CITY OF PHILADELPHIA

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ALAN BUTKOVITZ
City Controller
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July 7, 2017

Harvey M. Rice, Executive Director
Pennsylvania Intergovernmental Cooperation Authority
1500 Walnut Street, Suite 1600
Philadelphia, PA 19102

Dear Mr. Rice:

In accordance with Section 12720.209(f)(1) of the Pennsylvania Intergovernmental Cooperation Authority Act, my office conducted an examination of the Forecasted General Fund Statements of Operations (the forecast) for each of the fiscal years ending June 30, 2018 through June 30, 2022, also known as the "Five Year Plan" (Plan). The Plan was prepared by management of the City of Philadelphia's Office of the Director of Finance (City) and submitted to the Pennsylvania Intergovernmental Cooperation Authority (PICA) on June 19, 2017.

My staff conducted its examination of the Plan in accordance with attestation standards established by the American Institute of Certified Public Accountants. Those standards require that we evaluate the presentation of the Plan and whether the assumptions used by management are reasonable. Attached is the independent accountant's report signed by my deputy who is a Certified Public Accountant.

I am recommending that PICA accept the Plan, however, I want to highlight that the forecasted statements include particularly sensitive assumptions, which PICA should consider when assessing the plan. The outcome of the new commercial reassessment for real estate tax is vulnerable to the appeals process, an area in which Philadelphia significantly under-performs compared to peer cities. The Philadelphia Beverage Tax (PBT) also fell significantly below projections in fiscal year 2017. The City's PBT projections appear overly optimistic and did not sufficiently account for changes in consumer behavior.

Additionally, the forecasted statements do not include any potential costs above $200 million in obligations for future labor contract settlements over the life of the plan. This forecasted amount is dependent on the successful completions of negotiations with American Federation of State, County and Municipal Employees District Council 47, Local 810 Courts, and arbitration with the Fraternal Order of Police and the International Association of Fire Fighters.

Finally, I remind PICA that with any forecast, events and circumstances frequently do not occur as expected. There could be differences between the Plan and actual results and these differences could be material.

It should be noted that while the School District of Philadelphia's approved budget projects a positive fund balance of $89.8 million in 2018, it will incur a $39.8 million deficit in 2019 and a $243 million deficit by 2020. Additionally, the School District's deficit is expected to grow exponentially in the ensuing years.

The City has not earmarked any funds to close the gap and the prospect of additional state funds is remote. Any future unexpected commitments to the School District of Philadelphia, could drastically impact City operations, and further erode the fund balance available for future appropriations.

In closing, my office would like to express our thanks to the management and staff of the City's Office of Budget and Program Evaluation within the Office of the Director of Finance for their courtesy and cooperation in the conduct of our examination.

Respectfully submitted,

ALAN BUTKOVITZ
City Controller

cc: Chair and Board Members of the
Pennsylvania Intergovernmental Cooperation Authority
Honorable James F. Kenney, Mayor
Rob Dubow, Director of Finance
Anna Adams, Budget Director

CITY OF PHILADELPHIA PENNSYLVANIA

OFFICE OF THE CONTROLLER

CITY OF PHILADELPHIA

FORECASTED GENERAL FUND
STATEMENTS OF OPERATIONS

FISCAL YEARS 2018 – 2022

City Controller

Alan Butkovitz

Promoting honest, efficient & fully accountable government

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CITY OF PHILADELPHIA

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ALAN BUTKOVITZ
City Controller

CHRISTY BRADY
Deputy City Controller

INDEPENDENT ACCOUNTANT'S REPORT

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

We have examined the accompanying financial forecast of the City of Philadelphia, Pennsylvania, which comprises the forecasted general fund statements of operations and summaries of significant assumptions and accounting policies of the City of Philadelphia, Pennsylvania for each of the five years ending through June 30, 2022, based on the guidelines for the presentation of a forecast established by the American Institute of Certified Public Accountants (AICPA). City of Philadelphia's Office of the Director of Finance management is responsible for preparing and presenting the forecast in accordance with the guidelines for the presentation of a forecast established by the AICPA. Our responsibility is to express an opinion on the forecast based on our examination.

