City Council of Philadelphia

From: Council President's Office – Finance and Budget Team
RE: Comparable Study: Philadelphia Debt and Fixed Costs compared to Other Cities
Date: November 10, 2016

Philadelphia Debt and Fixed Costs Study

In response to discussions during the Finance Committee Hearing on Fiscal Stability and Intergovernmental Cooperation, City Council's Finance and Budget Team has compared the debt and fixed costs burden of Philadelphia to 13 other major cities. We have also looked at other indicators that are relevant to evaluating Philadelphia's fiscal condition. The13 cities were chosen based on population and demographic similarity, and/or availability of data. The results of our analysis, including charts and tables, appear below.

Credit Standing: Median and Average Comparison

Fitch Ratings affirmed the A- rating on Philadelphia general obligation (GO) bonds in September 2016, but also changed the City's outlook from Stable to Negative (Standard and Poor's (S&P) Ratings also changed the City's outlook from Stable to Negative recently). While this rating is still investment grade, it leaves significant room for improvement. Boston has the highest rating at 'AAA', which is the highest rating possible from Fitch. The median rating is AA, which is four notches above Philadelphia's rating and two below AAA. The comparison below is a combination of Fitch and Comprehensive Annual Financial Report (CAFR) data.

The City is worse than the average and median values of the 13 comparable cities in the following categories:

- Net Direct Debt as a % of Full Value (Total Taxable Value)
- % of Debt to Debt Limit
- Bonded Debt Per Capita
- Fund Balance

The City remains around the average and median values of the 13 comparable cities in the following categories:

- Carrying Costs as a % of Expenditures
- Total Bonded Debt

Table 1:

Data Point	Philadelphia (Current)	Philadelphia (Policy Goal)	Comparable City Median	Comparable City Average	Comparable City Minimum*	Comparable City Maximum
Credit Rating	A- (6)	AAA (1)	AA (3)	AA- (4)	BBB- (worst)	AAA (best)
Net Direct Debt as a Percentage of Full Value	4.4%	3.5%	1.8%	3.9%	0.7% (best)	13.4% (worst)
Carrying Cost as a % of Expenditures (Fitch)	21.4%	15.0%	22.3%	23.0%	14.4% (best)	45.0% (worst)
% of Debt to Debt Limit	40.8%	-	18.3%	23.5%	0.0% (best)	67.4% (worst)
Bonded Debt Per Capita	$4,588	-	$3,943	$4,007	$1,851 (best)	$9,491 (worst)
Total Bonded Debt (in thousands)	$7,191,600,000	-	$4,621,258,500	$11,202,364,383	$689,800,000	$81,150,000,000
Fund Balance	4.0%	17.0%	16.1%	15.9%	0.7% (worst)	29.0% (best)

*Chicago is rated at BBB-, which would be 9th on the rating scale. Detroit is, however, ranked lower by other Credit Rating Agencies (Fitch does not rank Detroit).

How does Philadelphia Stack Up to Average and Median of Observed Cities?

The City's internal benchmark goal is to have a ***Net Direct Debt* to *Total Taxable Value*** ratio of 3.5%. The FY15 Comprehensive Annual Financial Report (CAFR) lists a *Net Direct Debt* of $4.1 billion and a *Total Taxable Value* of $92.1 billion, which equates to a ratio of approximately 4.4%. When *Overlapping Philadelphia School District Debt* is included, the ratio jumps to about 7.8%. Overlapping Debt (debt shared by more than one jurisdiction) is included in this ratio because the Philadelphia School District and the City of Philadelphia share the same taxable base. Each city places different emphasis on *Net Direct and Overlapping Debt*, due to the relationship between the city and related entities. Additionally, assessments are sometimes only a portion of the city's true market value. When compared to the observed cities, Philadelphia has an above average ratio of 4.4%, which is notably higher than the median ratio of 1.8% but somewhat on par with other cities' average ratio of 3.9%.

Carrying Costs

Philadelphia has a relatively average ***Carrying Costs*** burden when compared to the 14 observed cities. The Carrying Costs burdens – or the costs of debt, pensions, and post-employment benefits – are an especially important fiscal indicator. It may be difficult to drastically reduce these costs in the short term without negatively impacting cash-flow or liquidity, which could be seen as a sign of fiscal distress, unless revenue raising or other cost reduction measures are taken. Of the observed cities, Philadelphia's Carrying Costs remain average at 21.4% of expenditures. Note that the largest individual Carrying Cost for Philadelphia is the annual contribution to its Pension Fund. In FY15, the City contributed $558.2 million towards Pensions out of the General Fund, while the Annual Required Contribution (ARC) for Other Post-Employment Benefits (OPEB) was approximately $132.1 million and the Debt Service payments amounted to approximately $131.9 million. The highest ratio observed was Chicago, whose Carrying Costs were 45% of expenditures, which is largely attributable to the cities' issues with pension funding.

