City contribution, it is assumed costs for FY 2014 – 2018 will approximate the FY12 average expenditure. The Plan does, however, include the lump sum payments described above to the DC33 and DC47 health plans.

The cost estimate for the IAFF is based on an average of six months of actual expenditures under the provisions of the expired contract ($1,620 per employee, per month) with no increase assumed for the life of the plan.

The cost of that increased contribution is estimated at $11.5 million per year. This cost is included in each year of the revised Plan. The court also ordered the City to make a one-time $6.2 million payment to the health fund and a one-time $7.5 million payment to the retiree trust fund. These costs are included in FY14 obligations in the revised Plan.

Because the City withdrew the appeal as discussed above, all of the costs of the 2012 award are included in the Plan, including a one-time $24.8 million retroactive payment to the health care fund and a $247,000 retroactive payment to the legal services fund.

The revised Plan includes costs anticipated due to the passage of the federal Patient Protection and Affordable Care Act (ACA). These costs related to new fees are expected to total $1.8 million over the life of the Plan.

c. Pensions

As part of the effort to control major cost drivers and to improve the health of the pension fund, several changes have been made over the past few years and the Administration continues to seek additional changes.

The City's Act 111 interest arbitration award with the FOP, Lodge No. 5 issued on December 18, 2009 requires all FOP employees hired on or after January 1, 2010 to make a one-time irrevocable election between:

1) Participating in the City's current defined benefit pension plan and increasing their contribution by 20%, from 5% of pay to 6% of pay; or

2) Participating in a hybrid plan, containing both a defined benefit and a voluntary defined contribution component.

Similar pension changes were awarded in the October 12, 2010 interest arbitration award with IAFF, Local 22. The award's pension provisions were not part of the 2010 Award appeal and, therefore, have been implemented. New IAFF members hired as of October 15, 2010, must make the same one-time irrevocable election between increasing their pension contribution from 5% to 6% of pay and enrolling in a new hybrid pension plan.

The new Plan 10 hybrid plan for Uniform employees includes the following elements:

1) Employee Contribution: A 5.5 % employee contribution for the first 20 years of service, and no employee contribution thereafter.
2) Normal Retirement Benefit: A defined benefit equal to 1.75% multiplied by the average final compensation for the employee, multiplied by up to a maximum of 20 years of service.
3) Average Final Compensation: The average of the employee's 5 highest annual compensations calculated for either five calendar years or 5 anniversary years.
4) After 20 years of credited service, employees will no longer earned credited service, will no longer make contributions to the pension fund and their average final compensation shall not increase.
5) Voluntary Defined Contribution Plan: Employees may make voluntary contributions to their accounts under the City's 457 Plan. For each fiscal year, the City will make a contribution to a defined contribution plan individual account of 50 cents on the dollar for each dollar contributed by the employee to their 457(b) plan account, up to a maximum City contribution of 1.5% of compensation.

Municipal Plan 10 for Civilians is a hybrid plan with a mandatory defined benefit and a voluntary defined contribution component. This plan is mandatory for new hires in the DC 33 Local 159 and the DC 47 Local 810 Courts arbitration awards, pending City Council approval. Newly-hired unionized employees of the Sheriff's office have the option of entering Plan 10 or raising their employee contribution from 30% of normal cost to 50% of normal cost, without offset, while newly-hired unionized employees of the Register of Wills are required to enter Plan 10, . Key elements of Plan 10 include:

1) Years of Credited Service: Only the first 20 years will be calculated.
2) Average Final Compensation: City will take the 5-year period in which the employee's compensation is greatest.
3) Multiplier: 1.25% x Years of Credited Service up to 20 x Average Final Compensation.
4) Employees will contribute 50% of normal cost of the Plan toward the defined benefit.
5) Voluntary Defined Contribution Plan: the City will contribute \$1 for every \$2 the employee contributes up to 3% of the employee's compensation contributed to the Defined

Contribution Plan. The City will contribute no more than 1.5% of eligible compensation.

Pending City Council approval, Plan 10 will be mandatory for all newly-hired exempt, non-represented and DC 47 Local 2186 employees. In addition, the Local 159 interest arbitration award raised the contribution for existing employees who are not in Plan 10 to a minimum of 50% of normal cost without any offset. This change awaits City Council approval, along with a similar change for exempt, non-represented and DC 47 Local 2186 employees.

Increasing employee pension contributions and introducing a hybrid pension plan are expected to reduce the costs to the City in the short and long term and help minimize the risk that the City faces from potential dramatic decreases in the stock market, like the ones suffered in FY09. Similar pension benefit changes are being sought as part of the City's ongoing union negotiations.

In addition to the changes in pension benefits over the past few years as outlined above, the City's pension fund has undergone the following changes:

- Re-amortized the pension fund's unfunded actuarial accrued liability over a 30-year period using level-dollar amortization payments.
- Deferred payment of a portion of its Minimum Municipal Obligation (MMO) to be repaid by end of the fiscal year ending June 30, 2014 with 8.25% interest, which was the fund's earnings assumption rate when the state law enabling the deferrals was enacted. The City deferred about 20% of its pension costs, $150 million and $80 million for the fiscal years ending June 30, 2010, and June 30, 2011, respectively to be paid (including interest due annually as accrued on the outstanding deferral) over the period ending in FY 2014; $106 million was budgeted to be paid back in FY 2013 with the balance of $124 million in FY 2014. The City has applied the proceeds of certain bonds issued in October 2012, together with other available amounts, to repay the Municipal Pension Fund the entire outstanding $230.0 million of the deferred minimum municipal obligation payment and $5.6 million of interest due on such deferred contributions. The change in amortization period and the partial deferral were approved by the Pennsylvania General Assembly as part of Act 44.
- Eliminated the eligibility of newly elected City officials to participate in Philadelphia's DROP.
- Reduced the pension fund's earnings assumption from 8.75% to 7.95%. Lower earnings assumptions allow funds to moderate the risk of their investments, which can also reduce the

likelihood of losses.

- Increased the smoothing period for actuarial losses and gain from five to ten years. Increasing the smoothing period reduces the impact that any particular year will have on the fund's funded status and on the City's required payments. This, in turn, reduces the volatility of pension payments.

The net impact of all of these changes to the City's pension benefits and fund is to moderate what would have been devastating increases in pension costs and to increase the City's ability to fund existing liabilities in the long term. The specific changes to the pension fund assumptions have been tested by the City's actuary and have been determined to be actuarially sound. The pension amounts included in the FYP are provided by the City's actuary and are based on the amounts required to be paid under state law.