Cash Report: Fiscal Year 2020

City Controller
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The City of Philadelphia (City) releases a summary of its current financial state, entitled the Quarterly City Manager's Report (QCMR), 45 days after the close of each fiscal quarter. As part of the QCMR, the City publishes actual and projected monthly cash balances for its major operating funds, as well as revenues and expenditures for its principal operating fund, the General Fund. The QCMR offers the most up-to-date snapshot of the current cash position of the City and the most accurate projection for cash balances at the close of the fiscal year. As part of our ongoing commitment to increasing transparency around the City's financials, the Controller's Office releases data on the City's cash position in an interactive format following the release of each QCMR.

This report summarizes the City's cash position at the end of the fourth quarter of fiscal year 2020 (FY20 Q4). It is the first report to reflect the initial impacts of the ongoing COVID-19 pandemic on the City's finances. The ultimate impact of the pandemic remains unknown, but as unemployment remains above 15% and many small businesses remain closed, the effect on the city's economy continues to be substantial. The Controller's Office will continue to monitor the City's finances in future cash reports.

The report is divided into two main sections. The first discusses the cash balances for the City's major funds, and the second examines the revenues and expenditures associated with the General Fund. In both sections we present actual data for the entirety of FY20. All data used in this report is taken directly from the City's QCMRs. The QCMR for FY20 Q4 can be found here.

Key Takeaways

- The City's General Fund ended FY20 with a balance of $759M, down from a year-end balance of $966M in FY19. This is the first year-over-year decrease since FY15, and the largest single-year decline since the last recession in FY08.
- The Consolidated Cash account ended with its highest balance since FY07, due in part to a historically high Capital Fund balance and an influx of grant money as part of the federal response to the COVID-19 pandemic.
- Total cash revenue for the General Fund declined by 4.6% relative to FY19. Major factors include a delay in the filing deadlines for the City's business taxes as well as the economic shutdown in response to the ongoing pandemic, which led to year-over-year declines in all major tax revenue collections in FY20 Q4.
- Total cash spending for the General Fund increased by 4.0% in FY20 relative to FY19. Payroll spending accounted for the largest increase, which increased by 36% in FY20 Q4 relative to FY19 Q4. Spending on contracts and materials/equipment increased 26% and 24%, respectively. Contributing factors include historically high overtime spending, temporary wage increases, retroactive labor contract extensions, and higher costs associated with the City's response to the COVID-19 pandemic.

Cash Balances

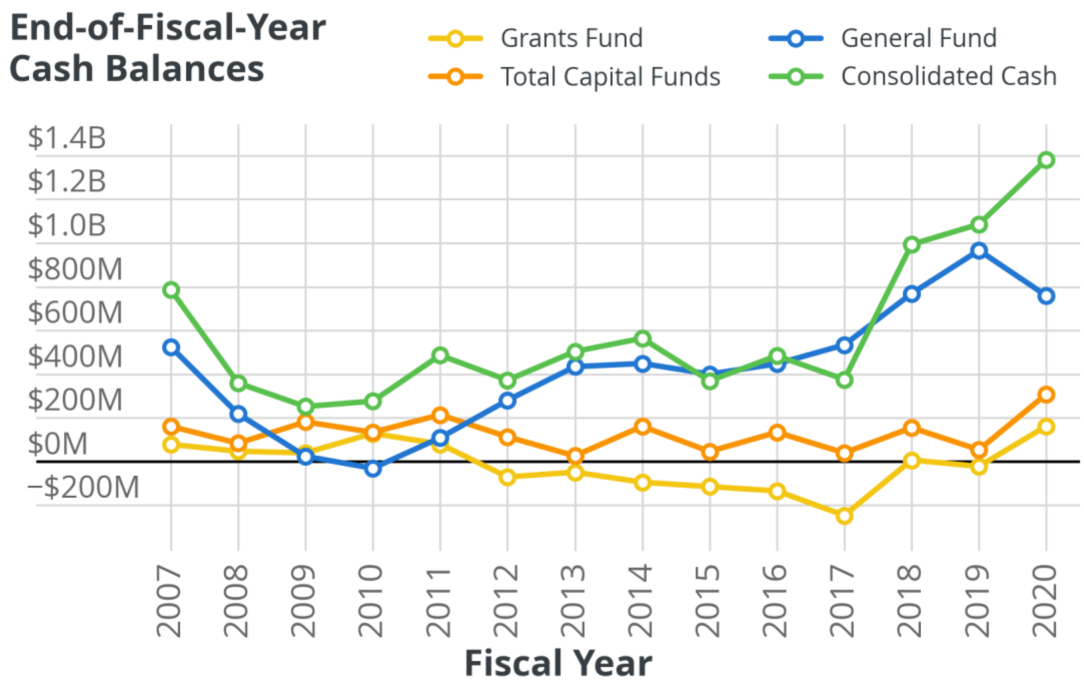
The City publishes the monthly cash balance, actual and projected, for each of its major funds, within the QCMR. For its day-to-day operations, the City pools together the cash balances associated with several funds into a single account, known as the Consolidated Cash account. Three major funds, listed below, and several smaller funds, including the Housing Trust and Hospital Assessment Funds, contribute to the Consolidated Cash account:

