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ALAN BUTKOVITZ
City Controller
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August 26, 2016

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

Dear Mr. Rice:

In accordance with Section 209(f)(1) of the Pennsylvania Intergovernmental Cooperation Authority Act, my office conducted an examination of the updated City of Philadelphia's Forecasted General Fund Statements of Operations (the updated forecast) for each of the fiscal years ending June 30, 2017 through June 30, 2021, also known as the "Five Year Plan" (Plan).

The Plan, as updated, was prepared by management of the City of Philadelphia's Office of the Director of Finance and submitted to the Pennsylvania Intergovernmental Cooperation Authority (PICA) on August 8, 2016. It replaces the initial submission, on which we opined July 14, 2016. That Plan was subsequently retracted due to the recent International Association of Fire Fighters arbitration award and collective bargaining agreement with the American Federation of State, County and Municipal Employees (AFSCME) District Council 33, which together necessitated updating the Plan to incorporate ensuing costs.

My staff conducted its examination of the updated 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 updated Plan, however, I want to emphasize that it does not include any potential costs above $328 million in obligations for current and future labor contract settlements over the life of the Plan. Because this forecasted amount is dependent on the outcome of negotiations and arbitrations with the city municipal unions, it is a particularly sensitive assumption.

Additionally, as I previously indicated in my letter to you dated July 15, 2016, critics of the Sweetened Beverage Tax reportedly continue to vow court challenges against the tax. To date, no litigation has been initiated; however, PICA must continue to be mindful that if such litigation should occur, the outcome could affect the forecasted revenue and obligation amounts over the life of the updated Plan.

Finally, as I routinely remind PICA, there could be differences between the updated Plan and actual results. These differences could be material. Any significant deviations because of unforeseen circumstances such as litigation, severe weather, or future unexpected commitments to the School District of Philadelphia, could dramatically impact city operations, and further erode the fund balance available for future appropriations.

In closing, my office once again 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
James F. Kenney, Mayor
Darrell L. Clarke, Council President
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 (As Updated August 8, 2016)

FISCAL YEARS 2017 – 2021

City Controller

Alan Butkovitz

Promoting honest, efficient & fully accountable government

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 Intergovernmental Cooperation Authority

We have examined the accompanying Forecasted General Fund Statements of Operations of the City of Philadelphia for the fiscal years ending June 30, 2017 through June 30, 2021, as Updated, August 8, 2016 (the updated forecast). Management of the City of Philadelphia's Office of the Director of Finance is responsible for the updated forecast. Our responsibility is to express an opinion on the updated forecast 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 Office of the Director of Finance management and the preparation and presentation of the updated forecast. We believe that our examination provides a reasonable basis for our opinion.

In our opinion, the accompanying updated forecast is presented in conformity with guidelines for presentation of a forecast established by the American Institute of Certified Public Accountants, and the underlying assumptions provide a reasonable basis for the City of Philadelphia's Office of the Director of Finance management's updated forecast. 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 updated forecast referred to in the preceding paragraph includes assumptions that are particularly sensitive as described in Note C.6. These assumptions, which pertain to $328 million in obligations for current and future labor contract settlements during the forecasted periods, are particularly sensitive due to the uncertainty in the outcome of the City of Philadelphia's negotiations and arbitration rulings with the municipal unions.

GERALD V. MICCIULLA, CPA
Deputy City Controller
Philadelphia, Pennsylvania
August 25, 2016

Forecasted General Fund Statements of Operations

Fiscal Years Ending June 30, 2017 through June 30, 2021 – Budgetary Basis

(As Updated August 8, 2016)

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 - Budgetary Basis
Fiscal Years Ending June 30, 2017 through June 30, 2021
(As Updated, August 8, 2016)

(Amounts in thousands)

