FORECASTED GENERAL FUND STATEMENTS OF OPERATION

CITY OF PHILADELPHIA

ACCOUNTANT'S REPORT

FISCAL YEARS 2012 – 2016

CONTENTS

CITY OF PHILADELPHIA

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ALAN BUTKOVITZ
City Controller

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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, 2012 through June 30, 2016 (the forecasted statements). The City of Philadelphia's management is responsible for the forecasted statements, which were prepared for the purpose of complying with the provisions of the Pennsylvania Intergovermental Cooperation Authority (PICA) Act. Our responsibility is to express an opinion on the 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 forecasted statements. We believe that our examination provides a reasonable basis for our opinion.

In our opinion, the accompanying forecasted statements are presented in conformity with guidelines for presentation of forecasted information established by the American Institute of Certified Public Accountants, and the underlying assumptions provide a reasonable basis for management's forecasted statements. However, there will usually be differences between the forecasted and actual results because events and circumstances frequently do not occur as expected, and those differences may be material. We have no responsibility to update this report for events and circumstances occurring after the date of this report.

The forecasted statements referred to in the preceding paragraph include assumptions that are particularly sensitive relating to wage and benefit cost savings and self-insurance costs. The assumptions relating to wage and benefit savings totaling $59.5 million ($11.9 million per year) are considered particularly sensitive because they are dependent on successful labor negotiations and are described in Note B.6 (a). The assumptions relating to self – insurance costs totaling $202.5 million ($40.5 million per year) are based on previous premium based costs due to the uncertainty in the timing and outcome of the appeal of the IAFF arbitration award as described in Note B.6 (b) and, accordingly, are considered particularly sensitive.

The accompanying forecasted statements and our report are intended solely for the information and use of the management of the City of Philadelphia and PICA and are not intended to be used and should not be used by anyone other than these specified parties.

July 20, 2011

Gerald V. Micciulla
GERALD V. MICCIULLA, CPA
Deputy City Controller

City of Philadelphia - Office of the Director of Finance

Forecasted General Fund Statements of Operations

Fiscal Years Ending June 30, 2012 through June 30, 2016

(Amounts in Thousands)

NO.	ITEM	FY 2012 Estimate	FY 2013 Estimate	FY 2014 Estimate	FY 2015 Estimate	FY 2016 Estimate
(1)	(2)	(3)	(4)	(5)	(6)	(7)
	OPERATIONS OF FISCAL YEAR					
	REVENUES					
1	Taxes	2,539,452	2,614,063	2,670,726	2,578,109	2,627,820
2	Locally Generated Non-Tax Revenues	259,959	265,951	273,252	275,383	275,981
3	Revenue from Other Governments	651,800	667,137	620,838	633,140	645,453
4	Sub-Total (1)+(2)+(3)	**3,451,211**	**3,547,151**	**3,564,816**	**3,486,632**	**3,549,254**
5	Revenue from Other Funds of City	51,510	50,773	51,244	43,453	43,745
6	Total - Revenue (4)+(5)	**3,502,721**	**3,597,924**	**3,616,060**	**3,530,085**	**3,592,999**
7	Other	0	0	0	0	0
8	**Total Revenue and Other Sources (6)+(7)**	**3,502,721**	**3,597,924**	**3,616,060**	**3,530,085**	**3,592,999**
	OBLIGATIONS/APPROPRIATIONS					
9	Personal Serviees	1,330,088	1,331,929	1,332,627	1,333,117	1,333,482
10	Personal Services-Pensions	554,325	661,009	657,416	588,930	595,786
11	Personal Services-Other Employee Benefits	468,378	487,158	503,433	518,691	534,365
12	**Sub-Total Employee Compensation**	**2,352,791**	**2,480,096**	**2,493,476**	**2,440,738**	**2,463,633**
13	Purchase of Services	758,994	768,395	772,573	768,054	768,902
14	Materials, Supplies and Equipment	78,960	76,164	77,594	77,594	77,594
15	Contributions, Indemnities, and Taxes	117,544	117,104	117,165	117,726	117,288
16	Debt Service	130,739	134,682	149,835	149,708	152,465
17	Capital Budget Finaneing	0	0	0	0	0
18	Advances and Miscellaneous Payments	4,000	4,000	4,000	4,000	4,000
19	Sub-Total (12 thru 18)	3,443,028	3,580,441	3,614,643	3,557,820	3,583,882
20	Payments to Other Funds	27,066	31,138	32,219	33,291	33,291
21	**Total - Obligations (19+20)**	**3,470,094**	**3,611,579**	**3,646,862**	**3,591,111**	**3,617,173**
22	Oper.Surplus (Deficit) for Fiscal Year (8-21)	32,627	(13,655)	(30,802)	(61,026)	(24,174)
23	**Prior Year Adjustments:**					
24	Revenue Adjustments	0	0	0	0	0
25	Other Adjustments	24,500	24,500	24,500	24,500	24,500
27	Total Prior Year Adjustments	24,500	24,500	24,500	24,500	24,500
28	**Adjusted Oper. Surplus/ (Deficit) (22+27)**	**57,127**	**10,845**	**(6,302)**	**(36,526)**	**326**
	OPERATIONS IN RESPECT TO PRIOR FISCAL YEARS					
	Fund Balance Available for Appropriation					
29	June 30 of Prior Fiscal Year	3,454	60,581	71,426	65,124	28,598
30	Residual Equity Transfer	0	0	0	0	0
31	Fund Balance Available for Appropriation June 30 (28)+(29)+(30)	**60,581**	**71,426**	**65,124**	**28,598**	**28,924**

