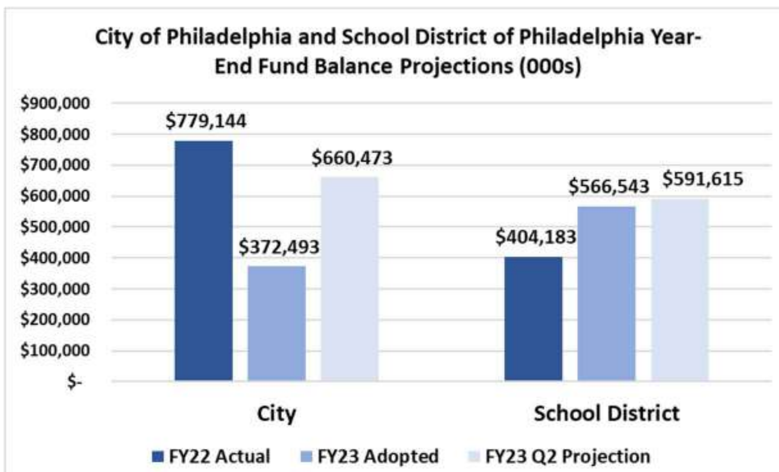
Mid-Year Financial Update: City of Philadelphia and the School District of Philadelphia

Executive Summary

Following the close of each quarter of the fiscal year – 9/30 (Q1), 12/31 (Q2), 3/31 (Q3), and 6/30 (Q4) – the City of Philadelphia and the School District of Philadelphia separately release a quarterly managers report. The mid-year reports for the period ending 12/31/22 were released to the public on February 15th, 2023. Both the City's report and the School District's report highlight continuing positive trends as we approach the FY24 Budget Hearing Process.



Projected year-end General Fund balances for the City and School District have been adjusted positively upwards: from $372.5 million to $660.5 million for the City of Philadelphia and from $566.6 million to $591.6 million for the School District. These positive adjustments to the City and District's fund balances are a result of two concurrent situations: continued strong revenue collections and staff vacancies which remain higher above adopted projections. While revenue and expenditure projections have been significantly reduced for the School District, this is due to the revenues included in the adopted Pennsylvania budget, which differed significantly from the Governor's proposed budget that the district used for projections.

City of Philadelphia Financial Outlook

On Thursday, February 16th, 2023, the *Pennsylvania Intergovernmental Cooperation Authority* held its annual Regional Economist's Spring Conference. This conference allows for the City of Philadelphia's Finance Department and the Federal Reserve Bank of Philadelphia to present their economic outlooks for the upcoming fiscal year. The Administration's consultant (S&P Global) highlighted the following points for the economy in the City of Philadelphia:

- **S&P expects Philadelphia's economic growth to largely mirror the U.S. as a whole over the next few years.**
- **A recession could be relatively mild for Philadelphia, given the structure of the local economy.**
    - Philadelphia's housing market should be resistant to an economic downturn.
    - The commercial real estate market (namely office space) is still rather uncertain.
        - While residential traffic is up, only 60% of office workers have returned to Center City.
- **While a recession may be milder than the country as a whole, the recovery from a recession may also be more "mild" than the nation overall.**
    - Philadelphia's growth in population and labor force remains low, which limits growth potential.
- **Education and health care remains a major source of growth for city economy.**
    - Universities should be mostly back to "normal" operations this year; remain a magnet for top talent, while generating new economic opportunities via research.
    - Innovation Advantage: specialized treatments such as cell and gene therapy have emerged as a regional strength.

Overall, the Administration is projecting consistent revenue growth throughout the upcoming Five-Year Plan. In the upcoming FY24 budget, the Administration is currently projecting growth in all of our major taxes except for BIRT, which experienced significant growth in the revenues last fiscal year due to a drop in refunds. For the current fiscal year (FY23), the only significant projected drops in revenues are for the Realty Transfer (-21.1%) and Beverage Tax (-9.7%). Note, the stark reduction in Realty Transfer Tax is due to a delay in processing sales during the height of the COVID pandemic, which led to an artificial inflation of revenues in FY22.

City of Philadelphia Five Year Revenue Growth Projections: As of February 16th								
Fiscal Year	Wage and Earnings	Realty Transfer	Sales Tax	Beverage Tax	Parking Tax	Net Profits	Amusement	BIRT
FY23	5.2%	-21.1%	-0.7%	-9.7%	12.2%	9.8%	42.5%	0.0%
FY24	3.7%	2.0%	4.0%	1.3%	3.0%	3.5%	3.4%	-0.8%
FY25	4.8%	2.0%	4.2%	1.2%	3.8%	5.9%	2.7%	2.2%
FY26	4.6%	2.0%	3.8%	-1.0%	4.2%	2.8%	2.2%	-2.3%
FY27	4.1%	2.0%	3.6%	-0.5%	3.9%	5.5%	2.1%	6.8%
FY28	3.9%	2.0%	3.6%	-0.4%	3.9%	6.1%	2.0%	2.0%

