

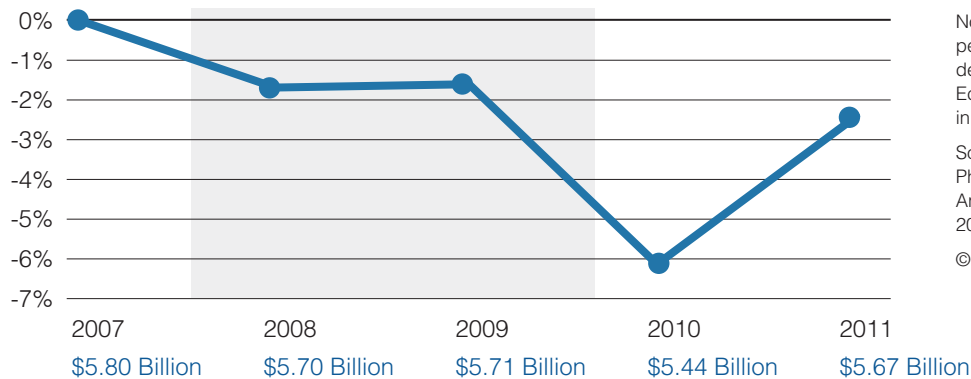
Philadelphia

Grim budget forecasts forced Philadelphia to make hard choices

By 2011, revenue was still 2 percent below the pre-recession peak, and Philadelphia's financial outlook was mixed. (See Figure 1.) Revenue bottomed out in 2010, primarily because of declines in intergovernmental aid. Then, faced with budget projections of \$2 billion in shortfalls over the next five years, city and state officials made a series of tough decisions.¹ The city raised taxes, aggressively drew down reserve funds, and reduced many major areas of spending.² In 2010 and 2011, property tax collections contributed to a revenue uptick, and spending cuts helped policymakers begin restoring the city's reserves. Still, underfunded retirement obligations remain a concern for city finances going forward.³

FIGURE 1

Philadelphia Governmental Revenue, Percent Change From Pre-downturn Peak, 2007-11



Note: Shaded area indicates the period of the Great Recession as defined by the National Bureau of Economic Research. Amounts are in 2011 dollars.

Source: Pew calculations from Philadelphia's Comprehensive Annual Financial Reports for fiscal 2007-11.

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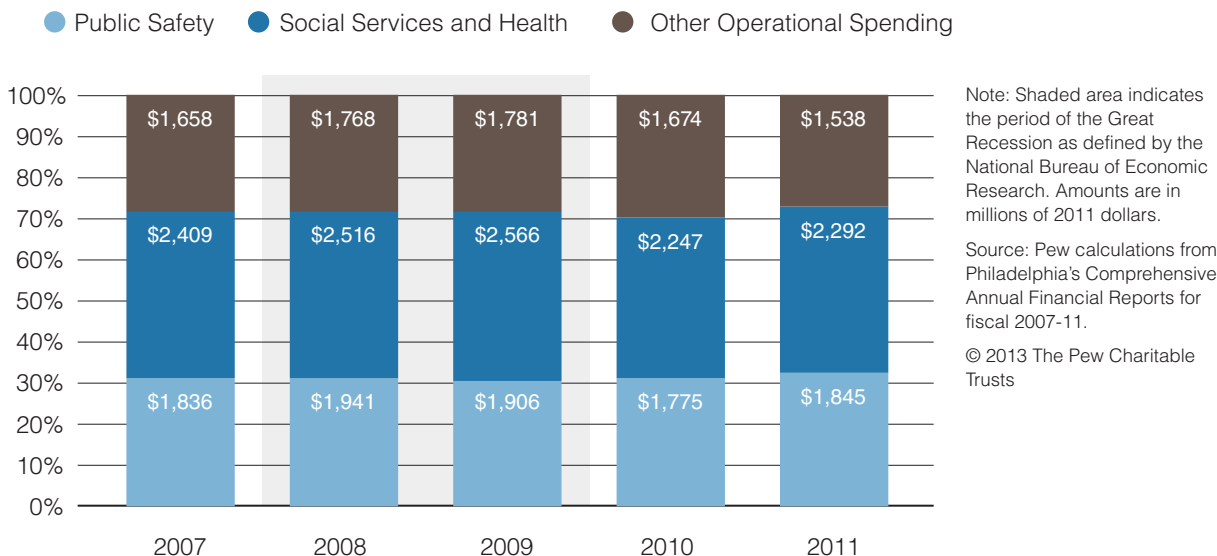
Increases to sales tax and property tax rates and a delay to reductions in income taxes kept revenue afloat