- the General Fund, which is the principal operating fund of the City. About three-quarters of the revenue flowing into the General Fund is generated from local taxes;
- the Grants Fund, which manages grants received from state, federal, and private agencies; and
- the Capital Fund, which manages resources for investing in facilities and infrastructure throughout the City. The majority of its revenue arises from bond proceeds.

Following years of strong economic growth, the City began FY20 with historically high cash levels, a trend that continued through the first three quarters of the fiscal year. However, beginning in April 2020, the COVID-19 pandemic had a dramatic and immediate effect on the City's cash levels. Social distancing measures and the city's stay-at-home order led to a sharp decline in economic activity, leading tax revenue collections to fall sharply in the last quarter of FY20. In addition to declining revenues, the City shifted the filing dates for the Business Income and Receipts Tax (BIRT) and the Net Profits Tax from April 2020 to July 2020 to match changes to the federal tax filing date. For these reasons, revenue collection fell sharply in FY20 Q4, and the City's General Fund ended the fiscal year with a balance of $759M, a decline of $208M from the year-end balance for FY19. While this represents the largest year-over-year decline for the General Fund since the Great Recession in FY08, the year-end balance in FY20 is similar to the year-end balance for FY18 and is still larger than any closing balance from FY07 to FY17. These reserves will be necessary throughout the next fiscal year, as the economic impact of the ongoing pandemic continues. The City projected further declines in the adopted FY21 budget and is expecting to end the year with a General Fund cash balance of $505M.

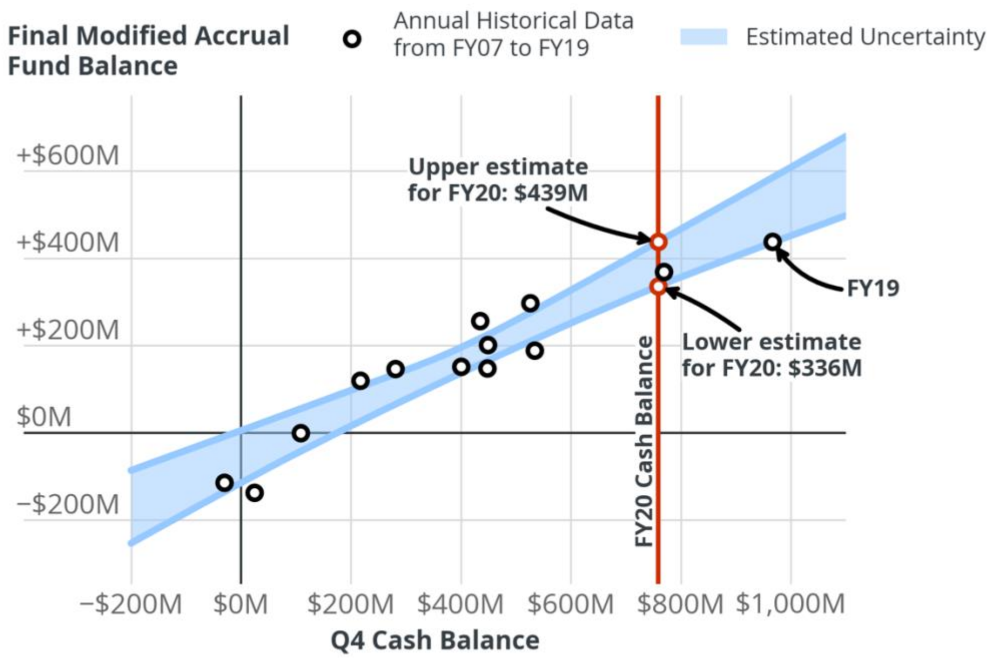
Despite the General Fund's lower balance, the City's Consolidated Cash account ended the fiscal year with a balance of $1,382M, an increase of $296M from FY19 and the highest year-end balance since at least 2007. This was due in part to higher balances for both the Capital Fund and Grants Fund at the end of FY20. The year-end Capital Fund balance remained historically high following an uncommonly large issuance of new debt (about $300M) in the first quarter of FY20. These funds will continue to be spent down over the course of the next several years, as capital projects for facilities and infrastructure across the city are undertaken. The Grants Fund ended the fiscal year with a positive balance of $162M resulting from an influx of grant funding in response to the ongoing COVID-19 pandemic. This funding included $276M from the federal CARES Act,[1] with $100M going to the General Fund and the remaining amount ($176M) going to the Grants Fund.