Our examination was conducted in accordance with attestation standards established by the AICPA. Those standards require that we plan and perform the examination to obtain reasonable assurance about whether the forecast is presented in accordance with the guidelines for the presentation of a forecast established by the AICPA, in all material respects. An examination involves performing procedures to obtain evidence about the forecast. The nature, timing, and extent of the procedures selected depend on our judgment, including an assessment of the risks of material misstatement of the forecast, whether due to fraud or error. We believe that the evidence we obtained is sufficient and appropriate to provide a reasonable basis for our opinion.

In our opinion, the accompanying forecast is presented, in all material respects, in accordance with the guidelines for the presentation of a forecast established by the AICPA, and the underlying assumptions are suitably supported and provide a reasonable basis for management's forecast.

There will usually be differences between 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 forecast referred to in the preceding paragraph includes assumptions that are particularly sensitive as described in Note C.6. The assumptions pertaining to labor agreement costs are particularly sensitive due to the uncertainty in the outcome of the City of Philadelphia's negotiations with the municipal unions.

Christy Brady

CHRISTY BRADY, CPA
Deputy City Controller
Philadelphia, Pennsylvania
July 7, 2017

Forecasted General Fund Statements of Operations

Fiscal Years Ending June 30, 2018 through June 30, 2022

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, 2018 through June 30, 2022

(Amounts in thousands)

NO.	ITEM	FY 2018 Adopted	FY 2019 Estimate	FY 2020 Estimate	FY 2021 Estimate	FY 2022 Estimate
(1)	(2)	(3)	(4)	(5)	(6)	(7)
	OPERATIONS OF FISCAL YEAR					
	REVENUES					
1	Taxes	3,298,332	3,408,425	3,474,279	3,554,317	3,648,749
2	Locally Generated Non-Tax Revenues	307,058	290,366	291,651	291,393	295,862
3	Revenue from Other Governments	735,524	762,054	779,562	806,798	825,479
4	Sub-Total (1 thru 3)	**4,340,914**	**4,460,845**	**4,545,492**	**4,652,508**	**4,770,090**
5	Revenue from Other Funds of City	64,191	64,697	65,228	65,787	66,374
6	**Total Revenue and Other Sources (4)+(5)**	**4,405,105**	**4,525,542**	**4,610,720**	**4,718,295**	**4,836,464**
	OBLIGATIONS/APPROPRIATIONS					
7	Personal Services	1,628,903	1,640,219	1,647,999	1,648,553	1,648,944
8	Personal Services-Pensions	680,249	718,320	742,373	755,912	770,024
9	Personal Services-Other Employee Benefits	627,550	643,976	669,630	696,573	725,266
10	**Sub-Total Employee Compensation (7 thru 9)**	**2,936,702**	**3,002,515**	**3,060,002**	**3,101,038**	**3,144,234**
11	Purchase of Services	935,078	933,336	960,585	975,640	995,835
12	Materials, Supplies and Equipment	105,678	110,541	110,924	112,427	111,318
13	Contributions, Indemnities, and Taxes	196,010	193,522	194,522	193,765	195,258
14	Debt Service	157,322	174,421	194,158	192,366	200,031
15	Advances & Misc. Pmts. / Labor Obligations	20,000	30,000	40,000	50,000	60,000
16	Advances & Misc. Pmts. / Federal Grants	50,893	53,573	55,108	56,705	58,356
17	Sub-Total (10 thru 16)	4,401,683	4,497,908	4,615,299	4,681,941	4,765,032
18	Payments to Other Funds	36,026	37,657	39,369	41,167	43,056
19	**Total - Obligations (17)+(18)**	**4,437,709**	**4,535,565**	**4,654,668**	**4,723,108**	**4,808,088**
20	Oper.Surplus (Deficit) for Fiscal Year (6)-(19)	(32,604)	(10,023)	(43,948)	(4,813)	28,376
21	**Prior Year Adjustments:**					
22	Other Adjustments	19,500	19,500	19,500	19,500	19,500
23	Total Prior Year Adjustments	19,500	19,500	19,500	19,500	19,500
24	**Adjusted Oper. Surplus/ (Deficit) (20)+(23)**	**(13,104)**	**9,477**	**(24,448)**	**14,687**	**47,876**
	OPERATIONS IN RESPECT TO PRIOR FISCAL YEARS					
25	Fund Balance Available for Appropriation June 30 of Prior Fiscal Year	88,596	75,492	84,969	60,521	75,208
26	Fund Balance Available for Appropriation June 30 (24)+(25)	**75,492**	**84,969**	**60,521**	**75,208**	**123,084**