Total Bonded Debt per Capita

Perhaps the best comparative variable across the observed cities is the amount of ***Bonded Debt per Capita***. This ratio was found using FY15 CAFR Net Direct and Overlapping Debt levels and 2015 census population numbers. Philadelphia had approximately $4,588 in bonded debt per capita, compared to an average of $4,007 in the observed cities. While the per capita numbers serve as a good indicator for comparison purposes, the ***Total Bonded Debt*** figure is also a good indicator of the scope of municipal size. For example, New York City had an FY15 population of 8.5 million and $81.2 billion in Total Bonded Debt, while Tampa has an FY15 population of 369,000 and only $689.8 million in Total Bonded Debt. For reference, Philadelphia had an FY15 population of over 1.5 million and $7.2 billion in Total Bonded Debt.

Debt Limit

Additionally, of the observed cities, **Philadelphia has a higher ratio of debt as a percent of the municipality's stated debt limit.** However, this proportion is dependent on how each municipality determines its debt limit, and is relatively arbitrary. There were a couple of cities observed (including San Diego and Tampa) that do not have legally restrained debt limits or debt borrowed that is applicable to its debt limit; it is important to consider the other financial indicators of these cities to fully assess how each city is managing its debt burden.

General Fund Balance as a Percentage of Expenditures

Another important financial indicator is the ***General Fund Balance as a Percentage of Expenditures, as it provides municipalities with liquidity and financial flexibility to help mitigate against financial shortfalls***. As covered in the hearing held by the Committee of Fiscal Stability and Intergovernmental Oversight held on September 7th, 2016 a high fund balance is an integral part of credit ratings, as a high fund balance is a positive indicator of fiscal flexibility. According to Philadelphia's FY17 Five Year Plan (FYP), the City is aiming to increase the fund balance to 6-8% of the General Fund. The Government Finance Officers Association (GFOA)

recommends a fund balance of approximately 17% (two months of spending), but the report acknowledges that this goal is somewhat flexible, stating that 'it may be appropriate for states and large local governments' to have fund balances lower than the GFOA recommendation (FYP - page 192). In our sample, the average fund balance was 16% compared to Philadelphia FY15 fund balance of 4%, which leaves significant room for improvement.

It is also noteworthy to point out that New York City's General Fund Balance may not fully represent the city's true financial reserve level. New York City's Prior-Year Accumulated Resources and Reserves (PARR) includes reserves and rollover funds from the previous fiscal year, and had an FY15 balance of $5.3 billion. New York City's Comptroller called the PARR a 'new measure of the fiscal cushion'. If this $5.3 billion were to be combined with the $467 million in Unrestricted General Fund Balance monies, then the General Fund Reserves as a percentage of Expenditures indicator for New York City would be nearly 8%.[1]

Municipal Government Structure

Note that, of the observed cities, only San Francisco and Philadelphia exist as consolidated city-county governments. This structure, where the city government and county are coterminous, poses *structural disadvantages* to the City of Philadelphia. The overwhelming majority of cities exist within a larger county; and as such, these cities share revenues and services with surrounding suburbs. This structural issue is evident when comparing Fitch's 'Debt per Capita' to each FY15 CAFR's Net Direct Debt per Capita: Philadelphia has a proportionally higher direct debt ratio when compared to total bonded debt (Figures 2 &3 below), which is likely attributable to its City-County structure. Additionally, Philadelphia has higher debt levels and ratios when compared to the observed cities. New York City is the other exception, where the government represents five united counties that do not have their own governments. This fact, coupled with the nature of New York City's infrastructure and importance to the region and country, leads to an above average debt load.

[1] *Measuring New York City's Budgetary Cushion: How Much is Needed to Weather the New Fiscal Storm? Office of the New York City Comptroller,*

Charts and Figures

The following charts include the most relevant data for understanding the fiscal condition of the observed cities, and how debt and fixed costs ratios correlate with each city's credit rating. Note that the cities in the charts are ranked in order from highest to lowest credit rating, from left to right.

Figure 1 below displays the percentage of ***Bonded Debt to Total Market Value***, as described by Fitch. Philadelphia is slightly above average (that is, worse than average) when compared to the observed cities. A lower ratio correlates with higher credit scores, meaning there is less debt borrowed when compared to the total market value of the municipality.

