Budget Office
CITY OF PHILADELPHIA

April 14, 2023

The Honorable Darrell Clarke
City Council President
City Hall, Room 490
Philadelphia, PA 19107

Dear Council President Clarke,

This letter is in response to questions raised by Councilmember Gilmore Richardson in writing following the Finance Budget Hearing on March 29, 2023. The following questions were asked:

Topic: Water

1. **The Water Department is currently pursuing a rate case that will lead to a 20% increase in water rates for our residents. The Department is basing this rate increase on the following: 1) inflation; 2) regulatory requirements; 3) pandemic-associated revenue loss.**

    a) **How much funding was set aside for the FY23 Inflation Reserve? How much has been spent and on which departments? How are departments able to request funds from the inflation reserve? Has the Water Department made any requests, and if any requests were denied, what was the reason for the denial?**

    The FY23 General Fund Budget set aside $32 million in the Recession, Inflation and Reopening Reserve and an additional $25 million was appropriated in the Fall FY23 Transfer Ordinance for a total of $57 million. The Spring FY23 Transfer Ordinance proposes utilizing $50 million of the Recession, Inflation and Reopening Reserve for the following departments included in the Spring FY23 Transfer Ordinance: Department of Behavioral Health and Intellectual disAbility Services, Department of Fleet Services, Labor Department, Law Department, Mayor's Office, Office of the Director of Finance, Philadelphia Fire Department, and Procurement Department.

    In FY23, departments have had opportunities to request funds from the Recession, Inflation and Reopening Reserve as part of both the FY23 Target Budget process and the FY24 operating budget development process. As part of both processes, departments met with the Budget Office to discuss their operations, including any areas of concern with spending due to inflation. If additional costs stemming from inflation in FY23 were deemed necessary, request(s) were included in either the fall or spring transfer ordinance.

The FY24 General Fund Operating Budget process also included an opportunity for all departments to request an increase of up to 5% over their FY23 Class 200, 300, and 400 General Fund budget allocations. Departments submitted forms outlining their needs. Nearly all departments identified a need for some or all the funds. This resulted in $42.2M to departments for increased General Fund costs in FY24, for a total of $215M over the Five-Year Plan.

The fall FY23 transfer ordinance included $13.9 million for the Water Department to cover the impact of inflation on Water's costs for materials and chemicals. Water's projected revenue and expenditure requirements table included in FY24-FY28 Five Year shows an additional $47 million in increased expenditures in FY24.

b) How much funding has been used in FY23 on capital pay go? Has the Administration spoken with PWD about using any of our surplus or ARPA funds on any of its debt obligations? (We've been told by PWD that they have asked and were told no to ARPA $.)

The FY23 Operating Budget includes the following amount for PAYGO: $11.4M in the Adopted Budget, an additional $60M via the Fall Transfer Ordinance, and $71M proposed through the Spring Transfer Ordinance. These funds are being used for a variety of purposes, including funding for two new Health Centers; funding to support Rebuild; and certain vehicles.

The ARPA funds did allow the General Fund to provide additional support to the Water Fund. After the City received its American Rescue Plan Act allocation, the City was able to adjust the pension contribution allocation across funds, such that $25M/year less is coming from Water (being covered by the General Fund instead). This is recurring ($125M over 5 years). This allocation is how the General Fund has been able to help the Water Fund on an ongoing basis.

PWD also pursues low cost federal (WIFIA) and state loans (Pennvest), which reduce the need for PWD to borrow directly. PWD secured a $340 million federal WIFIA loan and $375 million across seven Pennvest loans. These low-cost financing streams are built into Water's existing projections.

i) If ARPA funds were allocated to the Water Fund, would their permissible use be for capital improvements to the City's water, sewer and stormwater infrastructure? If not, can you please provide an explanation of the other uses ARPA funds allocated to the Water Fund could be put to?

