



City of Philadelphia Updated budget forecast

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Mayor

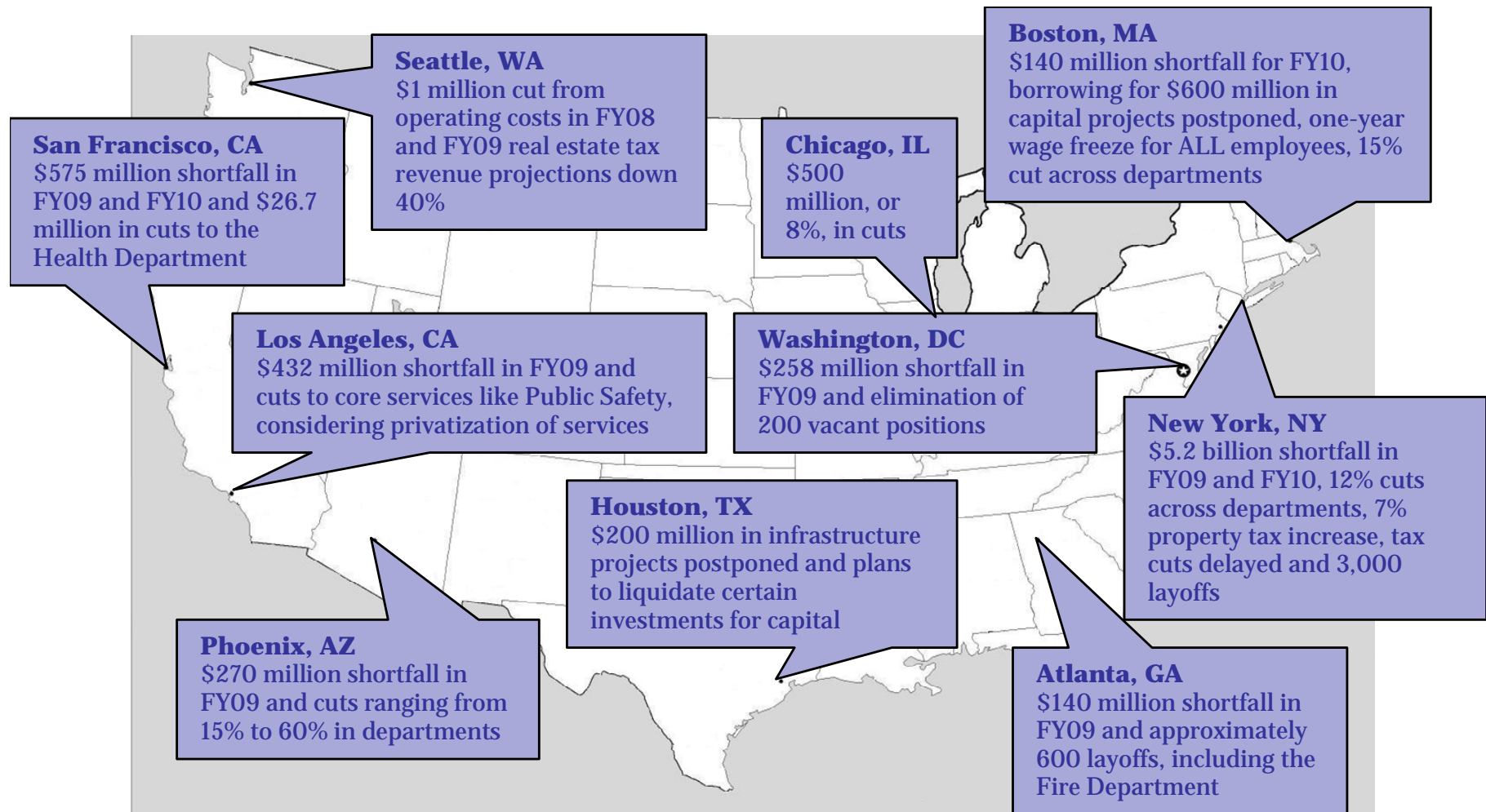
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Philadelphia's crisis in perspective



- The crisis is unprecedented
 - President-elect Barack Obama, January 2009: “A crisis unlike any we have seen in our lifetime”
- According to the National Bureau of Economic Research, the national economy is now in a recession that began in December 2007
 - Current forecasts suggest that in the 4th Quarter 2008 the US economy declined significantly and may shrink as much as 5% from the 3rd Quarter of 2008
- The crisis is global
 - UK and Spain are also officially in recession, with every other major economy anticipating a recession
- Since November, the City's revenues have dropped further, forcing us to close another \$1 billion gap over the next five years