Philadelphia lost \$356 million in total, inflation-adjusted revenue between a high point in 2007 and the lowest point in 2010. Declines in intergovernmental aid drove the losses despite an infusion of funds from the American Recovery and Reinvestment Act for the city.⁴ Wage tax revenue also fell precipitously, declining \$107 million over the period, even though the city delayed a scheduled 2009 rate decrease.⁵ Sales taxes grew \$71 million, offsetting other losses, but only after state officials authorized the city to temporarily increase sales tax rates in 2009.

City officials cut operating spending sharply between 2007 and 2010. A \$149 million drop in social service and health expenditures and a \$50 million reduction in public safety were the largest of the cuts. Together, these categories represent about two-thirds of city expenditures.⁶ (See Figure 2.) Cutbacks in spending also included workforce reductions, mandatory furloughs for certain employees, and pay cuts for executive staff.⁷ Philadelphia also deferred annual recommended payments to its pension system to meet current spending needs. Still, despite these cuts and other maneuvers, the city ran a \$259 million deficit in its general fund in 2010.

FIGURE 2

Philadelphia Operating Spending by Category (in millions), 2007-11



In 2010, the city council raised property tax rates, a move that helped this revenue source grow 18 percent a year later and become the major driver of the city's fiscal rebound.⁸ The city also cut spending another \$16 million in 2011. Combined, revenue growth and expenditure cuts in 2011 helped Philadelphia reduce its general fund deficit to \$46 million.

Managing the future: Long-term liabilities loom large as Philadelphia works to meet 5-year balanced-budget projections

Demand for services, investment decisions, and revenue performance will be critical factors in Philadelphia's future fiscal well-being. Two long-term obligations which can be analyzed using the data available are pensions and retiree health care and other benefits.

As the result of a previous state intervention to help turn around Philadelphia's finances,⁹ the city is required to submit an annual plan that balances the budget five years into the future to a state oversight board.¹⁰ Among other fiscal concerns, this long-term planning highlights issues in the management of retiree liabilities.

Philadelphia had not set aside any assets to cover \$1.8 billion in retiree health care liabilities as of 2010.¹¹ Of even greater concern, however, was \$7 billion in shortfalls the city faced in its pension funds, which were just 61 percent funded that year.¹² At press time, unresolved contracts with city workers' unions could raise future personnel costs, and, consequently, the cost of pension obligations.¹³ These bills are cause for concern as growing annual pension payments claim an increasing portion of the city's available revenue.

See Pew's 30-city interactive at pewstates.org/City-Fiscal-Conditions-Interactive for complete data.

Endnotes

1 Moody's Investor Service, *Moody's Assigns Aa2 Rating to the City of Philadelphia Municipal Authority's (PA) \$13.2 Million City Agreement Revenue Bonds, Series 2012A and B New Issue* (2012), https://www.moody.com/research/MOODY-ASSIGNS-A2-RATING-TO-THE-PHILADELPHIA-MUNICIPAL-AUTHORITYS-PA-PR_243694.

2 *Municipal Pension Plan Funding Standard and Recovery Act - Omnibus Amendments* (2009), <http://www.legis.state.pa.us/WU01/LI/LI/US/HTM/2009/0/0044..HTM>; Moody's Investor Service, *Moody's Assigns Aa2 Rating to the City of Philadelphia Municipal Authority's (PA) \$13.2 Million City Agreement Revenue Bonds, Series 2012A and B* (2012).