NO.	ITEM	FY 2017 Adopted	FY 2018 Estimate	FY 2019 Estimate	FY 2020 Estimate	FY 2021 Estimate
(1)	(2)	(3)	(4)	(5)	(6)	(7)
	OPERATIONS OF FISCAL YEAR					
	REVENUES					
1	Taxes	3,089,590	3,227,786	3,301,147	3,377,288	3,448,366
2	Locally Generated Non-Tax Revenues	287,291	280,020	281,091	281,886	282,318
3	Revenue from Other Governments	699,568	722,733	745,994	761,426	786,577
4	Sub-Total (1 thru 3)	**4,076,449**	**4,230,539**	**4,328,232**	**4,420,600**	**4,517,261**
5	Revenue from Other Funds of City	75,570	63,269	63,621	63,988	64,370
6	**Total Revenue and Other Sources (4)+(5)**	**4,152,019**	**4,293,808**	**4,391,853**	**4,484,588**	**4,581,631**
	OBLIGATIONS/APPROPRIATIONS					
7	Personal Services	1,565,831	1,572,299	1,576,097	1,576,320	1,576,320
8	Personal Services-Pensions	648,768	658,772	691,020	707,590	712,742
9	Personal Services-Other Employee Benefits	594,284	617,619	642,022	667,981	695,315
10	**Sub-Total Employee Compensation (7 thru 9)**	**2,808,883**	**2,848,690**	**2,909,139**	**2,951,891**	**2,984,377**
11	Purchase of Services	896,926	931,675	914,711	926,142	950,964
12	Materials, Supplies and Equipment	109,128	103,497	107,909	107,959	107,959
13	Contributions, Indemnities, and Taxes	189,395	190,254	189,418	190,407	190,865
14	Debt Service	153,950	161,652	178,920	189,895	199,505
15	Advances & Misc. Pmts. / Labor Obligations	29,962	53,419	65,000	85,000	95,000
16	Sub-Total (10 thru 15)	4,188,244	4,289,187	4,365,097	4,451,294	4,528,670
17	Payments to Other Funds	32,064	33,944	35,471	37,078	38,768
18	**Total - Obligations (16)+(17)**	**4,220,308**	**4,323,131**	**4,400,568**	**4,488,372**	**4,567,438**
19	Oper.Surplus (Deficit) for Fiscal Year (6)-(18)	(68,289)	(29,323)	(8,715)	(3,784)	14,193
20	**Prior Year Adjustments:**					
21	Other Adjustments	19,500	19,500	19,500	19,500	19,500
22	Total Prior Year Adjustments	19,500	19,500	19,500	19,500	19,500
23	**Adjusted Oper. Surplus/ (Deficit) (19)+(22)**	**(48,789)**	**(9,823)**	**10,785**	**15,716**	**33,693**
	OPERATIONS IN RESPECT TO PRIOR FISCAL YEARS					
24	Fund Balance Available for Appropriation June 30 of Prior Fiscal Year	105,676	56,887	47,064	57,849	73,565
25	Fund Balance Available for Appropriation June 30 (23)+(24)	**56,887**	**47,064**	**57,849**	**73,565**	**107,258**

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 FY2017 budget and the FY2017-2021 Five Year Financial Plan (FYP) submitted to the Pennsylvania Intergovernmental Cooperation Authority (PICA) on August 8, 2016. 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 August 8, 2016, 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, as Updated August 8, 2016 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 FY17 total $4.152 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 seven major taxes, totaling over $3.065 billion in the Updated FY17-21 Five-Year Plan (FYP), as well as $287.3 million of Locally Generated Non-Tax revenues, and $699.6 million in Revenue from Other Governments. These three sources comprise 98% of the revenues anticipated within the updated FY17 estimate.

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

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. 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 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 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 Sweetened 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 Sweetened 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 74% of the City's General Fund revenue. 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 projected growth of 1.9% for 2016, lower than the 2.4% growth in 2015. Growth is expected to rebound in 2017 at 2.3%. The consensus forecast projects pre-tax corporate profits to grow 3.9% in 2017 after flat growth between 2015 and 2016.[1]

Households are showing steady personal consumption expenditures with growth of 2.6% in 2016 and 2.5% in 2017, albeit lower than the 3.1% growth in 2015. Unemployment is expected to decline from 5.3% in 2015 to 4.8% in 2016 and then to 4.5% in 2017.[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. According to IHS estimates, private-sector payrolls will expand a cautious 0.7% on average from 2016 to 2021, although considerable upward pressure will originate from the construction sector amid increased capital spending and an improvement in the local housing market. The City's unemployment rate as of May 2016 is 7.0%, down from 7.6% in May 2015. This is higher than the statewide rate (5.5%), the national rate (4.7%), and the rates in most of the top ten U.S. cities.[3] The City is projecting the unemployment rate to remain fairly 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 74% of the expected General Fund revenue in FY17. 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] Blue Chip Economic Indicators June 10, 2016.
[2] Blue Chip Economic Indicators June 10, 2016.
[3] Bureau of Labor Statistics, Local Area Unemployment Statistics (not seasonally adjusted).