Situations in cities across the country



Philadelphia's forecasts



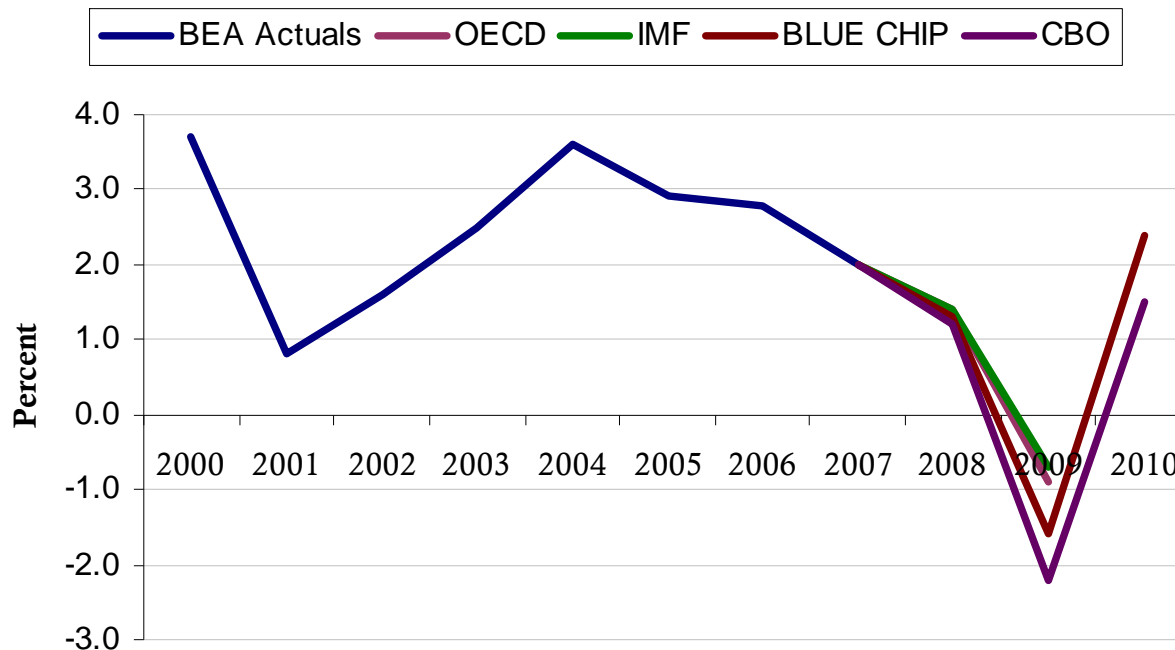
- To forecast local economic growth and City revenues, the City uses economic models based on a range of variables, most importantly national economic growth (GDP).

Real GDP falls



Real GDP is one of the key indicators of economic activity, and all national indicators show a significant contraction in 2009.

U.S. Annual Real GDP, 2000-2009



Sources:

