City of Philadelphia

Financial Performance

For big cities all across America, progress begins with managing the bottom line.

Many big cities face daunting challenges, and Philadelphia is no exception: chronic poverty that affects more than one in five of our residents and drives demand for a range of social, behavioral, and educational services that outpace local tax revenues; a stubbornly high workforce shortage that impacts the City's ability to provide robust services; and the ongoing challenges of improving public education despite a lack of adequate state funding.

In the face of these challenges, the City's ability to manage its finances is the bedrock upon which all of its programs and priorities must rest. Here in Philadelphia, that means working in partnership with City Council to balance the municipal budget and improve the efficiency of municipal operations; stabilizing and strengthening the City's pension fund; and restoring its credit status to reduce the cost of municipal borrowing for investments that are critical to Philadelphia's future.

Philadelphia's remarkable fiscal performance

By any measure, Philadelphia's fiscal performance over the last decade has been remarkable. In partnership with City Council and the shared commitment of the City's four municipal employee unions, the City has reached a level of fiscal stability few thought possible a generation ago.

The General Fund balance had a balance of $779 million (13.5 percent of revenues) at the end of FY2022, with an estimated FY2023 Fund balance of $682 million (11.5 percent of revenues).

In June, the City marked a major milestone of financial progress and made **the final payment on the original $475 million bond issuance from the Pennsylvania Intergovernmental Cooperation Authority (PICA),** which staved off financial ruin for the City a generation ago.

With the help of federal American Rescue Plan Act funds, **the City closed a pandemic-induced budget gap of $1.5 billion in just two years, while continuing to make incremental reductions to the Wage Tax and the Business Tax, which have reached their lowest levels in decades.**

In partnership with City Council, **the Kenney Administration enacted $1.5 billion in new local funding for Philadelphia's public schools** over the last five years.

The Kenney administration made great strides in restoring the health of the City's pension fund, which is currently 57.6 percent funded and on track to be 80 percent funded by FY 2029 – a significant jump from 44.8 percent in FY17, to a level once thought nearly impossible to achieve just 15 years ago, when pension costs threatened to overwhelm the City's budget and imperil its ability to meet its pension obligations.

As a result, the nation's **major credit rating services have continued to upgrade Philadelphia's municipal bond rating –** most recently in July 2022 – to A- and A1 with stable outlooks, giving Philadelphia its highest combination of ratings in more than 40 years, while significantly reducing the City's borrowing costs in the process.

Philadelphia's rocky financial history

The final payment on the City's original PICA bond this year warrants a moment of reflection on how far Philadelphia has come in successfully managing its finances since the early 1990s, when the City careened from one fiscal crisis to another and came within days of making history as the first city in America to declare bankruptcy.

Back then, Philadelphia was rated by City and State magazine as the worst of America's 50 largest cities in fiscal soundness. At one point, it was so bad that City leaders met each week to decide which bills would be paid, and one national expert described Philadelphia as "'one of the most hair-raising municipal horror stories in the country.'"[1]

Yet today, having survived a pandemic that saw a huge segment of its wage tax base, particularly its Center City workforce, virtually disappear for months, Philadelphia's financial foundation is as strong as it has been at any time in the last 60 years, providing a solid platform for continued growth and success.

We were in great shape, and then COVID-19 hit, and everything changed literally overnight. At that point, it was all hands on deck to keep the City afloat. We were in survival mode."

Finance Director Rob Dubow

Managing through the COVID-19 pandemic

Following steady progress in fiscal management during the first term of the Kenney Administration, by March 2020 the City was projecting a year-end fund balance of $350 million, which had positioned the City to address additional investments in public education, poverty reduction, and public safety.

Pivoting to manage municipal finances during the pandemic was among the biggest financial challenges the City has ever faced. Revenue collections quickly evaporated as the local economy shut down.

At the same time, the City confronted a range of unanticipated and critically important expenses:

- Operating temporary medical facilities and shelters for COVID-19 victims.
- Purchasing protective equipment, medicines, refrigeration trucks in anticipation of body storage.
- Identifying vaccine sites intended for prompt and equitable distribution of COVID-19 vaccines.
- Identifying and funding ways to keep the City workers alive, safe, and productive as the pandemic raged.