Tax (millions)	FY19 Actual	FY20 Actual	FY21 Actual	FY22 Actual	FY23 Projection	Revenue Growth (FY23 vs. FY22)
Wage/Earnings	$1,582	$1,599	$1,451	$1,654	$1,709	3%
BIRT	$541	$534	$542	$750	$729	-3%
Realty Transfer	$328	$320	$304	$537	$424	-21%
Sales	$224	$205	$230	$278	$281	1%
Parking	$99	$77	$53	$87	$97	11%
Beverage	$77	$69	$70	$75	$68	-9%
Net Profits	$36	$29	$44	$27	$35	30%
Amusement	$26	$18	$3	$26	$37	42%

The Q2 projections, which were discussed at the PICA conference, highlight a positive trend**: the City's General Fund taxes have recovered and largely exceed pre-COVID (FY19) revenues.**

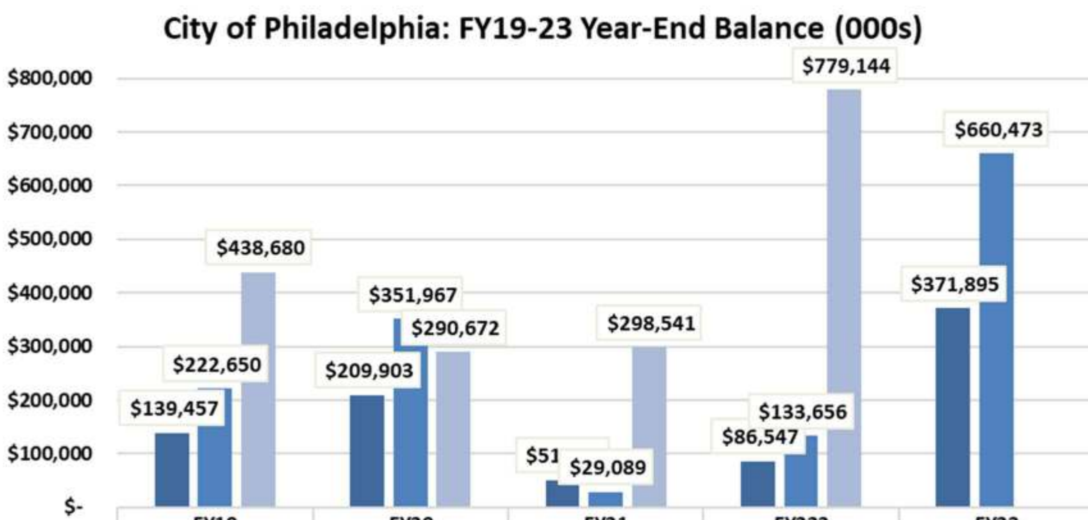
Local tax revenue collections have remained strong, despite the persistent high levels of inflation and economic uncertainty. In light of this great news, the City must remain prepared for the next fiscal downturn, especially considering our City's heavy reliance on economically sensitive revenues. Economic downturns can result in decreased consumer spending and business income, resulting in reduced sales, wage, and business taxes. When revenues decline, our city's ability to provide services and invest in the local community suffers. As a reminder: at the start of the COVID-19 crisis, the City had an approximate $438 million General Fund balance, which protected the City against significant service cuts prior to the receipt of CARES and ARPA revenues.

Highlights – City of Philadelphia Q2 Report

The City of Philadelphia released its mid-year financial update on February 15th, 2023. This report, updates fiscal projections for FY23, will inform the figures included in the FY24 budget proposal.

Year-End Fund Balance

The general fund balance is now projected to end FY23 with a balance of $660.5 million. **This represents an increase of $288 million compared to the projection in the Adopted Budget,** which was $372 million. Continued strong revenue collections as well as underspends in personnel contributed to the higher fund balance projection. This projection represents approximately 11% of revenues, above the City's goal of 6-8% and below the Government Finance Officers Association (GFOA) goal of 17%.



	FY19	FY20	FY21	FY222	FY23
Adopted	$139,457	$209,903	$51,350	$86,547	$371,895
Q2	$222,650	$351,967	$29,089	$133,656	$660,473
Actual	$438,680	$290,672	$298,541	$779,144	

Revenues

Changes in Revenue Projections: Adopted Budget vs. Q2 Report ($000s)		
Tax	$ Change	% Change
Wage and Earnings	$ 83,570	5%
Real Property	$ 599	0%
BIRT	$ 97,925	16%
Sales	$ 2,928	1%
Real Estate Transfer	$ 5,517	1%
Net Profits	$ (1,830)	-5%
Parking	$ 4,023	4%
Amusement	$ 14,427	64%
Beverage	$ (9,807)	-13%
Other	$ (11,065)	-57%
Total Tax Revenue	$ 186,287	5%

General Fund tax revenues are now projected to end FY23 at $5.89 billion—**$188 million above the figure included in the Adopted Budget.** The Adopted Budget projections factored in declines for the BIRT (11% reduction) and Realty Transfer tax (32% reduction), but positive adjustments were made given the collections from the first half of this fiscal year. Next quarter will provide a clearer picture of BIRT collections as that is when the tax is due. Overall, current FY23 revenue projections are slightly higher than FY22 year-end actuals by $134.7 million.