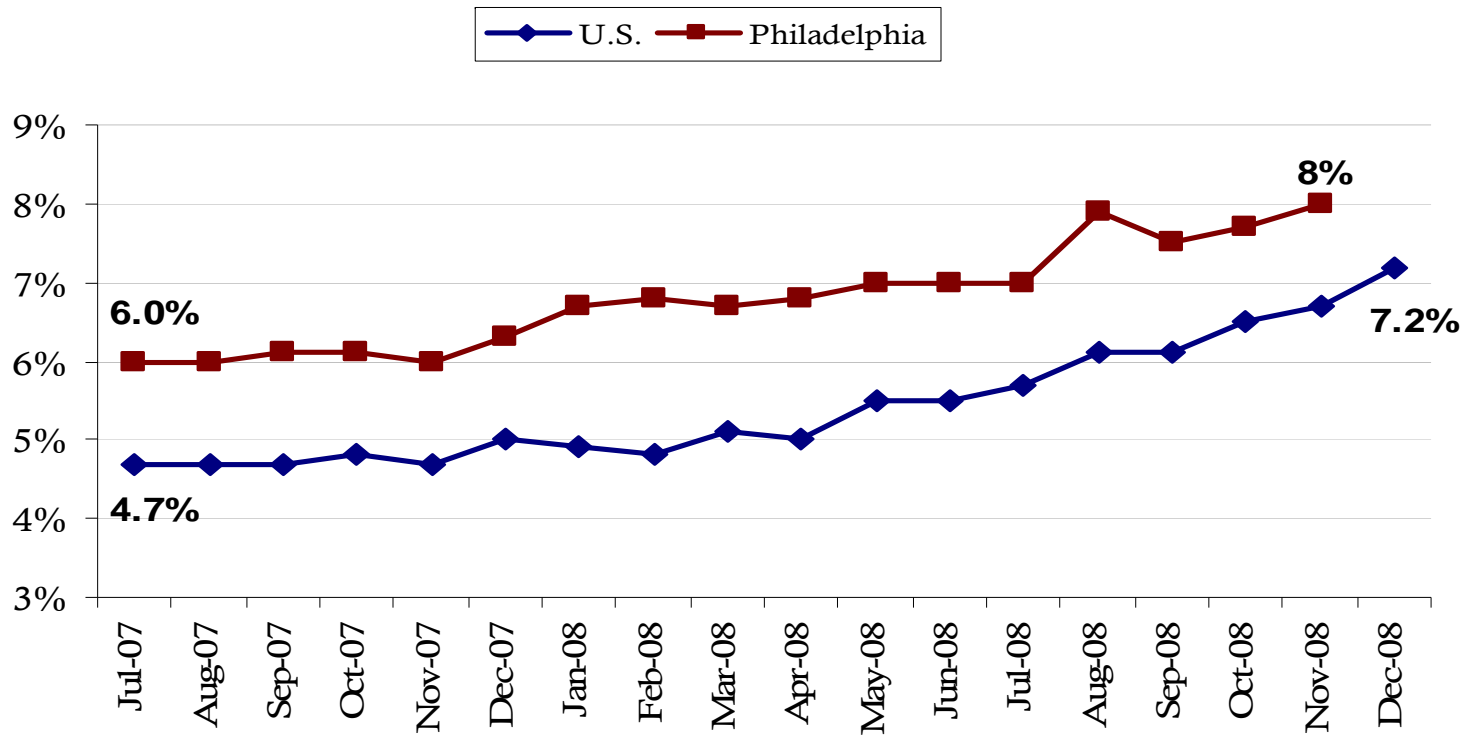
Bureau of Economic Analysis, "GSP: Third Quarter 2008 (Preliminary)", November 25, 2008; "Blue Chip Economic Indicators", January 2009; International Monetary Fund, "World Economic Outlook Update", November 2008; Organisation for Economic Co-Operation and Development, "OECD Economic Outlook", December 2008; Congressional Budget Office, "The Budget and Economic Outlook: Fiscal Years 2009 to 2019" January 2009

Unemployment rises



Unemployment reached a national 15-year high in November 2008, and grew further in December. Philadelphia's unemployment rate has also risen, reaching 8% in November 2008. However, there is a lag in the data, and many national economists predict that national unemployment will exceed 10%.