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 FY2018 budget and the FY2018-2022 Five Year Financial Plan (FYP) submitted by the Mayor to the Pennsylvania Intergovernmental Cooperation Authority (PICA) on June 19, 2017. These financial forecasts present, to the best of management's knowledge and belief, the City of Philadelphia's (City) expected results of operations for the forecast periods. Accordingly, the forecasts reflect the City's judgment as of June 19, 2017, 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 FY18 total $4.405 billion. Approximately 75% 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 seven major taxes, totaling over $3.273 billion in the adopted FY18 budget, as well as $307.1 million of Locally Generated Non-Tax revenues, and $735.5 million in Revenue from Other Governments. These three sources comprise 99% of the revenues anticipated for the FY18 budget.

OBPE employs several approaches to developing its forecasts of local revenues. These include:

a. Forecasts of economic activity provided by several sources including the Congressional Budget Office;

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. Analysis and tax history provided by experienced staff within the Philadelphia Department of Revenue;

f. Discussions with economists at a meeting at the Federal Reserve Bank of Philadelphia; and

g. The extensive experience of its staff.

OBPE's tax forecasts for the FYP were developed in conjunction with a revenue forecasting consultant, IHS Markit, Ltd. (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 forecast tax revenues for the City. IHS focused on the following taxes – Wage and Earnings Tax, Net Profits Tax, Business Income and Receipts Tax, Real Estate Transfer Tax, Parking Tax and Sales Tax. These forecasts were refined by OBPE after discussions with leading economists at a meeting at the Federal Reserve Bank of Philadelphia, as well as experienced staff within the Department of Revenue. The remaining major taxes – Real Estate Tax and Philadelphia Beverage Tax – were developed using the internal expertise of employees within the City. The Real Estate Tax estimates were forecasted by OBPE with data and input from the Office of Property Assessment and the Department of Revenue, and the Philadelphia Beverage Tax estimates were developed by the Department of Revenue, with data from external sources described further in this document.

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 75% of the City's General Fund revenue. The Congressional Budget Office (CBO) forecast for U.S. Real Gross Domestic Product shows projected growth of 2.1% for 2017, higher than the 1.6% growth in 2016. Growth is expected to continue in 2018 at 2.2%. The CBO forecast projects corporate profits to grow by 0.2% in 2018 continuing the trend of flat growth seen 2016 and 2017.[1]

Personal income is projected to continue to grow at 4.2% in 2017 and 4.6% in 2018, exceeding the 3.6% growth experienced in 2016. Unemployment is expected to decline from 4.9% in 2016 to 4.4% in 2017 and then to 4.2% in 2018.[2]

The medium-term economic outlook for Philadelphia is mildly optimistic, but persistent low employment growth and unemployment will continue to be a drag on aggregate economic growth. Per IHS estimates, total payrolls will expand a cautious 0.6% on average from 2017 to 2022, although considerable upward pressure will originate from the manufacturing sector amid increased capital spending and an improvement of Philadelphia's port facilities. The City's unemployment rate as of May 2017, is 6.7%, down from 6.8% in May 2016. This is higher than the statewide rate (5.2%), the national rate (4.3%), and the rates in most of the top ten U.S. cities.[3] The City is projecting the unemployment rate to remain flat through the life of the FYP.

3. The City's Major Taxes

The City receives revenue to fund its services and programs from seven major taxes which are budgeted to contribute 75% of the expected General Fund revenue in FY18. These include:

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

[1] Congressional Budget Office, An Update to the Budget and Economic Outlook: 2017 to 2027 (June 2017 Report).
[2] Congressional Budget Office, An Update to the Budget and Economic Outlook: 2017 to 2027 (June 2017 Report).
[3] Bureau of Labor Statistics, Local Area Unemployment Statistics (not seasonally adjusted).