7. Sweetened 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 (35% 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 47% 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 FY17, the Wage Tax rate has been reduced from 3.9102% to 3.9004% for residents and from 3.4828% to 3.4741% 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 $1.451 billion in FY17. This projection includes a 3.73% growth rate under Wage and Earnings component and 8.34% growth rate under the Net Profit component of the tax (implemented changes to the BIRT have had a corollary and positive effect on Net Profit growth).[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 FY21, the Wage Tax rates in the FYP are 3.7276% for residents and 3.3202% for non-residents.

b. Real Property Tax

The Real Property Tax (Property) is the City's second largest source of tax revenue (19%), estimated to contribute $594.9 million of the FY17 tax revenues. This tax is levied on the assessed value of residential and commercial property in the city. The Adopted FY17 Budget has a

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

combined City/School District property tax rate for FY17 of 1.3998%, unchanged from FY16. The City portion of the tax is 0.6317% and the School District portion is 0.7681%. The property tax projection takes into account 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 93.3%, 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 $446.0 million in FY17, 14% 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. 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. When the exclusions are fully applied in FY17, the first $100,000 of receipts will be excluded. 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 $249.6 million in FY17; a growth rate of 5.1% over FY16 anticipated collections and influenced by the rate change to the tax from 3.0% to 3.1%. Lower growth rates of 2.7%, 3.4% and 2.5% are projected for FY19, FY20 and FY21, respectively. The City currently imposes a 3% tax on real property sales and an additional 1% is charged by the Commonwealth for a 4% total RTT. The rate change, effective January 1, 2017, will increase the City portion to 3.1% and the total for RTT to 4.1%.

e. Sales Tax

Sales Tax revenues are projected to generate $182.2 million for the City's general fund in FY17, based on a growth rate of 5.1%, 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 FY16 through FY21, the City's pension fund is projected to receive an additional $188 million from the proceeds of the sales tax. In FY17 the State will be expanding the base of the Sales and Use Tax, resulting in a projected revenue increase of $4.7 million dollars to the City, of which $2.35 million will be contributed to the Pension Fund.

f. Parking Tax

The Parking Tax is levied on the gross receipts from all parking transactions. Parking Tax revenue is projected to generate $95 million in FY17. This amount reflects a FY16 raise in the Parking Tax from 20 percent to 22.5 percent, which led to an estimated $92 million in collected revenues. Going forward the City estimates a 3.5 percent growth rate for each year of the forecast.

g. Sweetened Beverage Tax

The Sweetened 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 will be 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 will be effective January 1, 2017 and will impact revenues and expenditures in the following ways:

- An estimated $416 million will be collected in gross revenue from FY17-FY21, before additional costs for collection, advertising and auditing. Because the tax will be implemented in January of 2017, halfway through the fiscal year, expected revenue for FY17 is approximately $46 million, with approximately $92 million of annual revenue expected in the following years.
- Revenues from the Sweetened Beverage Tax will fund 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 2017 - 2021 Five Year Financial Plan
Major Taxes ($ in Millions) with Percentage Change from Previous Year

Tax	Actual FY15	Projected FY16	Projected FY17	Projected FY18	Projected FY19	Projected FY20	Projected FY21
Wage & Net Profits - Current & Prior	1,347.0	1,402.3	1,451.1	1,496.7	1,517.2	1,534.5	1,551.2
% change from prior year	n.a.	4.1%	3.5%	3.1%	1.4%	1.1%	1.1%
Real Property - Current & Prior	536.4	573.4	594.9	603.0	623.0	643.6	665.4
% change from prior year	n.a.	6.9%	3.7%	1.4%	3.3%	3.3%	3.4%
Business Income & Receipts - Current & Prior	438.2	455.2	446.0	450.2	459.7	472.3	481.7
% change from prior year	n.a.	3.9%	-2.0%	0.9%	2.1%	2.7%	2.0%
Sales	149.5	167.6	182.2	192.3	203.3	214.5	225.7
% change from prior year	n.a.	12.1%	8.7%	5.5%	5.7%	5.5%	5.2%
Real Property Transfer	203.4	237.5	249.6	269.1	276.5	286.0	293.2
% change from prior year	n.a.	16.8%	5.1%	7.8%	2.7%	3.4%	2.5%
Parking	79.7	91.9	95.1	98.5	101.9	105.5	109.2
% change from prior year	n.a.	15.3%	3.5%	3.6%	3.5%	3.5%	3.5%
Other Taxes	22.8	23.5	24.5	25.6	27.0	28.3	29.9
% change from prior year	n.a.	3.1%	4.3%	4.5%	5.5%	4.8%	5.7%
Sweetened Beverage Tax	0.0	0.0	46.2	92.4	92.5	92.6	92.1
% change from prior year	n.a.	n.a.	n.a.	100.0%	0.1%	0.1%	-0.5%
Total Taxes	**2,777.0**	**2,951.4**	**3,089.6**	**3,227.8**	**3,301.1**	**3,377.3**	**3,448.4**
%Change from prior year	**n.a.**	**6.3%**	**4.7%**	**4.5%**	**2.3%**	**2.3%**	**2.1%**