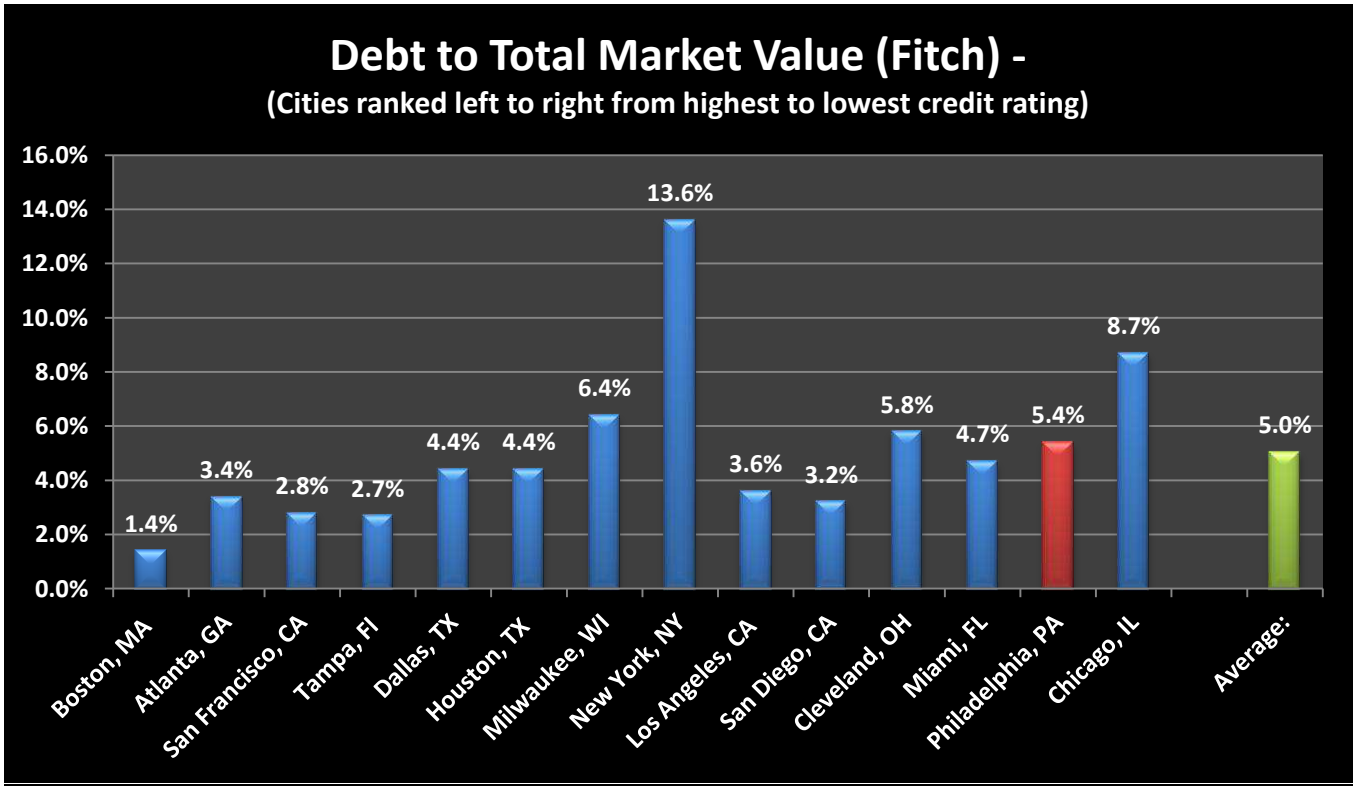


Figure 2 below highlights the ***Total Bonded Debt Per Capita*** for the observed cities. This includes *Net Direct and Overlapping Debt* that may be shared with another entity (county, school district, etc.). Although Philadelphiais not the highest, it still stands as an above-average debt load, especially when compared to cities with the highest credit ratings. Philadelphia is also atypical in the sense that it carries school district debt as well, which many municipalities do not (due to separate school district financing). Philadelphia also is a City and County, typically making its service delivery load higher than cities that are within a larger county (e.g., health service costs, law enforcement, etc.).