7. Philadelphia Beverage Tax.

The remaining taxes, including the amusement tax, are budgeted to provide less than 1% of General Fund revenue. Philadelphia's reliance on the Wage Tax (34% of the General Fund), the BIRT (11%) and the Sales Tax (4%) 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 45% of tax revenues) is the Wage Tax, which encompasses the wage, earnings, and net profits taxes. The Wage Tax is collected from all employees working within city limits, and all Philadelphia residents regardless of work location. In FY18, the Wage Tax rate has been reduced from 3.9004% to 3.8907% for residents and from 3.4741% to 3.4654% for non-residents. The resident rate includes 1.5% that is reserved for the PICA. PICA has overseen the City's finances since 1992, when it was first established. The PICA statute permits the Authority 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 $1.494 billion in FY18. This projection includes a 3.41% growth rate under Wage and Earnings component and 2.62% growth rate under the Net Profit component of the 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 if 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 grow. By FY22, the Wage Tax rates in the FYP are 3.6997% for residents and 3.2953% for non-residents.

b. Real Property Tax

The Real Property Tax (Property) is the City's second largest source of tax revenue (20%), estimated to contribute $651.5 million of the FY18 tax revenues. This tax is levied on the assessed value of residential and commercial property in the City. The Adopted FY18 Budget has a combined City/School District property tax rate for FY18 of 1.3998%, unchanged from

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

FY17. The City portion of the tax is 0.6317% and the School District portion is 0.7681%. The property tax projection considers the continuation of the homestead exemption of $30,000 for eligible property owners and relief measures with a cap of $20 million for the City and School District combined. The FYP assumes taxable assessed values grow each year of the plan, based upon regular reassessments provided by the City's Office of Property Assessment. The projection also uses a historical average collection rate of 93.9%, which is a 3-year average after the delayed and reduced revenue is also factored into the model due to appeals related to the change in assessed values due to the Actual Value Initiative.

c. Business Income and Receipts Tax

The Business Income and Receipts Tax (BIRT) is projected to produce $489.9 million in FY18, 15% of total tax revenue. Most the BIRT is derived from corporate profits which are volatile and dependent on economic conditions within the City. In FY12, BIRT tax reform legislation was signed by Mayor Nutter, 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. The first $100,000 of receipts have been excluded since the exclusions were first fully applied in FY17. Lastly, the bill called for implementation of single sales factor apportionment in FY16. 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. 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 solid growth in this tax. The RTT is projected to provide $242.9 million in FY18; a growth rate of 4.3% over FY17 anticipated collections and influenced by the rate change, effective January 1, 2017, to the tax from 3.0% to 3.1%. Lower growth rates of 3.4%, 2.6%, 2.5% and 3.0% are projected for FY19, FY20, FY21 and FY22, respectively. The City currently imposes a 3.1% tax on real property sales and an additional 1% is charged by the Commonwealth for a 4.1% total RTT.

e. Sales Tax

Sales Tax revenues are projected to generate $198.1 million for the City's general fund in FY18, based on a growth rate of 4.0%, and comprising 6% of tax revenues. As part of its response to projected City 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% through the end of FY14. This raised the total Sales Tax rate to 8%, with 6% going to the Commonwealth and 2% to the City. The tax was made permanent starting in FY15 with 1% of the local Sales Tax being for the benefit of the School District of Philadelphia and the City's pension fund whereby $120 million of the sales tax goes directly to the School District and remaining amounts flow through the City's General Fund to pay for debt service on a borrowing on behalf of the School District and for additional contributions to the Pension Fund. From FY17 through FY22, the City's pension fund is projected to receive an additional $251 million from the proceeds of the sales tax.

f. Parking Tax

The Parking Tax is levied on the gross receipts from all parking transactions. Parking Tax revenue is projected to generate $104 million in FY18, based on prior year revenue history and local economic trends.

g. Philadelphia Beverage Tax

The Philadelphia Beverage Tax is a new revenue source, applied to both sugar-sweetened and diet beverages, at one and one-half cents per ounce. The tax is levied on licensed beverage distributors, rather than at the point of sale. Tax estimates were developed by the City's Department of Revenue, and utilized local consumption data provided by the University of Connecticut's Rudd Center for Food Policy and Obesity, along with a -1-elasticity rate. The tax was effective January 1, 2017 and is projected to impact revenues and expenditures in the following ways:

- An estimated $461 million will be collected in gross revenue from FY18-FY22, before additional costs for collection, advertising and auditing. Because the tax was implemented in January of 2017, halfway through the fiscal year, expected revenue for FY17 is approximately $40 million, with approximately $92 million of annual revenue expected in the following years.