As the City government burned through its cash to provide these critical services, it did so without knowing whether the state or federal government would provide a means of reimbursement.

"We had only one objective— keeping people alive, whatever it took." - Finance Director Rob Dubow

[1]"Bissinger, H.G., A Prayer for the City, pp. 35-36 (Random House, 1997).

> The way that everyone came together in response to the pandemic – our first responders who risked their lives every day, all the City employees who kept going every day, the business community, everyone – it was a real inspiration. People forget just how devastating COVID-19 was for all of us. We've really come back strong, and we're poised to be better than ever."

Mayor Jim Kenney

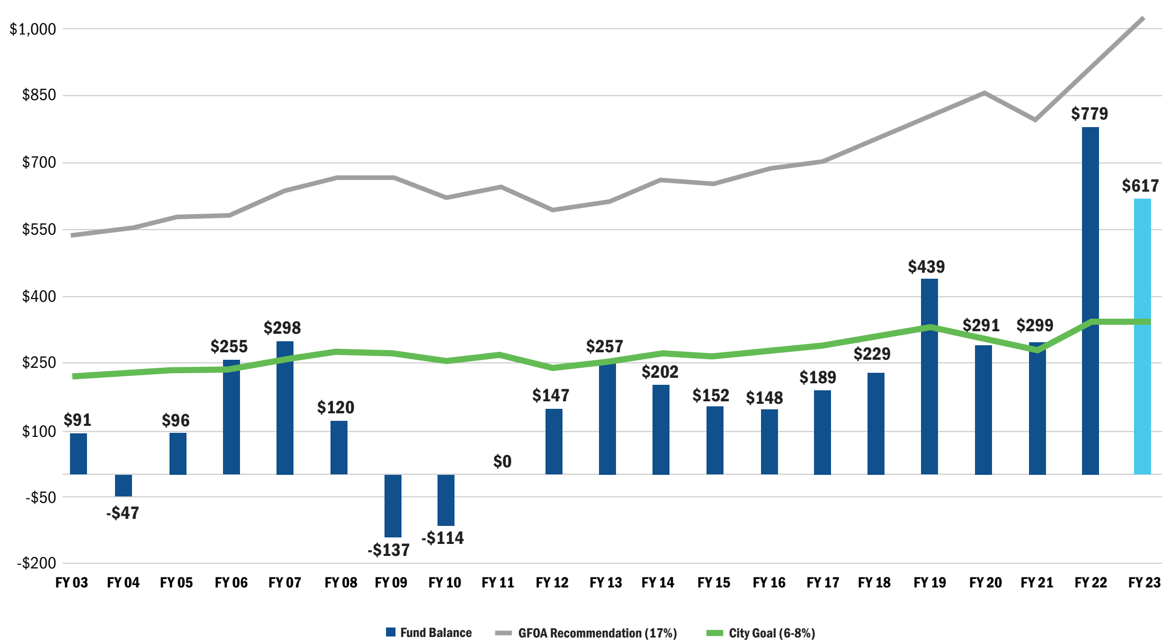
Rebounding from the pandemic

Not surprisingly, the pandemic devastated the City's finances. In just two months, the City's projected $350 million fund balance was wiped out, replaced by a projected deficit of $1.5 billion.

With the help of federal COVID-19 relief funds, Philadelphia came roaring back from the brink of financial disaster in just two years – to the point that, by FY2022, the fund balance reached a modern record of $779 million, with a projected fund balance for FY2023 of $682 million.

At the same time, property tax collections have risen from $571.6 million in FY2016 to just over $700 million in FY2022, with a collection rate that's reached 96.4 percent, up from 94.7 percent in FY2016.