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

A. **Nature of the Forecast**

The City of Philadelphia 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 FY2012 budget and the FY2012-2016 Five Year Financial Plan (FYP) submitted by the Mayor to the Pennsylvania Intergovernmental Cooperation Authority (PICA) on July 7, 2011. 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 July 7, 2011, 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 may be differences between the forecasted and actual results because events and circumstances frequently do not occur as forecasted or expected.

B. Summary of Significant Accounting Policies

The Forecasted General Fund Statement of Operations is 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 FY12 total \$3.503 billion. Approximately 72% of the city's budget comes from local taxes, and 19% 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 \$2.5 billion in the adopted FY12 budget, as well as \$260.0 million of Locally Generated Non-Tax revenues, and \$651.8 million in Revenue from Other Governments. These three sources comprise 98% of the revenues anticipated for the FY12 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 projections 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 project tax revenues for the City. IHS focused on four taxes – Wage and Earnings Tax, Business Privilege Tax, Real Estate Transfer Tax, and Sales Tax. These projections were refined by OBPE after discussions with leading economists at the Federal Reserve Bank of Philadelphia.

2. The National and Local Economic Context

Although its effects did not begin to be felt by the City until the summer of 2008, according to the National Bureau of Economic Research, the recession officially took place between December 2007 and June 2009. Governments and businesses across the globe have had to grapple with a world economy beset by a profound financial crisis, large declines in residential housing markets, a global contraction in economic activity, and a weak job market characterized by high unemployment. While the recession may be officially over, the recovery has been slow and particularly slow for employment and real estate.

Growth in the United States' output since the middle of 2009 has been very weak compared to previous economic recoveries. This type of weak growth tends to occur following recessions brought on by financial crises like the one just experienced.[1] U.S. gross domestic product (GDP) increased 2.9% in 2010 after a decline of 2.6% in 2009. Consensus forecasts of economic growth have tempered somewhat over the last few months and U.S. GDP growth is projected to be 2.6% in 2011. The housing sector remains troubled -- the consensus estimate of projected housing starts continues to decline and is now estimated to be only slightly higher in 2011 than 2010.[2]

National unemployment remains high and is not expected to decline significantly over the next year. According to the Blue Chip consensus, unemployment is expected to be 8.8% in 2011, declining to a still high 8.2% in 2012. All of this taken together signifies that while continued modest growth is expected, the recovery will be slow and economists do not expect a return to pre-recession levels in the near future.