There is no restriction against using ARP funds for capital improvements, but ARP funds cannot be used to pay debt service for borrowings. We have also been advised by counsel that any funds provided by the General Fund cannot be counted towards the Water Fund's rate covenant calculations. Water needs to meet its rate covenants with sufficient rate revenue in order to avoid defaulting on outstanding bonds.

ii) If the Water Fund received $450 million in ARPA funds, how would it impact PWD's existing and proposed debt service and potential borrowing for FY 2024 and FY 2025? ($450m is what advocates are calling for).

Based on current interest rates, if the Water Fund didn't have to borrow for $450 million for infrastructure investment, its debt service would be reduced by about $40 million annually. At the same time, if those ARPA funds were diverted from the General Fund, it would create large deficits in the City's General Fund. By the end of the five year plan, the General Fund is projected to have a $120 million fund balance, meaning that moving $450 million to another fund would create a gap of hundreds of millions of dollars that the City would have to close. Unlike many other cities, Philadelphia had to use all its ARP funding for revenue replacement because of the huge revenue losses we suffered. While the $1.4 billion the City received allowed it to avoid devastating budget balancing actions that would have damaged the entire region, it did not replace the entire $1.5 billion that the City lost due to the pandemic.

As is required under the ARPA legislation and shown in the FY24-FY28 Five Year Plan, the $1.4 billion is fully allocated by the end of next calendar year.

iii) How would the Water Fund's receipt of grants in the amount of $100 million per year over a 10-year period to fund capital work impact PWD's existing and proposed debt service and potential borrowing through FY 2055?

Each $100 million of avoided borrowing would reduce the Water Fund's debt service by about $9 million annually based on Water's current credit rating. Providing those annual grants, however, would create massive deficits in the City's General Fund since the proposed FY24-FY28 Five Year Plan ends with a fund balance of only $120 million. Providing annual grants would also increase the likelihood of a credit rating downgrade which would result in higher future borrowing costs for the City and Water.

c) With the stated goal of using underspending and surplus on one time funding obligations that can provide immediate relief, has Finance spoken with PWD about its financial situation and how general fund dollars could help PWD lower costs to avoid the 20% rate increase proposal?

As stated above, after the City received its American Rescue Plan Act allocation, the City was able to adjust the pension contribution allocation across funds, such that $25M/year less is coming from Water (being covered by the General Fund instead). This is recurring. This allocation is how the General Fund has been able to help the Water Fund on an ongoing basis.

Topic: Recession and Our Preparedness

1. **In your testimony you acknowledge that there is potential for an economic slowdown on the horizon but that one of your goals is to strengthen the city's long term fiscal health.**
   a. **I see that we are projected to have a fund balance of $524M (8.7=%), which is above our internal goal of 6-8%. How are we making strides to ensure we end with that amount and potentially reach that GFOA target of 17%?**

      The Administration weighs a number of tradeoffs in targeting its annual ending fund balance. While the GFOA recommends a fund balance of 17%, the Administration believes attaining and maintaining that level of fund balance would require too many tradeoffs in terms of foregone investments as we try to meet the other needs of the city. As a result, we target achieving a fund balance of between six percent and eight percent. Achieving that level will be challenging once the ARPA funding has been exhausted, but the City will continue to have the same focus on the general fund's long-term health that allowed us to achieve our target fund balance level before the pandemic upended our finances.

   b. **How are we keeping Philadelphians informed about this information and how this impacts them?**

      Before the proposed FY24 Budget was developed by the Kenney Administration, the Budget Office's Education Engagement and Impact Unit reached out to community members across Philadelphia about their priorities for City spending. This is the second year that in-depth focus groups were utilized. Details regarding this outreach are available on the City's website.

Topic: Pay equity

1. **In your testimony, you provided your staff demographics summary. Your department is closer on pay equity than many others, but there are still some instances of disparities, specifically for your general full time staff and your executive staff. For example, the median salary for white men full time staff is $95,624 and for Black women, it's $70,467.**

Ensuring pay equity among Finance employees is and has been a key priority for the Office of the Director of Finance. As your question notes, we have had success, but there is always more that can be done.