[1] "Update on the City's Recovery Efforts," Recovery Office, September 2020 (Slide 22).



As the COVID-19 pandemic continues, the City is expecting revenue declines to persist through the next fiscal year, and the City's reserves will be an important tool in weathering the economic downturn. Internally, the City aims for a General Fund balance that is between 6% and 8% of annual expenditures, while the Government Finance Officers Association (GFOA) recommends municipalities, regardless of size, maintain a fund balance equal to at least 17% of annual expenditures. These guidelines are set for a fund balance reported on a modified accrual basis, rather than a cash basis. The modified accrual basis accounts for future, but known, revenues and expenditures. Fund balances using this method are typically lower than balances on a cash basis. For example, in FY19 the City's General Fund balance on a modified accrual basis was $438.7M, or 9.2% of annual expenditures. On a cash basis, the General Fund balance was $996.4M, or 21% of expenditures.

The General Fund's FY20 cash balance of $758.8M represents about 16% of the year's cash expenditures. On a modified accrual basis, the end-of-year balance is currently projected to be $254.9M, which is about 5.0% of total expenditures. As seen in the chart below, this modified accrual projection is likely to be underestimated. Based on the General Fund's cash balance at the end of FY20, the final modified accrual balance is likely to fall between $336M and $439M, or about 6.6% and 8.6% of annual expenditures, respectively. If the balance were to fall within this range, it would satisfy the City's internal goal of 6% to 8% but still fall short of the GFOA's recommended level.



General Fund Revenue / Spending

As the principal operating fund for the City, the General Fund's finances offer a unique perspective on the City's current fiscal state. Monthly revenues and expenditures for the General Fund are published as part of the QCMR and offer further insight into the cash position of the City. The majority of revenues for the General Fund are generated from local taxes, the largest of which are the Wage Tax, Real Estate Tax, and the Business Income and Receipts Tax. On the expenditure side, the City's largest annual costs are due to payroll, pension payments, and employee benefits. Other costs include purchases of services (e.g. contracts), debt payments, and equipment and supplies.

Total cash revenue for the General Fund totaled $4,627M in FY20, a decline of $220M from last fiscal year, while cash spending totaled $4,835M, an increase of about $185M. As seen in the chart below, FY20 was the first fiscal year that General Fund spending exceeded cash receipts since FY15. Over that period, the City's annual cash spending has increased dramatically, by more than $1,000M. In recent years, strong economic and revenue growth supported the increased spending, but the economic contraction initiated by the COVID-19 pandemic saw City revenues fall and spending rise, forcing the City to rely on its reserves to account for the deficit.