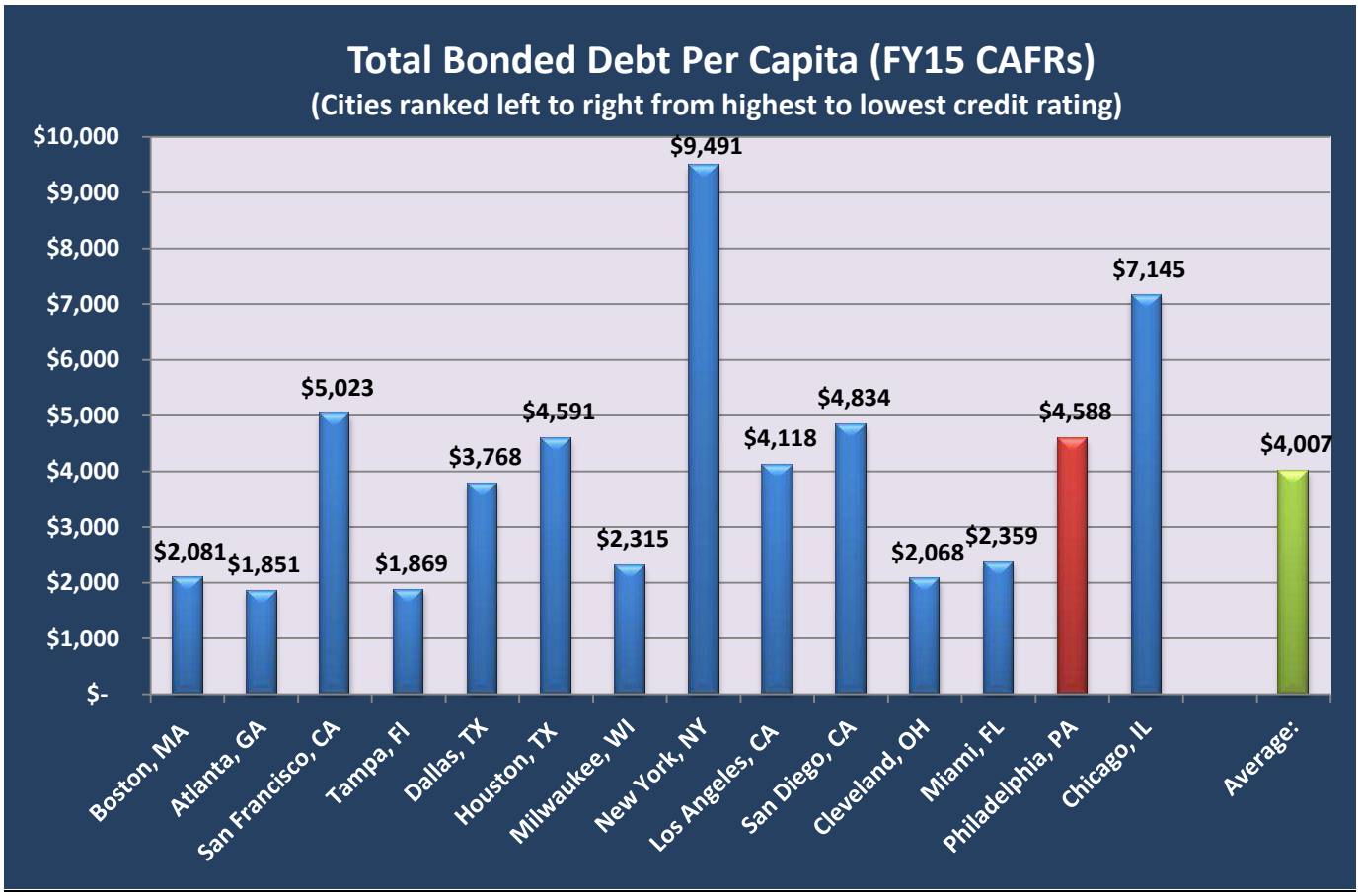


Figure 3 below shows the ratio of **Net Direct Debt to Taxable Assessed Value**. Philadelphia has a goal of keeping this ratio under 3.5%. Before the implementation of the Actual Value Initiative (AVI), this variable was artificially high, as taxable assessed values were often significantly lower than market values in the city. Philadelphia has a *higher than average* Net Direct Debt load, but this may be a by-product of having the burden of being a City-County government. For example, San Diego has a low level of Net Direct Debt for its size, but a high level of Total Bonded Debt when Overlapping Debt is included. This is because San Diego County and affiliated entities issue many of the bonds that make up their Overlapping debt load, which partially skews this variable when comparing to cities similar to Philadelphia.