Monthly Unemployment Rates, U.S. vs Philadelphia, July 2007- December 2008



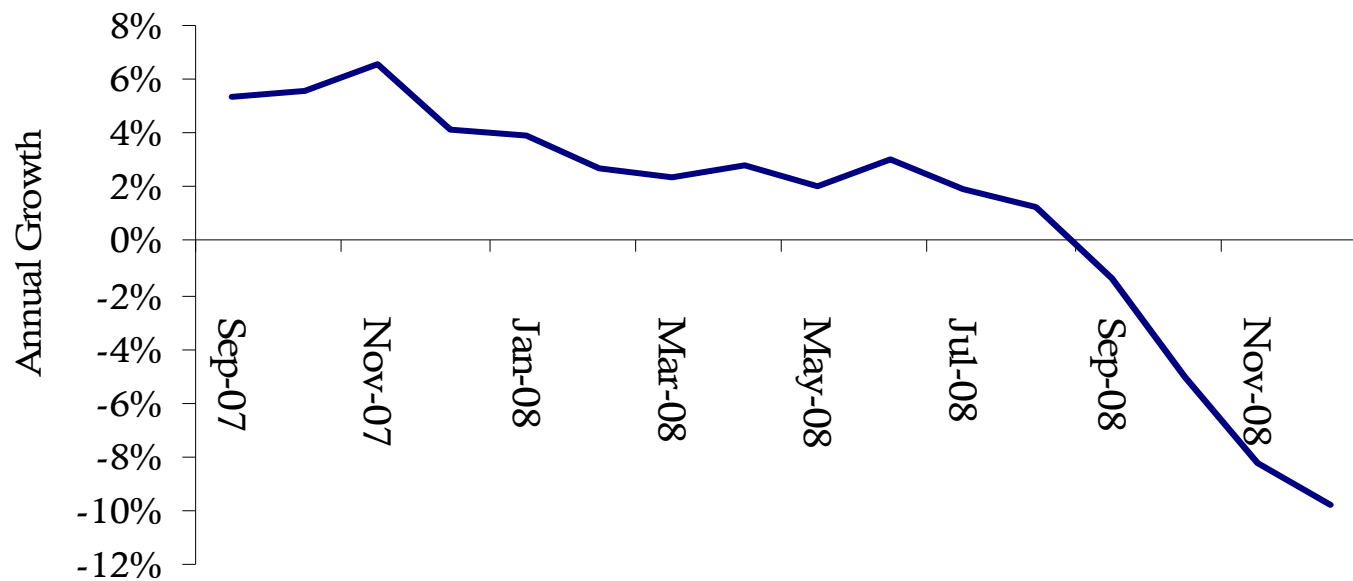
Source: Bureau of Labor Statistics, "Selected unemployment indicators", December 2008

Consumer Spending Falls



Consumer spending accounts for 2/3 of the national economy, driven by consumer demand for goods and services. Since the onset of the recession in December 2007, national retail sales have steadily decreased.

Total National Retail & Food Sales



Source: US Census Bureau, "Advance Monthly Sales for Retail and Food Services", December 2008