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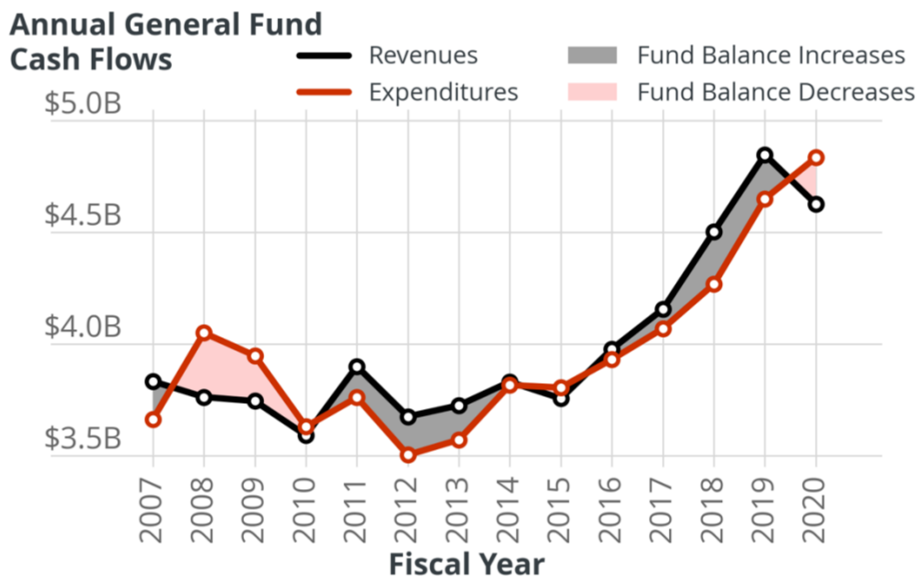
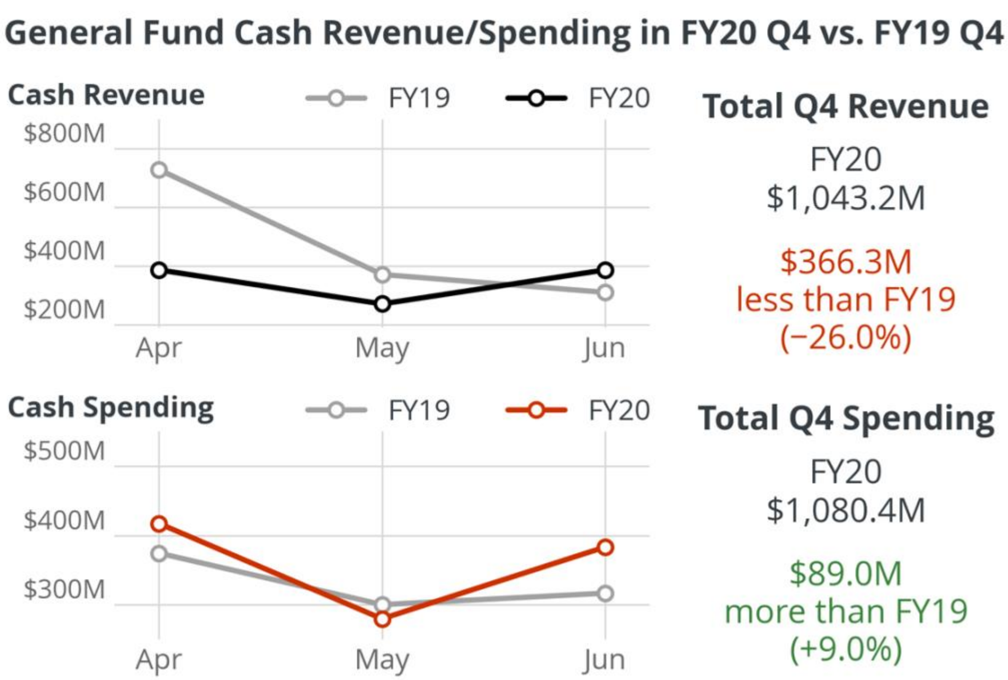
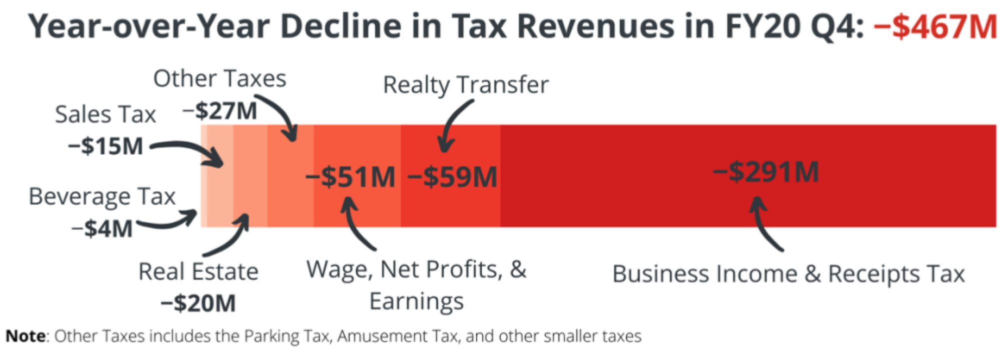