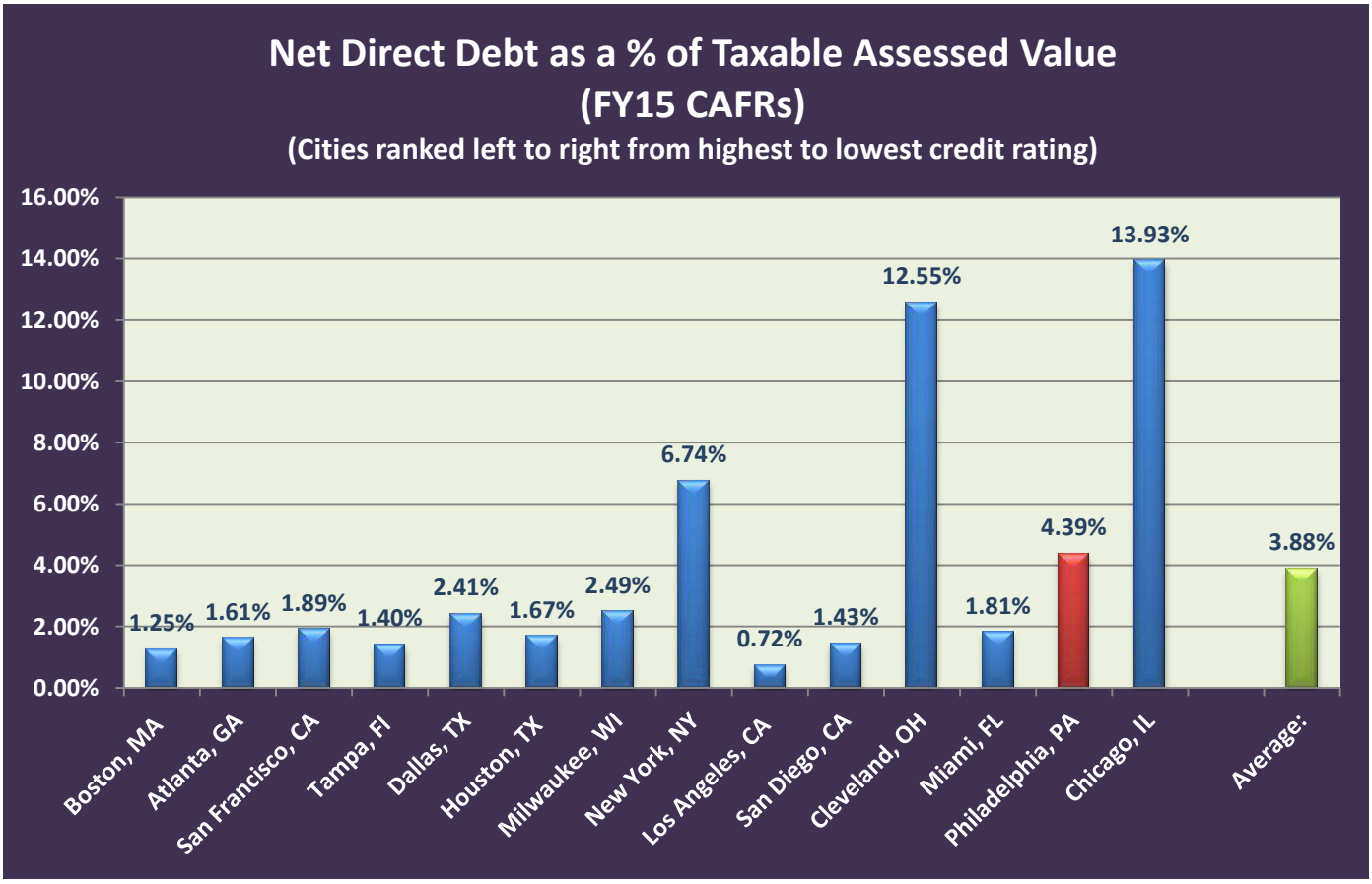


Figure 4 below shows the ratio of **Carrying Costs as a Percentage of Expenditures**, as calculated by Fitch. This metric includes costs for debt service, other post-employment benefits (OPEB), and pensions. As previously discussed, Chicago's continued structural fiscal issues make it an outlier when compared to other cities. Philadelphia would actually be around 15% if it did not have to include carrying costs associated with the School District.