- Revenues from the Philadelphia Beverage Tax is funding expenditures for three major initiatives: expanded Pre-K, community schools, and debt service for the Rebuilding Community Infrastructure program when those programs are fully implemented.

City of Philadelphia
General Fund
FY 2018 - 2022 Five Year Financial Plan
Major Taxes ($ in Millions) with Percentage Change from Previous Year

Tax	Actual FY16	Projected FY17	Projected FY18	Projected FY19	Projected FY20	Projected FY21	Projected FY22
Wage & Net Profits - Current & Prior	1,398.4	1,450.1	1,494.3	1,524.9	1,548.5	1,571.3	1,610.8
% change from prior year	n.a.	3.7%	3.0%	2.0%	1.5%	1.5%	2.5%
Real Property - Current & Prior	571.6	583.1	651.5	686.4	696.0	723.1	741.6
% change from prior year	n.a.	2.0%	11.7%	5.4%	1.4%	3.9%	2.6%
Business Income & Receipts - Current & Prior	474.2	435.1	489.9	506.3	512.9	518.0	527.9
% change from prior year	n.a.	-8.2%	12.6%	3.3%	1.3%	1.0%	1.9%
Sales	169.4	186.6	198.1	209.1	219.8	229.8	239.5
% change from prior year	n.a.	10.2%	6.2%	5.6%	5.1%	4.5%	4.2%
Real Property Transfer	237.4	232.9	242.9	251.2	257.7	264.1	272.0
% change from prior year	n.a.	-1.9%	4.3%	3.4%	2.6%	2.5%	3.0%
Parking	92.7	96.7	103.7	111.3	119.1	127.0	135.3
% change from prior year	n.a.	4.3%	7.2%	7.3%	7.0%	6.6%	6.5%
Philadelphia Beverage	0.0	39.7	92.4	92.5	92.6	92.1	91.7
% change from prior year	n.a.	n.a.	132.7%	0.1%	0.1%	-0.5%	-0.4%
Other Taxes	22.9	24.5	25.5	26.7	27.7	28.9	29.9
% change from prior year	n.a.	7.0%	4.1%	4.7%	3.7%	4.3%	3.5%
Total Taxes	**2,966.6**	**3,048.7**	**3,298.3**	**3,408.4**	**3,474.3**	**3,554.3**	**3,648.7**
% Change from prior year	**n.a.**	**2.8%**	**8.2%**	**3.3%**	**1.9%**	**2.3%**	**2.7%**

Note: Wage & Net Profits Taxes include rate reductions that resumed in FY14 and the table does not reflect the PICA portion. Business Income & Receipts Tax incorporate rate reductions and changes in passed legislation that began in FY13. In FY15 the Commonwealth reauthorized the 1% increase of the Sales Tax as this revenue is dedicated to the School District and the Pension Fund. The increased estimate for the Real Estate Tax in FY16 is the result of a rate adjustment from 0.006018 to 0.006317, intended to provide the School District an additional City contribution of $25 million. Likewise, the increased estimate for Parking Tax in FY16 is the result of a rate adjustment from 20% to 22.5% with the aim of raising $10 million of revenue to be directed to the School District. Finally, both the RTT rate increase and introduction of the Philadelphia Beverage Tax went into effect on January 1, 2017.

