

# NEWS



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## MAYOR'S OFFICE OF COMMUNICATIONS

Michael A. Nutter, Mayor  
Douglas I. Oliver, Press Secretary

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**FOR IMMEDIATE RELEASE**

### MAYOR NUTTER'S STATEMENT ON CITY FINANCIAL SITUATION

*Philadelphia, September 11* – Mayor Michael A. Nutter gave the following statement this afternoon at a press conference in City Hall:

Good afternoon. We're here today to talk about the city budget and some serious challenges that the City of Philadelphia faces at this time.

We're living in a time of dramatic economic change with volatile changes in the marketplace on a daily basis. We've seen energy prices soar. Consumer confidence plummets. Mortgage foreclosure crises.

Add an increase in the rates of inflation and unemployment, and the most charitable thing you can say about our economy is that we're living in perilous times.

We've seen the sub-prime mortgage debacle continue to work its way through the economy leaving wreckage in its wake. In March, Bear Stearns, the global investment bank, crashed and was eventually sold at pennies on the dollar. In an effort to cope with the spreading economic decline, we've seen The Fed lower interest rates while the U.S. government sent out tax refunds to stimulate the economy. Neither of these tactics have yet to stop the bleeding.

And in the last week, we've seen something on the order of the unthinkable when the federal government took over Fannie Mae and Freddie Mac, the giant mortgage companies which own or guarantee half of the \$12

trillion US mortgage market. For taxpayers, the costs of these actions and others are currently off the charts but probably in hundreds of billions of dollars.

These bad economic trends are now working their way into governments and businesses all over the world. As the economy slows, tax collections level off and then decline as compared to what many governments anticipated, budgeted or projected. For example, the United States Federal budget deficit has grown by \$246 billion this year, according to the Congressional Budget Office.

Here in Pennsylvania, which concludes its budget-making process a shortly after the city, the Commonwealth is now looking at a 3 percent drop in general fund revenue, including a 14 percent drop in the corporation tax.

So far, 29 states in the United States are now projecting shortfalls totaling \$48 billion. Chicago is facing a current year budget gap of \$280 million, a gap that is projected to grow to \$420 million in FY10, if no action is taken. And in Phoenix, the city manager has ordered his departments to assemble proposed reductions equal of up to 30 percent of the city's \$1.2 billion General Fund.

I've asked you all here today because the national economic problems have now come to the front door-step of Philadelphia. My budget and finance team have been working on this for the past few weeks and some pretty serious issues have become apparent.

Unless the City of Philadelphia takes prompt action, we're facing tax revenue losses and increased pension costs of at least \$450 million. These changes impact the current city budget and have increasingly dire consequences over the next five years.

The source of our problem is a dramatically weakened economy that in very short order has resulted in a substantial and rapid decline in our Business Privilege Tax receipts, a tax that represents about 17 percent of our total tax base.

Because of the peculiar nature of this business tax, the city only gets final collection numbers well after the close of the city's budget year and long after revenue estimates are made. And so, it was only in the last month that we found out how weak the actual collections on this tax were for the fiscal year that closed June 30. I would say about two thirds of the \$450 million challenge can be linked to weakness in the Business Privilege Tax.

In FY 07 the city collected \$436 million in BPT. In FY 08, the number dropped to \$408 million, almost 7 percent below the \$438 million we thought we'd collect. And while we budgeted on the assumption of \$441 million for FY 09, we now believe that collections will be below \$400 million. In the next few years, we're projecting a continued weakness in BPT collections.

Turning to the pension issue, as anyone who has a 401(k) or mutual funds knows, the economic downturn has also significantly depressed the stock and capital markets.

This has caused real losses to the city's Pension Fund, which is the retirement security for thousands of current and former city employees. While the fund has done well as compared to key industry benchmarks, it has nevertheless declined.

In FY 07, the fund grew by about 15 percent, but unfortunately, recalling the weak performance from seven years ago, the FY 08 performance has resulted in a 4 percent decline in assets. I should note that the fund has a target performance of 8.75 percent.

The result is of this dramatic swing means the city will have to contribute more tax dollars from the general fund to the Pension Fund in the future.

In addition, the turmoil in the credit markets has led us to conclude that it would not be prudent at this time to issue a Pension Obligation Bond in the current financial market environment. We had already delayed assuming the savings from the current year to FY10 and now we'll move that assumption back further. When market conditions improve and we find that a deal that is advantageous to taxpayers, we plan to execute the bond deal.

And so the decline in business taxes combined with the higher costs we will incur for pensions are likely to total more than \$450 million by the end of the Five-Year Plan.

Let me add that this number is likely to grow because there are many other costs such as energy and gasoline costs that will continue to have an impact on the city budget.

With the fiscal problem outlined in broad strokes, let me address what we're going to do about it.

The first thing is what we're doing right now. This is an open, transparent government that discloses issues of high importance in a timely manner to residents and taxpayers.

But disclosure is not enough. We are not going to sit around and wait until the next budget cycle begins. We are going to act now. It's a prudent and pro-active approach that will minimize the pain in the years to come.

Consequently, I'm immediately instituting a process to very closely monitor city spending regarding all hiring decisions.

I have also instructed my budget and finance team to begin a comprehensive review of all city spending and all city programs.

Everything, everything is on the table, including scheduled tax cuts.

City departments will be issued new spending targets and be asked to develop plans for how they will meet these new goals.

But unlike the city's experience in budget contractions in the past, I'm not asking for an across-the-board cut in each department.

What we're now beginning is a process of prioritizing our programs and looking for efficiencies.

Our challenge is in the current year and in the coming fiscal years. And so we need to find recurring savings and not just one time fixes for the current year's budget.

Parts of the budget are not available for reduction, areas like debt service on past city borrowings or pension payments. Nor are we going to cut costs that are reimbursed by state or federal sources: for example, certain spending in the Department of Human Services.

By the end of October, we will have a comprehensive plan to discuss with City Council and the public.

Finally, let me offer a cautionary note:

Between now and when we make our plan public, and we will certainly have regular discussions with City Council, I think it's safe to say that there will be a fairly loud buzz from the rumor mill – this program is ending, that program is being cut in half, and so on – but none of it's going to be true.

It won't be true because nothing is final until we announce it. We're going to get back budget information from our departments and put together a plan in light of the values and priorities that we have set out for this administration and then we'll present a plan to City Council and the public.

Until then, neither I nor my staff is going to discuss what might be, what could be, what won't be. We all need to let this eyes-wide-open review follow the course we've set out for it.

What I can promise is that any proposed spending change will be carefully considered in a thoughtful and deliberative process.

We will make tough choices and smart investments to secure the future of this city government.

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