Decline in the Stock Market – Impact on the Pension system

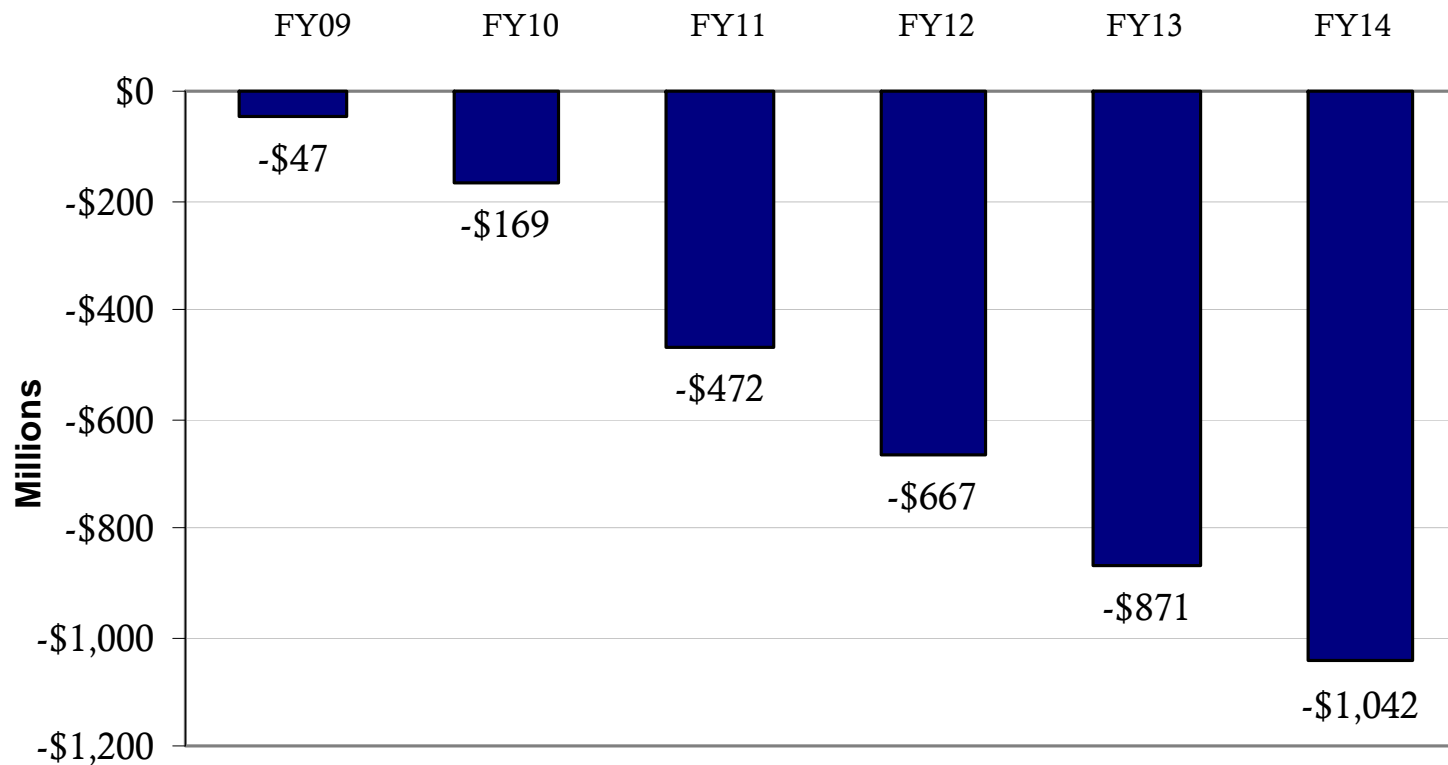


- Global stock markets suffered an unexpected decline in late 2008, causing a dismal ripple-effect worldwide. Several banks saw asset values diminish, and many were forced to merge or collapse. The credit and equities markets plummeted to unprecedented levels shortly afterwards.
- The weakening stock market caused significant losses in the value of the current pension system in Philadelphia. Since the beginning of the fiscal year through November 30, 2008, Philadelphia's pension system lost 21.86%. However, the City outperformed benchmark earnings in the same period (at -22.84%), showing the prudent investment strategy that the City has developed.
- Nevertheless, the City's pension system lost over \$650 million in the first 9 months of 2008. That loss increased the City's projected budget costs for pension contributions by \$300 million between FY10 & FY13.
- In addition, the credit crisis makes it increasingly difficult for Philadelphia to go to market for a new pension obligation bond. As the City is unable to plan for the proposed bond, the \$140 million in savings that were anticipated over the next five years cannot be received.

Projected Losses in the Fund Balance Total \$1.04 billion Over 5 years



Philadelphia must budget over five years (instead of one or two). This requires us to take a long-term perspective and promotes fiscal responsibility.



Projected Losses Total \$1.04 Billion Over 5 Years



Of the \$ 1 billion, over \$650 Million are based on data we have today, and another \$375 Million are anticipated based on assumptions of the economy's performance