Overall, the median salary for minority exempt employees is higher than the median salary for exempt white employees in the Office of the Director of Finance. That marks substantial progress over the last several years. You noted, however, that there is still a disparity in pay between Black women and white men. That difference is driven entirely by civil service employees. For exempt employees, over whom we have more latitude with regard to hiring and pay, salaries for Black women are higher than salaries for white men.

The 15 white men captured in the summary table include 5 exempt employees (for whom the median is $65,000) and 10 civil service employees (for whom the median is $104,658).

The 48 Black women captured in the summary table include 15 exempt employees (for whom the median is $93,587) and 33 civil service employees (for whom the median is $56,988).

Thus, for exempt roles where Finance leadership has the most ability to ensure that employees are being paid equitably, the median for Black women exceeds the median for white men by nearly $30,000. We understand that there is more work to do, but wanted to point out the progress that has been made with exempt employee pay.

a. **Please explain what your department is doing to improve pay equity and create upskilling opportunities for people of color?**

With respect to career opportunities and training, Finance sends employees to GFOA training every year. Over the last year, some Finance employees attended the GFOA Annual Conference while others participated in a virtual forum on finance basics, also presented by GFOA. The materials for the GFOA basics training were then made available to diverse fiscal staff across the City.

Over the last several years, Finance has prioritized improving communications with over 250 fiscal staff across the City via recurring fiscal staff calls; rolling out “Finance School” training via these regular calls; and making user-friendly fiscal staff training resources available on Finance’s intranet site. This year, Finance also convened its first fiscal staff mentorship cohort, which brings together roughly 15 diverse fiscal staffers from across the City for networking opportunities and panel discussions related to City finance career opportunities.

Finance’s approach to improving pay equity is to ensure we have a diverse staff throughout our organization, who are compensated the same as nondiverse staff in the similar roles. We have the most influence on pay equity in our exempt hiring. We set salary ranges based on job responsibilities, and benchmark them to similar roles in our department, as well as in other departments, to ensure pay equity between jobs. As discussed in answer 1, that has led us to a point at which our exempt minority employees have a higher median salary than our exempt white employees.

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Topic: DEI contracting

1. **Over the last two fiscal years, Finance has seen almost $9m more in contract spending, but you've had almost no growth in your MWDSBE contracting (spending has decreased from 30% in FY21 to 25% in FY23), and you're not predicting any additional growth for FY24.**

    a. **Why has your MWDBE participation rate decreased over the last 3 fiscal years?**

    The Office of the Director of Finance understands the importance of growing MWDSBEs. While we consistently met our participation goals before the last few years, some specific challenges have made that more difficult over the last several years. As noted in Finance's written testimony, for FY21 and FY22, Finance assumed a contract for the City Commissioners. Excluding that large PeopleShare contract, Finance's participation rate would be higher.

    In addition, as part of the response to the pandemic, Finance contracted with a consulting firm to help with grants management. That contract has 20% participation and accounts for 27% percent of all of Finance's FY23 professional service spend, which brings down our overall participation. The department is rebidding the contract and hopes to achieve higher participation moving forward.

    Finance also has three contracts with minority- or women-owned business who do not count towards our participation because they have declined to register with OEO. Without PeopleShare, and with those vendors, Finance's FY23 participation would be 33%.

    b. **How do you plan to achieve your MWDSBE contract participation rate of 30% when you have not reached this number since FY21?**

    Every time Finance has an RFP opportunity, Finance works with OEO to identify qualified vendors. In addition, as part of each contracting opportunity, Finance sees whether there are any opportunities for participation and encourages vendors to work with certified subcontractors. Finance's Deputy for Administration and Training also actively engages with vendors to help them register if they are eligible as MWDSBE vendors.

    c. **Of your professional services contracts, only one is listed as 100% MBE. Why does your department struggle to contract with MBEs? What is your strategic plan to improve this situation?**

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Please see above for an explanation on our participation rate and of the impact on our participation rates of: a contract Finance assumed for another department; one other large contract; and three Minority vendors who haven't been certified.