Philadelphia has been substantially impacted by the economic crises described above. The number of people employed dropped from 592,000 in April 2009 to a low of 575,100 in July 2010, rebounding slightly to 579,800 in May 2011, a decline of 2.1% since 2009. Unemployment has had a sizable

[1] Congressional Budget Office "The Budget and Economic Outlook: An Update" August 2010
[2] Blue Chip Economic Indicators June 10, 2011

increase, from 6.0% in August 2007 to a high of 11.2% in November 2010 and has improved somewhat to 10.1% in May 2011. [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 72% of the expected General Fund revenue in FY12). These include:

1. Wage and Earnings and Net Profit Tax (Wage),
2. Property Tax,
3. Business Privilege Tax (BPT),
4. Real Estate Transfer Tax (RTT),
5. Sales Tax, and
6. Parking Tax.

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 BPT (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. Currently, the Wage Tax rate is 3.9280% for residents and 3.4985% 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 projected to bring in $1.206 billion in FY12. This projection includes a 3.4% growth rate in the Wage and Earnings Tax and a 2.5% expected growth rate in the Net Profits Tax. [4] In FY14, assuming that the city's fund balances remains consistent

[3] Pennsylvania Department of Labor and Industry, Monthly Seasonally Adjusted Unemployment Rates
[4] Growth rates referenced throughout these notes are applied to the current portion of the tax base.

with or higher than those in the FYP, the city plans to resume previously planned wage tax reductions that were suspended in FY10.

b. Property Tax

The Real Property Tax (Property) is the city's second largest source of tax revenue (19%), estimated to contribute $486.7 million of the FY12 tax revenues. This tax is levied on the assessed value of residential and commercial property in the city. The two year 9.9% property tax increase is in effect through the end of FY12. FY12 projected revenues are slightly lower than FY11 revenues due to the expectation of some appeals and because of a lack of reassessments as the city prepares for the Actual Value Initiative (AVI) to take place. In the fall of 2012, the AVI is scheduled to be completed which will result in a substantial increase in assessed value. At this point, the tax rate will need to be substantially lowered for FY13 or significant excess revenues beyond those shown in the FYP would be generated. It is the Administration's plan to reduce the tax rate when AVI is complete to generate at least the amount of revenues needed to meet the property tax revenue projections in the FYP. Included in the FY12 – FY16 projected revenues are the return of abated properties to the tax roll. In addition, although AVI will adjust real property assessments to approximate current market value, we believe real estate tax growth will remain relatively modest over the life of the plan because of the slow recovery of the real estate market to the pre-recessionary level.

c. Business Privilege Tax (BPT)

The Business Privilege Tax (BPT) is projected to produce $369.3 million in FY12, 15% of total tax revenue. The majority of the BPT is derived from corporate profits which had a strong year in calendar year 2010 but are volatile and dependent on economic conditions within the city.

d. Sales Tax

Sales Tax revenues are projected to generate $256.5 million in FY12, 10% of tax revenues. As part of its response to projected budget deficits in 2009, the city passed new legislation which was approved by the Commonwealth of Pennsylvania (the Commonwealth) 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 increased rate is scheduled to be in effect through FY14 and return to 7% in FY15. Growth rates projected for Sales Tax are 3.5% for FY12, then peaking at 4.0% in FY13 as the economy rebounds, and tapering off to a low of 3.1% in FY16.

e. Real Estate Transfer Tax

Economic conditions have negatively affected the Real Estate Transfer Tax (RTT) since the housing market decline began in 2007. FY11 RTT revenues are anticipated to be slightly lower than FY10 RTT revenues. The RTT is projected to provide $120.9 million in FY12; a growth rate of 3.0% over FY11 anticipated collections. A growth rate of 5.0% is projected for FY13 and FY14 and a lower growth rate of 4.0% is projected for FY15 and FY16. 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 projected to generate $74.3 million in FY12, 3% of tax revenues.