3 See the full study methodology at pewstates.org/City-Fiscal-Methodology for a detailed explanation of the terms used in this profile and view the underlying data at pewstates.org/City-Fiscal-Conditions-Interactive.

4 Recovery.gov is the official U.S. government website for data related to the American Recovery and Reinvestment Act: <http://www.recovery.gov/Transparency/RecoveryData/Pages/RecipientReportedDataMap.aspx?stateCode=PA&PROJSTATUS=NPC&AWARDDTYPE=CGL>.

5 The city wage tax, the largest locally generated revenue source, had been undergoing incremental rate cuts since the mid-1990s. The current rates, at about 3.9 percent for residents and 3.5 percent for commuters, are the highest such municipal, flat-rate levies in the country. Joseph Henchman, "County and City Income Taxes Clustered in States with Poor Tax Climates," Tax Foundation (2008), <http://taxfoundation.org/article/county-and-city-income-taxes-clustered-states-poor-tax-climates>; Stephanie Marudas, "Good News: Lower Philly Wage Taxes in 2009," WHY (2009), <http://why.org/cms/itsourcity/2009/01/21/good-news-lower-philly-wage-taxes-in-2009>.

6 Philadelphia is one of 20 cities among those studied that has responsibilities for social services.

7 City of Philadelphia, Pennsylvania, *Supplemental Report of Revenues & Obligations, Fiscal Year Ended June 30, 2010* (2010), p. 3, http://www.phila.gov/finance/pdfs/supplementalfy10_2_18_11.pdf; City of Philadelphia, Pennsylvania, *Comprehensive Annual Financial Report, Fiscal Year Ended June 30, 2010* (2010), p. 3, http://www.phila.gov/reports/CAFR_2010_GAGAS_20110923.pdf.

8 Mike Dunn, "Huge Philadelphia Property Tax Hike Draws Near," *CBS Philly*, Nov. 17, 2010, <http://philadelphia.cbslocal.com/2010/11/17/philadelphia-property-tax-hike-looms>; Jeff Shields, "Philadelphia Must Justify Property-tax Projections, Katz Says," *Philly.com*, March 31, 2011, http://articles.philly.com/2011-03-31/news/29366291_1_pica-board-property-tax-hike-pennsylvania-intergovernmental-cooperation-authority; Mark Robyn, "Philadelphia Sales Tax Increases Tomorrow; State Debates Expanding the Sales Tax Base," Tax Foundation, *The Tax Policy Blog*, Oct. 7, 2009, <http://taxfoundation.org/blog/philadelphia-sales-tax-increases-tomorrow-state-debates-expanding-sales-tax-base>.

9 Throughout the country, states have varying regulations on how to intervene in local government fiscal distress. For example, New York City was required to submit financial data to New York State. The Pew Charitable Trusts, "The State Role in Local Government Financial Distress," http://www.pewstates.org/uploadedFiles/PCS_Assets/2013/Pew_State_Role_in_Local_Government_Financial_Distress.pdf.

10 The General Assembly of Pennsylvania, House Bill No. 209, *Pennsylvania Intergovernmental Cooperation Authority Act*, 1991, http://www.picapa.org/docs/OTH/PICA_Act.pdf.

11 For more information and analysis on the state of retirement funding in the 30 cities, see The Pew Charitable Trusts, American cities project, *Cities Squeezed by Pension and Retiree Health Care Shortfalls* (March 2013), http://www.pewstates.org/uploadedFiles/PCS_Assets/2013/Pew_city_pensions_brief.pdf.

12 Teacher pension liabilities were only included for cities that reported those obligations in their comprehensive annual financial reports, specifically New York, Philadelphia, and the District of Columbia.

13 Bob Warner, "Tensions Rising over Philadelphia's Lack of Municipal Union Contracts," *Philly.com*, March 9, 2013, http://articles.philly.com/2013-03-09/news/37564090_1_shannon-farmer-herman-j-pete-matthews-city-workers.