The fiscal impact of COVID-19 was large, leading to lower cash receipts and increased spending. Through three quarters of the year, cash revenue had increased year-over-year by about 4.2%, while spending had increased by 2.6%. However, by the end of the fiscal year total revenue had declined relative to FY19 by 4.6% and spending had increased by about 4.0%. Relative to FY19, the City collected $366M less in revenue during the fourth quarter of FY20, while spending $89M more than in FY19 Q4. As seen in the chart below, the largest revenue decline came in the month of April due to the City shifting deadlines for BIRT and the Net Profits Tax to July 2020 (the first month of FY21).



The year-over-year decline in General Fund revenue in FY20 Q4 (-$366M) underestimates the true revenue impact of COVID-19, as it includes $100M in additional revenue received through the CARES Act as part of the federal pandemic response.[2] When including only tax revenue receipts, revenue collections declined by $467M in FY20 Q4 relative to FY19 Q4. Due to the change in the filing date, the decline in BIRT collections was most severe, although the City anticipates making up most, but not all, of the BIRT decline following the July filing deadline. However, collections of all major tax revenues declined year-over-year in FY20 Q4, a reflection of the significant reduction in economic activity throughout FY20 Q4.



As the City addressed the COVID-19 pandemic in FY20 Q4, spending in three main areas had large increases relative to the fourth quarter of last fiscal year. Spending on payroll for City employees increased most dramatically, with the City spending $137M more on payroll in FY20 Q4 than in FY19 Q4, a year-over-year increase of 36%. Contracted spending and spending on materials/equipment also saw large relative increases, increasing by 26% (+$49M) and 24% (+$6M), respectively, relative to the fourth quarter of last fiscal year.

The large increase in payroll spending is the result of long-term trends, exacerbated by the COVID-19 pandemic. In recent years the City's workforce and overtime costs have both grown by a substantial amount, typically a sign of poor overtime controls and management. The City ended FY20 with 22,422 General Fund employees, 212 more employees than at the end of FY19. Meanwhile, the City's annual overtime costs surpassed $200M for the first time ever in FY20 and increased by 16% (+$28M) relative to FY19.[3] In addition to rising overtime costs, the City also agreed to temporary wage increases (a pay rate of 150% per hour) for about 15,000 employees deemed essential during the start of the pandemic. Finally, the City also agreed to one-year contract extensions with its four municipal unions that included negotiated wage increases and retroactive payments that impacts payroll costs in FY20 Q4.

Conclusion

The COVID-19 pandemic had a large and immediate effect on the City's finances. Delays in filing deadlines for BIRT shifted more than $200M in collections from FY20 Q4 to the first quarter of FY21. The economic shutdown precipitated by the pandemic led to sharp declines in all major revenue collections, while the public health response required additional spending increases. The

[2] Note that the City received $276M as part of the CARES Act and only $100M of that funding was transferred to the General Fund as revenue during FY20.
[3] Source: PICA FY20 Annual Overtime Report

result was the largest year-over-year decrease in the City’s year-end General Fund balance since the Great Recession. However, the City entered FY20 with historic cash levels, and the year-end General Fund balance in FY20 was on par with the year-end balance for FY18 and was still larger than any closing balance from FY07 to FY17. With the COVID-19 pandemic ongoing and the largest economic impacts expected in the next fiscal year, the City’s cash reserves will be more important than ever in weathering this unprecedented fiscal and public health crisis.