Obligations

General Fund expenditures are projected to end FY23 at $6.03 billion-- **$191 million above the original Adopted Budget estimate and $13.2 million above last quarter's projection**. The increase in projected spending since last quarter reflects additional spending approved by City Council for the mid-year transfer ordinance ($16.4 million). This includes $5.1 million in additional contributions to cultural and community organizations, $3.6 million towards salaries at the DAO, $3.6 million for programs in the MDO, and $1.85 for the activities fund.

Changes in Spending Projections: Adopted Budget vs. Q2 Report ($000s)		
	$ Change	% Change
Personal Services	$ 33,948	1.7%
Personal Services - Employee Benefits	$ (3,250)	-0.2%
Purchase of Services	$ 20,056	1.6%
Materials, Supplies and Equipment	$ 43,449	30.3%
Contributions, Indemnities and Taxes	$ 44,465	10.9%
Debt Service	$ -	0.0%
Payments to Other Funds	$ 85,000	74.2%
Advances & Miscellaneous Payments	$ (32,586)	-37.9%
Total Obligations / Appropriations	$ 191,082	3.3%

Overtime Summary

The issues with staff shortages continue to persist through FY23 Q2, requiring departments to utilize overtime for service delivery. The new labor contracts from FY22 increased staff salaries, further increasing overtime costs. **By the end of Q2, there were 5,950 open positions out of 32,310 full time positions, which is a vacancy rate of about 18%**. Notably, the following three departments have significant staffing issues and thus the highest overtime costs:

- Prisons: 40% vacancy (873 unfilled positions) with $58.6 million in overtime costs
- Fire: 18% vacancy (621 unfilled positions) with $37.1 million in overtime costs
- Police: 11% vacancy (851 unfilled positions) with $16.8 million in overtime costs

Total year-to-date overtime costs are $133.4 million which represents 14% of all Class 100 expenditures.

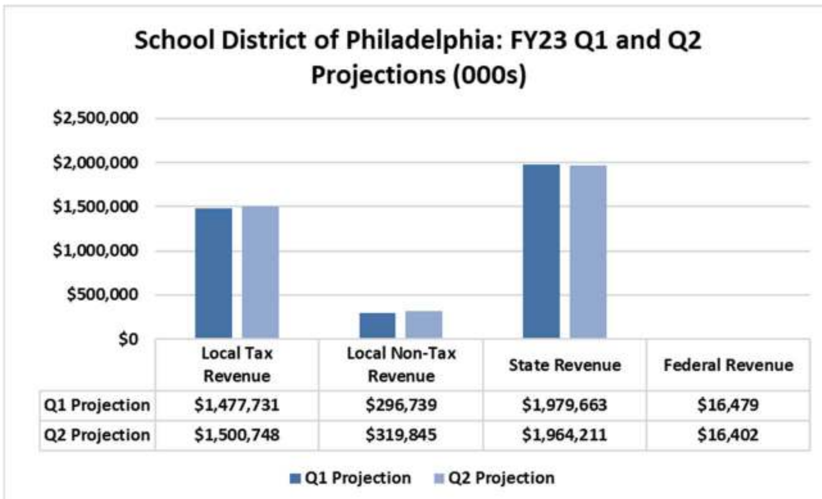
Highlights – School District of Philadelphia Q2 Report

The School District of Philadelphia released its Q2 report on February 15th, 2023. This report, which provides a mid-year financial update, highlights the differences between the June projections- when the budget was adopted- compared to the current outlook.

Fund Balance

The School District's projected year-end fund balance as of the Q2 report (period ending December 31st, 2022) was **upwardly adjusted to $591.6 million—a $45.1 million increase from the Q1 projection.**

Revenues



General Fund revenues for the School District remain close to the Q1, with a **$15 million reduction in overall projected revenue.** Local tax revenues, such as SIT, liquor sales tax, and ridesharing revenue, were upwardly adjusted with a minor reduction in real estate tax revenue. Local nontax revenue increased by $23.1 million while State Revenue was reduced by $15.5 million. Lastly, Federal Covid-19 Relief Revenue was lowered by $40.6 million due to a delay in spending the funds.

Please note: the District's original Adopted Budget included revenues from Governor Wolf's proposed FY23 budget, which called for significant increases in Basic Education funding. The decrease in projected revenues from the State represents the difference between Governor Wolf's proposal and what was ultimately passed by the legislature.

Expenditures

Overall**, General Fund expenditure projections were lowered by $63.6 million in the Q2 report,** from $4.4 billion in the Adopted Budget to $4.07 billion in the Q2 report. This is primarily driven by a <u>$49 million reduction in expenditure for District Operated schools due to staffing issues, turnover, and hiring delays as well as delays in facilities investments</u> funded by federal relief dollars. Charter school projected expenditures were lowered by $10.7 million, which includes a $5.7 million reduction in school transportation expense. This is due to reductions in enrollment (except for cyber charter). Finally, Non-District Operated School projections were lowered by $5.2 million, similarly driven by reduction in transportation expense.