4. Locally Generated Non-Tax Revenues

Locally Generated Non-Tax Revenues are forecasted 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 forecasted based on historical trends and state and federal budget information. The PICA City account which represents 57% of Revenue from Other Governments is forecasted 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 FY2018 budget and FY2018-2022 FYP submitted by the Mayor to the PICA on June 19, 2017. OBPE provides forecasts of all major expenditure categories. Obligations total $4.438 billion, an increase of $216 million due largely to the $49.2 million appropriated to address rising pension and health benefit obligations, $32.7 million required to pay debt service, $15.7 million to fund the Pre-K and Community Schools program, $20 million set aside for future labor obligations, $50.9 million reserved as a contingency against Federal grant reductions and $13.1 million for the American Federation of State, County and Municipal Employees (AFSCME) District Council 33 (DC 33) wage increase of 3 percent effective 7/1/17.

a. Labor Agreements

The forecasted statements include the contract pay raise in FY2018 for the AFSCME DC33 of 3.0%.

Negotiations with the other unions which include: AFSCME DC 33 Local 159; AFSCME District Council 47 (DC 47), Local 810 Courts; the Fraternal Order of Police (FOP) and the International Association of Fire Fighters (IAFF) are currently in progress. For members employed by the Register of Wills, wage increases and bonuses mirror those of District Council 33.

The Administration hopes to resolve all upcoming contract issues as soon as possible in a way that is fair to both employees and other taxpayers. The Forecasted Statements include a total of $200 million in obligations for current and future labor contract settlements over the life of the plan. Because this forecasted amount is dependent on the successful completion of collective bargaining agreements, this is a particularly sensitive assumption. If any final labor agreements result in significant unbudgeted costs across the plan, budget cuts to many departments are possible.

b. Health / Medical

The Administration implemented a self-insured group health plan in 2010 for medical benefits for non-union employees. The City also increased employee copays and instituted a disease management and wellness program with financial incentives for completing wellness activities. In FY15, the City added a tobacco user surcharge.

DC 47, the IAFF, and the FOP have also implemented self-insured group health plans. For the FOP, because the City has no control over the design of the its health plan, an increase of 7.5% per year based on medical cost trends has been included. For DC 47, an increase of 5.0% per year based on medical cost trends has been included.

AFSCME District Council 33 (DC 33) projections are based on prior year expenditures. Under the new contract, a $10 million lump sum payment was made within 30 days of contract ratification and another $10 million lump sum payment is scheduled on July 1st, 2017. There will be a reopener for determining the City's contribution to the health fund for fiscal years 2019 and 2020.

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 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 from 5% to 6%; or
2) Participating in a hybrid plan, containing both a defined benefit and a voluntary defined contribution component.

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 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 five highest annual compensations calculated for either five calendar years or five anniversary years.
4) Credited Service: After 20 years of credited service, employees will no longer earn 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(b) plan. For each fiscal year, the City will contribute 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. 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% times Years of Credited Service up to 20 times the Average Final Compensation.
4) Employees will contribute 50% of the 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.

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.

Significant pensions changes were also included in the DC33 collective bargaining agreement. Current employees will make increased contributions with the amount of the contribution increasing for higher earning employees. New employees will go into a stacked hybrid plan under which employees will receive a traditional defined benefit pension on their first $50,000 of salary and a defined contribution pension for salary above $50,000.

Other pension benefit changes are being sought as part of the City's ongoing union negotiations.

In addition to the abovementioned changes in pension benefits, the City's pension fund has also undergone the following changes:

- The Fund has re-amortized the unfunded actuarial accrued liability over a 30-year period using level-dollar amortization payments.
- The City continues to make at least its full minimum municipal obligation (MMO) each year and has dedicated a portion of additional revenues to the fund. Under 2014 state legislation, the additional 1% local sales tax provides funding for the School District of Philadelphia (first $120 million), debt service on a four-year borrowing for the District (next $15 million through FY18), and any remaining funds are dedicated to the pension fund. The pension fund will receive an estimated $18.3 million in FY17, and these revenues will increase over time, especially once the debt service is paid off. The sales tax revenues will supplement the City's MMO payment rather than supplanting a portion of it. By FY22, the sales tax revenues for the pension fund are projected to reach $59.8 million.
- 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 7.70%. Lower earnings assumptions allow funds to moderate the risk of their investments, which can also reduce the likelihood of losses. In addition, lower earnings assumptions increase the amount the City is required to contribute to the pension fund.
- Increased the smoothing period for actuarial losses and gain from five to ten years. Increasing the smoothing period reduces the impact that any 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 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 higher than the amounts required to be paid under state law.