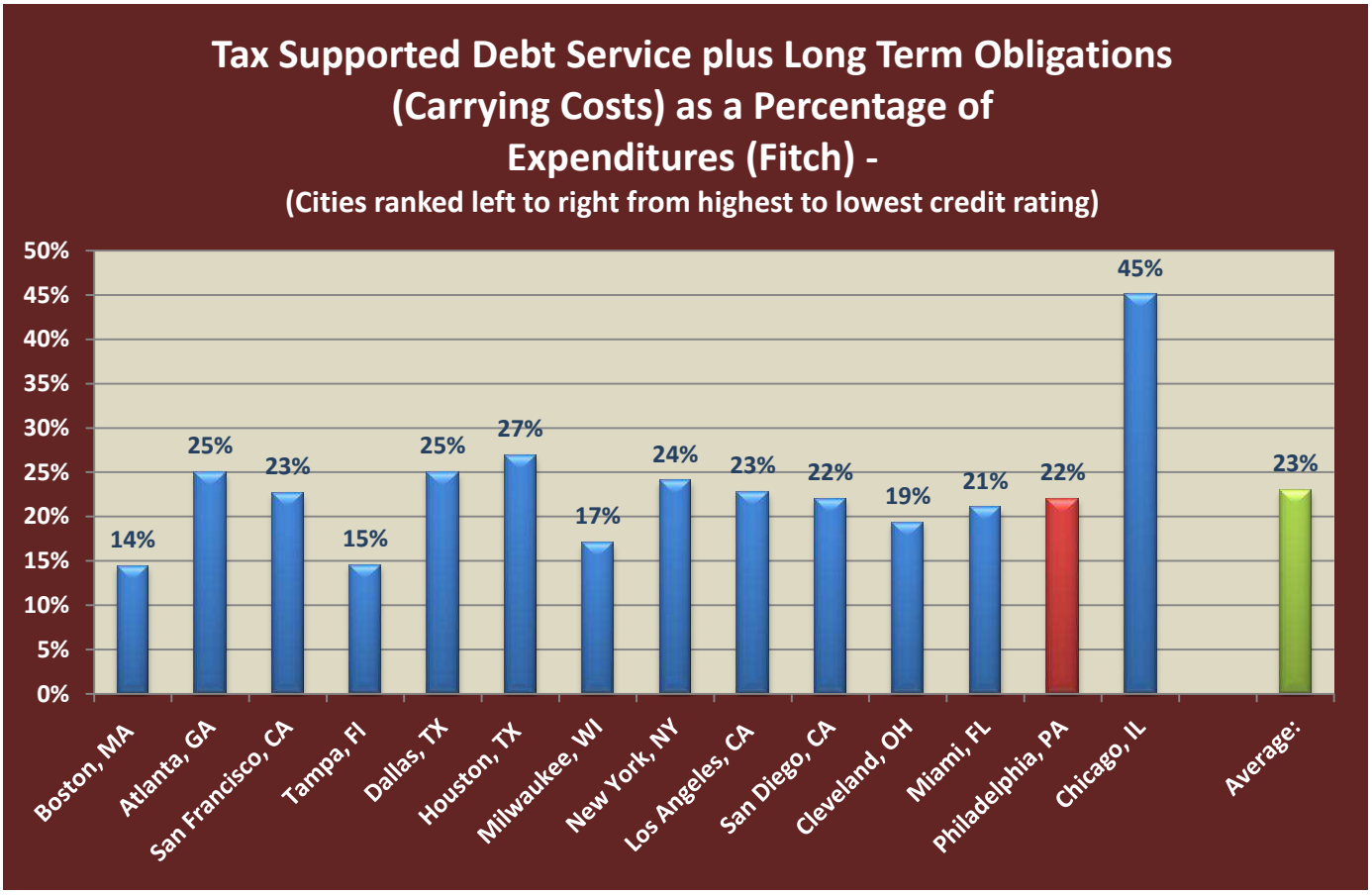


Figure 5 below shows the **Unrestricted General Fund Balance as a Percentage of General Fund Expenditures**. As covered in the Fiscal Stability hearings examining the fiscal condition of Philadelphia on September 7th, a high fund balance is an integral part of credit ratings, as a high fund balance is a positive indicator of financial liquidity and flexibility. The Government Accounting Standards Board or Government Financial Officers Association (GFOA) recommends having a general fund balance equal to two months, or approximately 17%, of general fund spending. In our sample, the average fund balance for cities with a rating of AA or higher was 21%, while Philadelphia was at 4%; the currently stated goal (internal policy) for Philadelphia's fund balance is 6-8%. As previously highlighted, New York City's budget maintains significant reserve levels in its Prior-year Accumulated Resources and Reserves ($5.3 billion in FY15), which the Comptroller described as the 'new measure of the fiscal cushion'. For FY15, the PARR was 7.5% of expenditures.