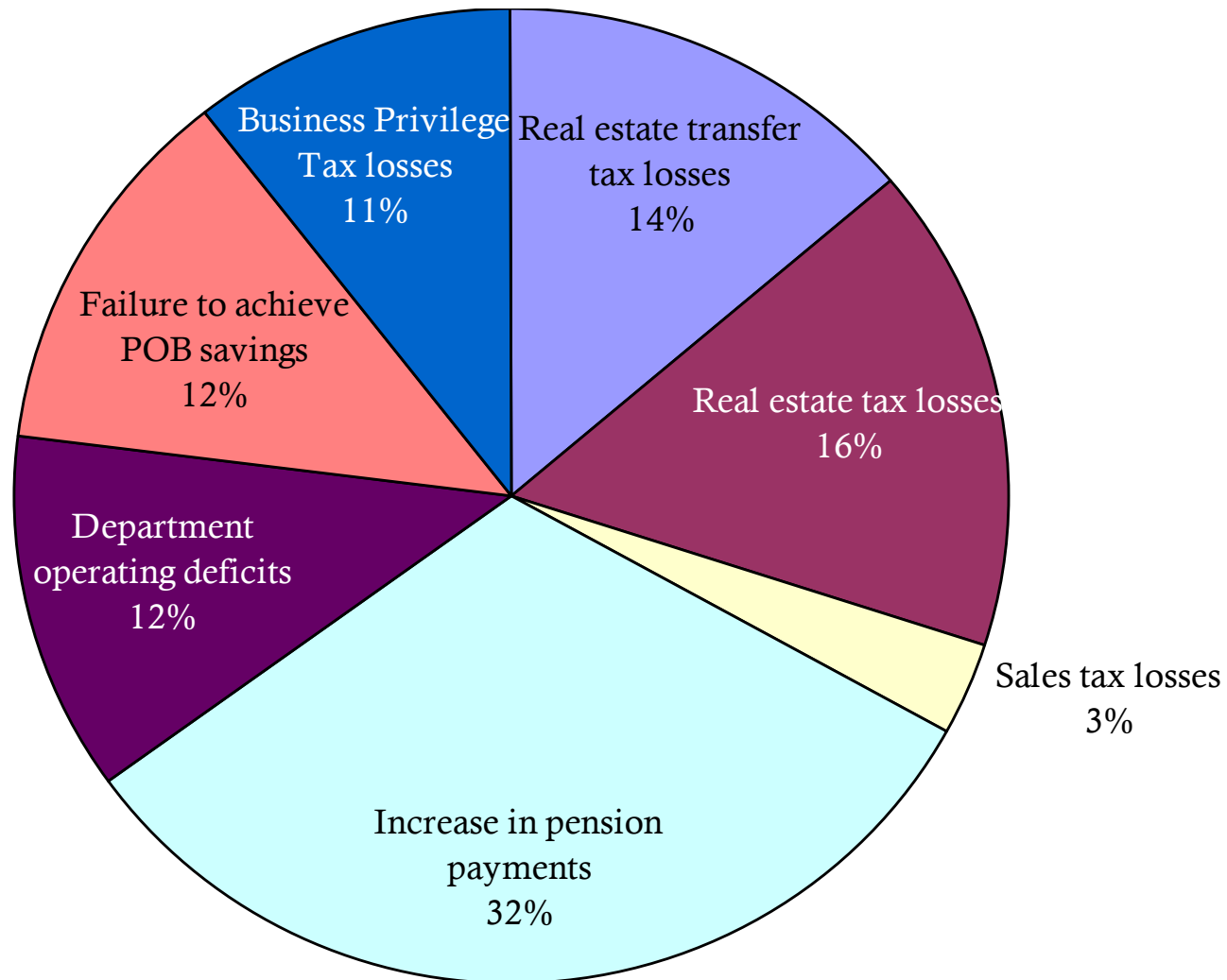
Real estate transfer tax losses	-\$158.4 million
Real estate tax losses	-\$180.4 million
Sales tax losses	-\$36 million
Increase in pension payments	-\$239 million
Department operating deficits	-\$138 million
Positive Fund Balance	\$88 million
Total Known Losses	-
\$663.7 million	
Failure to achieve POB savings	-\$140 million
Add. increase in pension payments	-\$119.5 million
Business Privilege Tax losses	-\$119.3 million
Total Additional Assumed Losses	-\$378.8 million
TOTAL LOSSES	-\$1.04 billion

A Breakdown of the Projected \$1.04 Billion in Losses



Cause	Effect
The failing stock market has produced poor returns on Philadelphia's pensions	Increased pension payments
A fall-off in the number of real estate transactions and price	Losses in real estate transfer taxes
Poor growth in assessments (0.25% in 2008 instead of a projected 2.5%)	Losses in real estate taxes
Declining consumer spending	Losses in sales taxes
Assumed impact of slowed business activity	Losses in business privilege taxes
The tightened credit market has hindered Philadelphia's ability to go to market	Failure to achieve Pension Obligation Bond savings

Components of the \$1.04 billion in Projected Losses Over 5 Years





Other Major Budget Challenges

In addition to the immediate budget shortfall, the City needs to find long-term solutions to deal with escalating costs

■ Prisons and Criminal Justice System

- The prison annual budget is more than \$230 million, and the courts cost the City over \$100 million. These two services alone account for 8% of the City's total budget.
- In 1985 the State Supreme Court ordered the Commonwealth to fund the court system. However, the Commonwealth has refused to comply with the Supreme Court's order, leaving the City to absorb the cost.
- Without these burdens, the City would have more discretionary funds to allocate across City services and programs.

■ Pensions and Health Care Benefits

- The revised FY09 budget's fringe benefits total \$965 million (of which \$461 million consists of pension costs) out of the \$3.9 billion total general fund budget, or 25% of total costs.
- Fringe benefits are expected to rise to \$1.2 billion in FY14 and account to 29% of total costs.
- Unless health care benefits and pension costs stop rising, Philadelphia will have to find other ways of balancing the budget, such as raising more revenues or cutting services

Things May Continue to Worsen



- The unprecedented financial and economic crisis remains volatile and exceptionally uncertain
- Economists cannot predict the length or the depth of the crisis
- If the economy continues to deteriorate, Philadelphia's revenues will drop further than presented here
- The City will continue to remain vigilant of the effects of the economic crisis on Philadelphia's budget because without getting the fiscal health of the City in order, the administration cannot govern effectively.