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

Tax	FY10 Actual	FY11 Estimate	FY12 Estimate	FY13 Estimate	FY14 Estimate	FY15 Estimate	FY16 Estimate
Wage & Net Profits - Current & Prior	1,128.7	1,167.0	1,206.0	1,253.5	1,282.2	1,309.0	1,336.0
% change from prior year	n.a.	3.4%	3.3%	3.9%	2.3%	2.1%	2.1%
Real Property - Current & Prior	402.2	488.7	486.7	486.7	491.8	500.2	507.0
% change from prior year	n.a.	21.5%	-0.4%	0.0%	1.0%	1.7%	1.4%
Business Privilege - Current & Prior	364.7	370.8	369.3	378.1	383.1	380.7	384.1
% change from prior year	n.a.	1.7%	-0.4%	2.4%	1.3%	-0.6%	0.9%
Sales	207.1	247.5	256.5	266.4	275.4	142.1	146.4
% change from prior year	n.a.	19.5%	3.6%	3.9%	3.4%	-48.4%	3.1%
Real Property Transfer	119.2	117.3	120.9	126.9	133.2	138.6	144.1
% change from prior year	n.a.	-1.6%	3.0%	5.0%	5.0%	4.0%	4.0%
Parking	70.5	72.5	74.3	76.2	78.1	80.0	82.0
% change from prior year	n.a.	2.9%	2.5%	2.5%	2.5%	2.5%	2.5%
Other Taxes	24.2	25.2	25.7	26.3	26.9	27.5	28.1
% change from prior year	n.a.	3.9%	2.2%	2.2%	2.2%	2.2%	2.2%
Total Taxes	**2,316.6**	**2,489.0**	**2,539.5**	**2,614.1**	**2,670.7**	**2,578.1**	**2,627.8**
% Change from prior year	**n.a.**	**7.4%**	**2.0%**	**2.9%**	**2.2%**	**-3.5%**	**1.9%**

Note: Property Taxes were increased in FY11. Wage and Business Taxes incorporate rate reductions that will resume in FY14. The reduced estimate for the Sales Tax in FY15 is due to the sunsetting of the temporary 1% increasa that began in FY10. Other Taxes include the Amusement Tax and miscellaneous taxes. Wage tax does not include the PICA tax.

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 45% of Revenue from Other Governments is estimated using Wage Tax variables.

Revenue from Other Governments in the FY12 budget is significantly lower than that of FY11 because of the move of the Department of Human Services' reimbursed costs and corresponding revenues to the grants fund beginning in FY12. As a result of this change, the City's general fund balance will better reflect the City's financial condition. For the past several years, the financial position of the City's general fund has been distorted by the timing of the receipt of reimbursements from the Commonwealth of Pennsylvania for DHS services. For a variety of reasons, some of those reimbursements have not been recognized in the same year as the costs were incurred. As a result, the costs have been reflected in the City's fund balances, but the reimbursements are not, leading to fund balances that are distorted and artificially low. Removing reimbursed DHS costs and their corresponding revenues from the general fund will remove this distortion from the City's general fund finances.

6. Obligation Estimates

The City of Philadelphia OBPE is responsible for providing obligation estimates to the Director of Finance and the Mayor for discussion and inclusion in the revised annual FY2012 budget and FY2012-2016 Five-Year Financial Plan (FYP) submitted by the Mayor to the Pennsylvania Intergovernmental Cooperation Authority (PICA) on July 7, 2011. OBPE provides forecasts of all major expenditure categories.

A major change to the FY 2012 – 2016 Five Year Plan is the shift of the Department of Human Services' reimbursed costs of $495 million from the General Fund to the Grants Revenue Fund. Making this change will add transparency to the City's finances as the General Fund balances will better reflect the City's financial condition.

The FY 2012- 2016 Five Year Plan also includes departmental spending reductions of $6.9 million in FY 2012 and $5.4 million in FY 2013 through FY 2016 and $47.3 million in increases in FY 2012 and $46.3 million in FY 2013 through FY 2016.