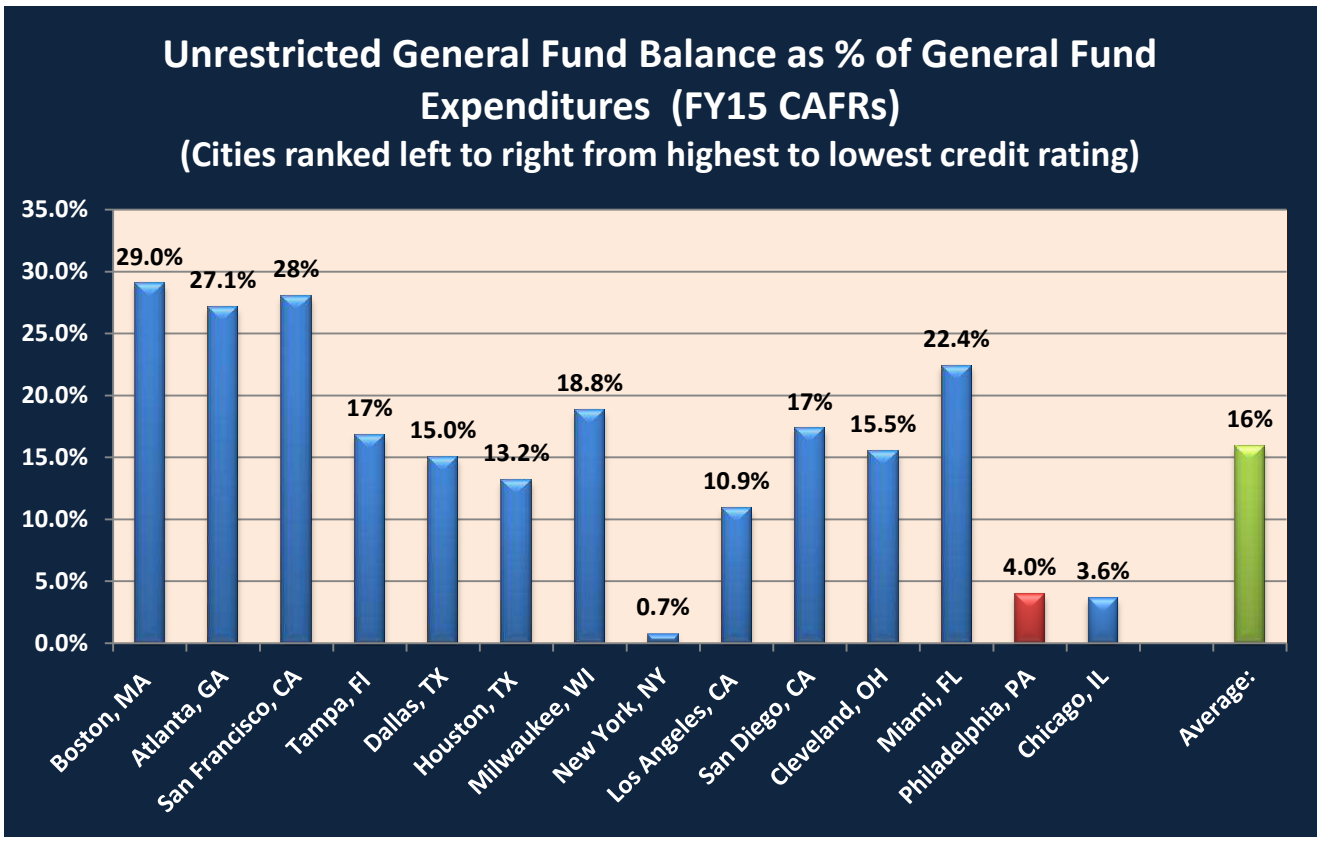
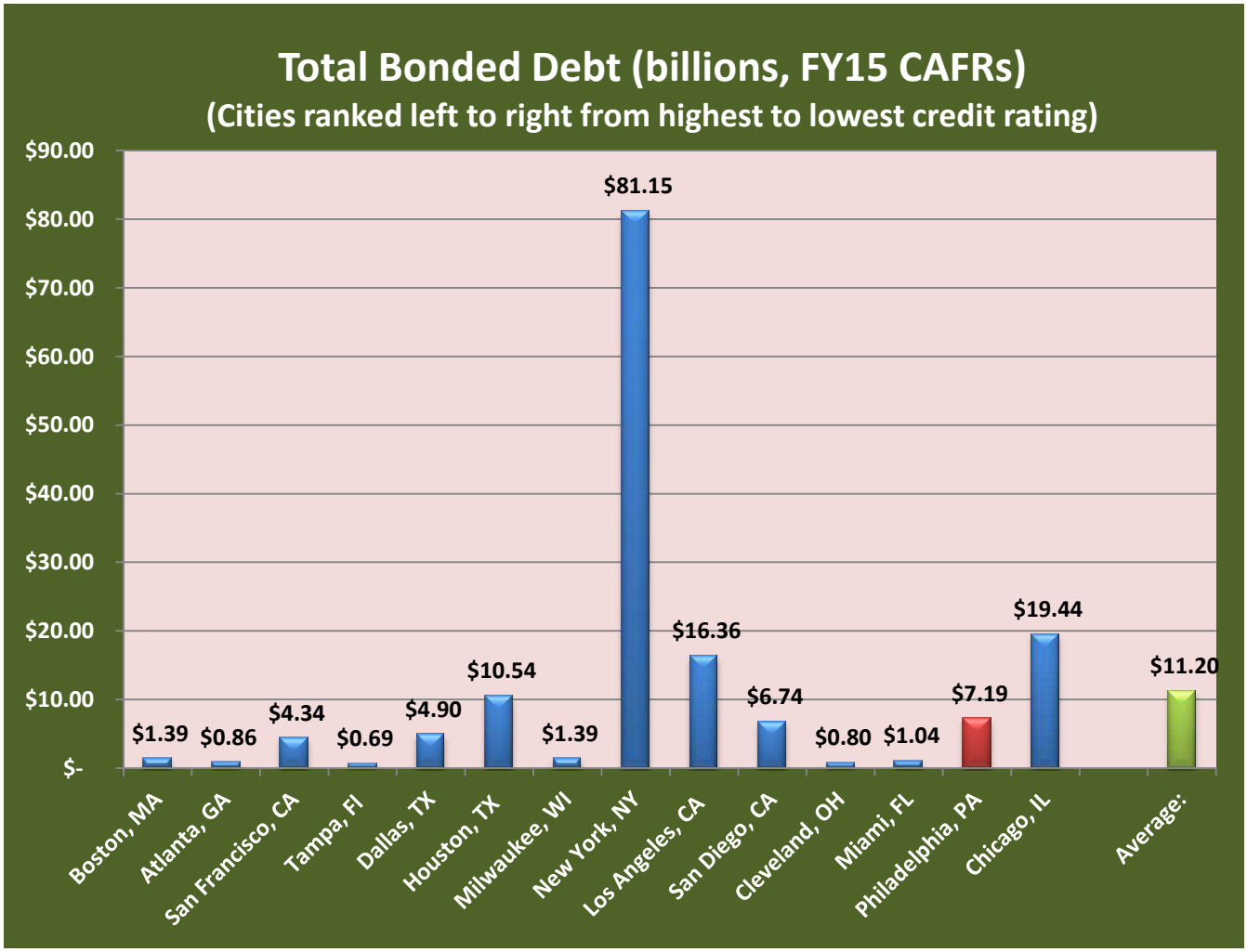
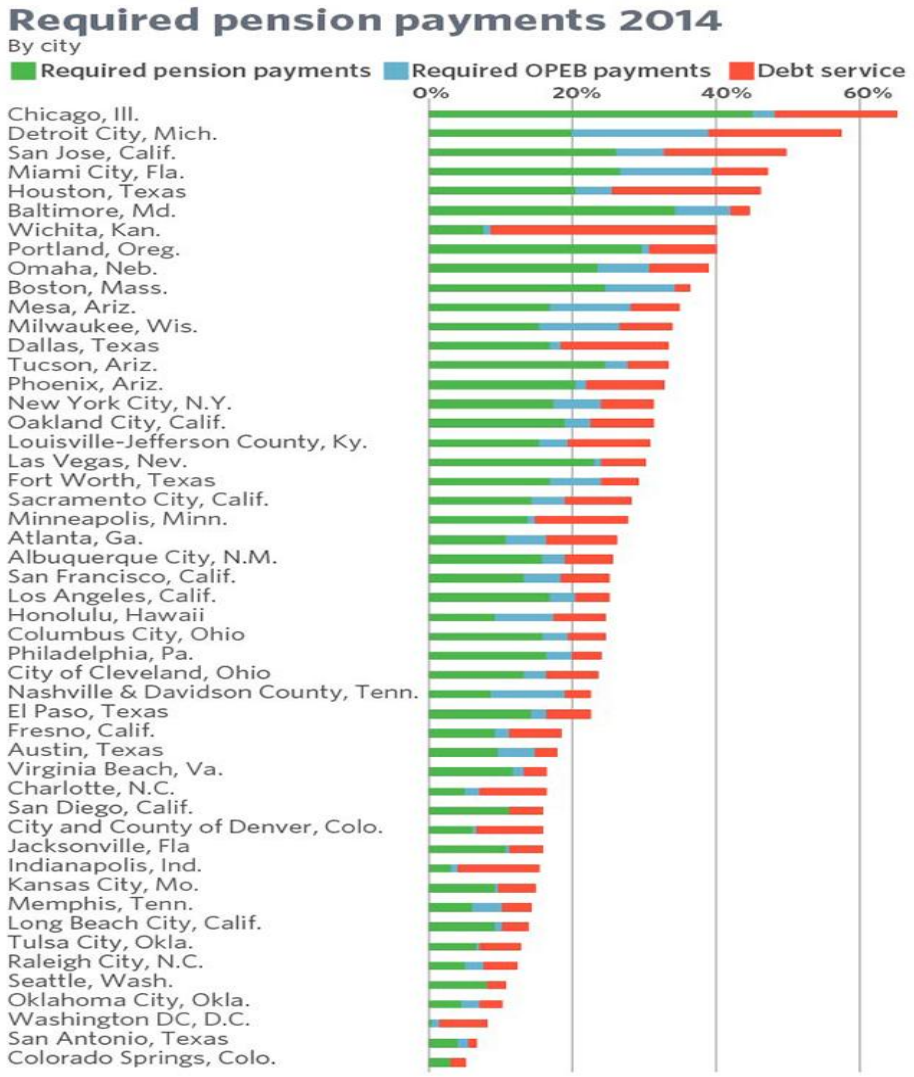