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 recently 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. In FY17 Sales Tax revenues are anticipated to grow by $4.7M due to a State enacted expansion of the SUT base. 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 Sugary Drink Tax are anticipated to go 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 55% 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 Updated FY2017-2021 FYP submitted to the PICA on August 8, 2016. OBPE provides forecasts of all major expenditure categories through the employment of qualitative techniques and time series analysis. The obligation estimates for the FY2017 Adopted Budget are based upon the Mayor's and City Council's priorities, and these form the basis for the FYP. Expenditures total $4.220 billion, an increase of $169 million due largely to the $64.4 million appropriated to address rising pension and health benefit obligations, $15.6 million required to pay debt service, $27.5 million to fund the Pre-K and Community Schools program, $12.7 million of reimbursable 911 equipment costs and $30 million set aside for future labor obligations of which agreements with the American Federation of State, County and Municipal Employees (AFSCME) District Council (DC) 33 and the International Association of Firefighters (IAFF) have recently been reached. All other new spending was matched by a cut at the citywide level.

a. Labor Agreements

On July 15th, 2016, a four-year tentative agreement was reached with the AFSCME DC33. The agreement pertains to all represented employees with the exceptions of those employees eligible for interest arbitration for whom only the requirements related to health, welfare and pension apply. Pending ratification by members of DC33, the material provisions of the agreement would be as follows:

- Effective July 1, 2016, a 3% increase in each step of each pay range in the DC 33 pay plan.

- Effective July 1, 2017, a 3% increase in each step of each pay range in the DC33 pay plan.
- Effective July 1, 2018, a 2.5% increase in each step of each pay range in the DC33 pay plan.
- Effective July 1, 2019, a 3% increase in each step of each pay range in the DC33 pay plan.
- The City will make a one-time lump sum payment to the DC33 Health Fund of $10 million within 30 days following ratification of the Memorandum of Agreement. The City will make an additional one-time lump sum payment to the DC33 Health Fund of $10 million on July 1, 2017 with reopener proceedings to determine the City contribution for FY19 and FY20.
- Effective October 1, 2016 or on the effective date of the ordinance (if later), the City will implement a tiered contribution system for current DC33 employees under which employees who have higher salaries pay a higher percent of their salaries as contributions to the pension fund. Contributions will increase by as little as 0% for those with annual salaries less than or equal to $45,000 to as much as 3% for annual salaries above $100,000.
- Additionally, all new hires as of the date of the legislation passage would be required to enter a stacked hybrid plan with a defined benefit equivalent to the existing Plan Y (Plan 87) for the first $50,000 of earnings and a defined contribution pension for earnings above $50,000. Plan 10 would be closed to new enrollment for members of DC33 and those currently in Plan 10 will have 90 days from the effective date to make an irrevocable election to opt into the stacked-hybrid.
- Within 30 days of the effective date of the ordinance implementing the pension changes described under the previous bullet, all DC33 bargaining unit members will receive a bonus payment of $500. Bonuses for part-time employees and school crossing guards will be in accordance with the practices put in place by the 2014 Memorandum of Agreement.

The updated forecasted statements include the contracted pay raises in FY2017 for the following municipal unions:

- AFSCME DC33, Local 159 – 3.25%;
- AFSCME DC47, Locals 2187 and 2186 – 3.0%;

- Fraternal Order of Police (FOP) Lodge 5 – 3.25%;
- FOP Deputy Sheriffs – 3.25%;
- IAFF – 3.25%.

Contracts with the above unions are scheduled to expire at June 30, 2017. It is anticipated that negotiations will occur during FY2017, prior to the expiration of these contracts.

Negotiations with the other unions, which include AFSCME DC47 and Local 810 Courts, are currently in progress. For members employed by the Register of Wills, wage increases mirror those of DC 33 negotiated for the period of July 1, 2016 through June 30, 2017.

The Administration hopes to resolve all upcoming contract issues as soon as possible in a way that is fair to both employees and taxpayers. The Forecasted Statements include a total of $328 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 likely to be necessary.

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.

AFSCME DC47, 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 DC47, an increase of 5.0% per year based on medical cost trends has been included.

AFSCME DC 33 projections are based on prior year expenditures, as the recent negotiation did not affect the per member per month City calculation. However, the updated FYP does account for the two $10 million lump sum payments detailed under the labor agreement section.

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 or 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 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 DC33 Local 159. 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. 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 $8.8 million in FY16, and these revenues will increase over time, especially once the debt service is paid off. By FY21, the sales tax revenues for the pension fund are projected to reach $52.9 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 7.75%. 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.

D. Subsequent Events

Subsequent to August 8, 2016, the completion date of the updated forecasted statement, members of AFSCME DC33 ratified their contract with the City. Estimated General Fund costs of $119.4 million over the life of the updated forecast have been included as future labor obligations.