FY12 Expenditure Reductions:

- Building off the successful efforts to lower the inmate census, almost $2 million will be removed from the Prison's budget. In addition, City Council cut an additional $4 million from the Prisons budget to fund electronic monitoring in the First Judicial District's budget. The Administration is still reviewing this budget change by City Council to determine if funding will be provided, but has conservatively put this change into the Five Year Plan.
- $200,000 will be saved in the Law Department, through elimination of unfilled vacancies. Likewise, the Department of Licenses and Inspections will also save $200,000 through the elimination of unfilled vacancies.
- $100,000 will be saved in the Office of the Director of Finance, through the elimination of a vacant position, and contract savings.
- The Office of Fleet Management shows cost reductions of $388,000 through savings in heavy equipment repair.

FY 12 Expenditure Increases:

The largest single increase in the FY12 Adopted Budget is an additional $10 million contribution to the School District of Philadelphia to help reduce a projected $629 million deficit. Due to the provisions of the Commonwealth of Pennsylvania's Act 46, these additional funds are now a permanent part of the City's contribution.

Almost half of the additional funding is for public safety. The Adopted Budget includes an investment of about $20 million in this area as listed below:

- $6.4 million for the Police Department will fund a new class of 120. This new class will allow the Department to build off the successes in crime fighting and prevention over the last three years.
- The Fire Department's budget increased by $4.7 million. This funding will pay for firefighters' personal escape systems, which were mandated in a previous Arbitration Award, and replacement for firefighters' oxygen bottles, which are coming to the end of their useful life. Also funded is

an increase in uniform overtime which will bridge the gap until a new class of firefighters can be brought on board and additional funds for grant matching requirements.

- $4 million in the First Judicial District for electronic monitoring of prisoners. The Administration is still reviewing this change to the budget ordinance made by City Council to determine if funding will be provided, but has conservatively put this change into the Five Year Plan. In addition, the Administration added $2.4 million for the restoration of probation positions funded by a Recovery Act grant that is expiring.
- $1.9 million for the District Attorney to allow the office to maintain needed initiatives.
- $450,000 for the Defender Association for health benefit cost increases. In addition, City Council added $500,000 for the Defender Association for the representation of indigent defendants. The Administration is still reviewing this change by City Council to determine if funding will be provided, but has conservatively put this change into the Five Year Plan.

The remaining investments include:

- $4.4 million is included for the Office of Property Assessment to allow it to complete overhauling the property assessment system, in order to provide fair and accurate property evaluations.
- The Streets Department is increased by $5 million. $4 million is to pay for snow removal. Using the past five years' average expenditures for contracted snow costs, this funding will help to ensure that the City is better able to manage in case of large snow storms. In addition, $1 million is included for alley lighting throughout the City.
- $1 million to increase funding to the Mayor's Commission on Literacy for an Adult Literacy program.
- $573,000 for the newly created PhillyRising program run out of the Managing Director's Office.
- $500,000 for lot cleaning in the Office of Housing and Community Development. The Administration is still reviewing this proposal by City Council to determine if funding will be provided, but has conservatively put this change into the Five Year Plan.
- $310,000 to adequately fund election workers pay in the City Commissioners.
- $220,000 for an increase to the Recreation and Activities Fund in the Department of Parks and Recreation. The Administration is still reviewing this proposal by City Council to determine if funding will be provided, but has conservatively put this change into the Five Year Plan.
- $180,000 to ensure that swimming pools will be open all summer long.

a. Labor Agreements

The City's labor agreements with its four major bargaining units – FOP Lodge No. 5, IAFF Local 22, DC 33 and DC 47 – expired on June 30, 2009. An interest arbitration award to the FOP was made in FY 10. Contracts with DC 33 and DC 47 remain outstanding; and except for its pension provisions, the interest arbitration award granted to the IAFF on October 12, 2010 is under appeal by the City.