Figure 6 below displays the total of **Net Direct and Overlapping Debt (Total Bonded Debt)** per municipality. This is not a per capita measure, but rather relates in large part to the size of the municipality. For instance, New York has over $81 billion of Total Bonded Debt; however, New York is also the most populous municipality by far. This measure is still a good indicator of the very significant amount of borrowed money incurred by virtually all municipalities.



Carrying Costs Comparisons: Center for Retirement Research Study[2]

Recently, the *Center for Retirement Research* released a comprehensive brief that highlighted the differing levels of required 'Carrying Cost' payments by major city and state for Fiscal Year 2014. The examined parameters were mandatory pension, OPEB, and debt service payments for each municipality. These payments were calculated as a percentage of locally raised revenues and ranked from highest to lowest. **This study shows that though Philadelphia's mandatory costs (which are ranked 29th out of 50) are higher than the recommended levels of Carrying Costs, they are not among the highest ratios. However, the largest portion of Philadelphia's Carrying Costs is its contributions to the Pension Fund. When compared to the other observed cities, Philadelphia has a disproportionate ratio of Pension Fund contributions to Carrying Costs, which can be attributed to the nearly $6 billion unfunded liability.** In FY14, Philadelphia contributed $646 million towards pensions, $122 million towards debt service, and an annual required contribution (ARC) on post-employment benefits of $128 million. These pension payments, while high, are fiscally responsible, as they are critical to the long term health of Philadelphia pension plans.



[2] *Will Pensions and OPEB Break State and Local Budgets?* Center for Retirement Research, October 2016