The City's Fund Balance



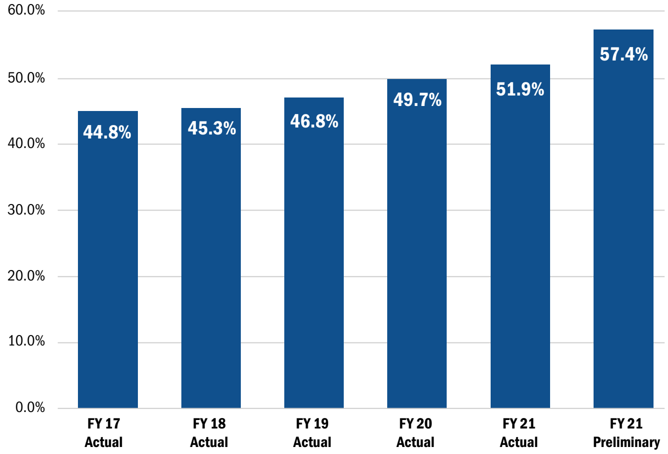
Restoring Pension Health

Fifteen years ago, the City's beleaguered Pension Fund was in crisis, with funding having reached 44 percent while costs threatened to spiral out of control. By FY2018, Mayor Kenney, the Pension Board of Trustees, and City Council members agreed that pension reform had become an urgent priority. Together, they implemented a comprehensive plan to improve the Fund's long-term health while reducing the rate at which future pension liabilities were growing.

Over the last five years, the Kenney Administration in partnership with City Council has put the Pension Fund on the road to full recovery. Today, the City's Pension Fund is 57.6 percent funded, and it is on track to be 80 percent funded by FY2029. Full funding is anticipated by FY2033.

All three of the nation's major credit ratings agencies have cited the City's pension reform initiatives as a major factor in Philadelphia's fiscal recovery. It is an achievement that could not have occurred without the support of the City's four municipal employee unions – AFSCME District Councils 33 and 47, the Fraternal Order of Police Lodge 5, and the International Association of Firefighters Local 22. Each union agreed to pension benefit reforms or increased pension contributions that will reduce the growth of future plan liabilities and/or increase its assets.

Pension System's Funded Percentage



Improved bond ratings

In June 1990, Philadelphia became the first major city in America to have its municipal bonds sink to "junk bond" status (below investment grade).[2] Today, by contrast, Philadelphia's General Obligation (GO) bonds have risen dramatically, achieving a rating in the 'A' category – an achievement many thought impossible a generation ago.

In announcing the most recent upgrades, Fitch Ratings Service referenced the City's "materially improved operating performance," its "proactive budgetary actions," its restored General Fund operating balance, and its commitment to pension reform.

Together with recent upgrades from Moody's and S&P ratings services, the City now has its highest combination of ratings in more than 40 years. The ratings send a clear message to financial markets and business leaders throughout the nation that the City's finances have stabilized and that it is on a path for future growth and success.

[2] "Junk Bond Philadelphia," The Baltimore Sun, September 23, 1990; see also, "Philadelphia Municipal Bonds Lose More Ground in Ratings," The Washington Post, November 17, 1990.

Maintaining our momentum

From a fiscal perspective, for all of the progress made thus far, looming challenges remain for the City in the coming years that will present both the mayor and City Council with difficult decisions. These include:

Poverty: Though Philadelphia's poverty rate is the lowest it has been in more than 15 years, by any measure it is still far too high. Reducing poverty is a moral imperative that also will strengthen the City's finances while reducing the need for services and expanding the City's tax base. Reducing poverty is not only the right thing to do; from a fiscal perspective, it is the smart thing for Philadelphia's future. Mayor Kenney has been committed to long-term and short-term strategies to address poverty, from piloting free transit programs to making historic investments in education. How the City sustains and builds on this progress – how we secure lasting equity and prosperity for all of our residents – will have a major impact on City finances.

The End of COVID-19 Relief Funds: Funding from the Biden Administration's American Rescue Plan (ARP) were a vital lifeline for the City during its recovery from the pandemic, enabling the City to continue providing essential services and supports to residents and businesses in the midst of economic and social upheaval. These funds will be fully allocated by December 2024, in compliance with the federal government's spending requirements, and future budgets must account for this reality in coming years.

Financial flexibility: As the pandemic demonstrated, balancing fixed costs such as debt service with available resources is essential for effective City operations. As we recover from the pandemic, this lesson offers a roadmap for our future. The City must continue to meet its established obligations while also prioritizing the need for flexibility to make targeted investments that will keep Philadelphia moving forward.