F.O.P. Lodge 5

On December 18, 2009, a five year interest arbitration award with the FOP, Lodge No. 5 was issued to cover FY10 through FY14. Important financial components of the award that affect FY12 through FY16 include:

- Three percent wage increase for FY12. Funding for the wage increase is included in the FY 2012 – 2016 Five Year Plan. 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.
- 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. The FYP includes an estimate for these costs based on an average of three months of actual FY11 expenditures increased by 10% per year based on medical cost trends.
- Pension changes for new hires – FOP members will now choose between increasing their pension contribution from 5% to 6% of pay or 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.

I.A.F.F.

On October 12, 2010, a five year interest arbitration award with the IAFF was issued to cover FY10 through FY14. Though the terms of the award are similar to those in the FOP award and takes a crucial step toward reform by establishing a hybrid pension system, it imposes more than $100 million in new costs over the Five Year Plan without giving the City the required tools to manage these costs.

Unlike the award for FOP members this award does not give the City the right to furlough, which could have been used to help fund the added cost of a contract. Because of the exorbitant costs and the absence of fiscal tools to manage those costs, the City has appealed portions of this contract award to the court.

The portion of the award not under appeal and already 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 October 15, 2010, must choose between increasing their pension contribution from 5% to 6% of pay or enrolling in a new hybrid pension plan.

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 FY12 through FY16 include:

- A 2.5% wage increase in FY12 for Deputy Sheriffs. 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. 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 will get a 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 will 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 District Council 33 and District Council 47

Negotiations continue with the City's other two major municipal unions, DC 33 and DC 47. The City is seeking zero wage increases across the life of the contracts. The City is also seeking similar health and welfare plan changes as awarded to the FOP, as well as hybrid pension plans for new members and increased contributions for existing members. In order to achieve short-term savings without requiring long term layoffs, the City is also seeking the FOP's contract terms for furloughs.

If the IAFF award appeal and the contracts with the City's non-uniformed employees exceed the amounts included in the Five Year Plan, the Administration and Council will need to find other ways to balance the Five Year Plan. Without those savings, the Administration would likely have to turn to service reductions or other revenue increases.

The Administration hopes to resolve all outstanding contract issues as soon as possible. Because the plan assumes savings from employee costs of $11.9 million per year and $59.5 million over the life of the plan, and any savings that will be achieved are dependent on the successful completion of the civilian negotiations, as well as the successful appeal of the arbitration award to the IAFF, these assumptions are of a particularly sensitive nature.

b. Health / Medical

The Administration implemented a self-insured group health plan in 2010 for medical benefits for non-union employees. In FY11, coverage for members of the Fraternal Order of Police (FOP), Lodge No. 5 also switched to self-insurance. For non-union employees, an average of five months of experience was 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 three months of actual experience was used. 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 an average of six months of actual expenditures in FY11. 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 2012 – 2016 will approximate the FY11 average expenditure.

As the arbitration award to the IAFF is under appeal, the move to self-insurance included in the award has not been implemented. For that reason, the cost estimate for the IAFF is based on an average of six months of actual expenditures under the provisions of the expired contract ($1,270 per employee, per month) with no increase assumed for the life of the plan. Due to the uncertainty in the timing and outcome of the appeal, the health / medical arrangement with the IAFF cannot be determined and therefore the assumption relating to IAFF medical costs of $40.5 million per year for FY12 – FY16 is particularly sensitive..

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 of Philadelphia's Act 111 interest arbitration award with the Fraternal Order of Police (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% to 6%; 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 are not part of the 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 or enrolling in a new hybrid pension plan.

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 dramatic decreases in the stock market, like the ones suffered in FY09. Philadelphia is one of only a handful of cities in the country to offer a defined contribution plan to its employees and is the only one to offer one to uniformed employees. Similar pension benefit changes are being sought as part of the City's ongoing negotiations with DC 33 and DC 47.

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.
- Eliminated the eligibility of newly elected city officials to participate in Philadelphia's DROP.
- Reduced the pension fund's earnings assumption from 8.25% to 8.15%. 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 over the five year plan 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. Yet despite these proactive changes, pension costs will continue to rise. Costs will be substantially higher each year from FY12 through FY16 than they were in FY11. That increase is caused in part by the deferral of FY10's and FY11's payments to FY13 and FY14. 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.