Topic: Climate/EJ

1. **How is the City considering its overall climate-related financial risk and how that can impact our future operations, bond ratings, and overall financial stability? Are you developing any sort of plan to assess this risk?**
2. **Your responses on the climate change questions are very limited, especially considering climate finance has gained significant national attention with lawsuits taking place over ESG requirements and the SEC's rulemaking process.**

    a. **Is anyone in your department tracking these issues? Have you considered hiring a climate finance expert who could assist with better understanding how our fiscal stability is impacted by climate change?**

    b. **What proactive approaches are we taking to ensure we are better prepared for extreme weather that would not be reimbursed by FEMA, like what happened with Tropical Storm Isaias?**

Thanks for the questions. We're providing responses to one and two together.

Understanding the risk of climate change is an important part of our processes. Every time the City issues bonds, we produce a series of bond disclosures that discuss the possible impact of climate change and our strategies for responding to climate change. We work with the Office of Sustainability on those disclosures. Those disclosures address the issues raised in your questions.

Here is our latest disclosure:

The City's Office of Sustainability ("OOS") works with partners around the City, both public and private, to educate and prepare the City for climate change, among other things. OOS is responsible for implementing Greenworks Philadelphia, the City's comprehensive sustainability plan, which consists of a variety of initiatives to prepare the City for future climate–related challenges.

Planning for the potential impact of climate change in the City is challenging. The City's climate is variable and projections of future conditions range significantly. Potential climate change impacts include rising temperatures (heat waves); air quality issues; increased heavy *precipitation events (rain or snow); rising sea levels (two feet by 2050 and four feet by 2100); and storm surges from more intense hurricanes and tropical storms.*

Under the mid-century (2050) and end-of-century (2100) analyses, the City projects that it will experience a greater frequency of heavy and extremely heavy precipitation events, with the largest increase occurring in precipitation that falls during winter months. Heavy precipitation and flooding can be caused by a variety of weather systems, including tropical storms and hurricanes, thunderstorms, and frontal activity. When these heavy precipitation events fall as rain, they often exceed the capacity of the City's storm sewer infrastructure; when they fall as snow, they require many City resources to manage. Some of these projections are already becoming a reality, as the City has experienced an increase in the intensity and frequency of storm events over the last decade, which has on occasion resulted in significant flooding.

The sea level rising is a particularly important risk for the City, as rising seas affect water levels in the Delaware and Schuylkill Rivers bordering the City. Higher sea levels will increase the depth and extent of flooding in and around the City from storm surges. Low-lying areas already experience localized flooding during heavy storm events, and both municipal infrastructure and private development exist along the two rivers. Because of the City's topography and its location next to tidal rivers, many City facilities and other properties are vulnerable to sea level rise, even under conservative sea level rise scenarios. For example, Philadelphia International Airport (PHL) and at least a dozen other City facilities would be exposed to flooding with two feet of sea level rise, a scenario that is likely to occur by mid-century. Under the mid-century sea level rise scenario (indicating two feet of sea level rise), only one City facility is highly vulnerable to flooding, but under the end-of-century sea level rise scenario (four feet of sea level rise), 19 facilities are highly vulnerable and another 12 City facilities are moderately vulnerable. Hundreds of additional facilities (both City and private) are highly vulnerable to both riverine flooding and the combination of sea level rise and storm surge.

As an example of the City's possible susceptibility to flooding from major storms or rising sea levels, on September 1, 2021, remnants of Hurricane Ida passed through the City and surrounding areas causing heavy rainfall, major flooding, and numerous tornadoes. The Schuylkill River rose to record levels, or near record levels, in various areas and caused flooding throughout parts of the City. While the City continues to evaluate the scope and costs of the damages caused by the storm, preliminary evaluations indicate that the City suffered at least $27 million in damages to date. The City will seek federal relief funding and other aid from the Commonwealth to offset costs the City may incur in addressing the damages from the storm.

<u>Financial Impact</u>. While the financial effects of climate change are difficult to quantify, the City has developed some cost estimates related to its future fiscal impact. Climate change will increase both the risk of expense of extreme events and the regular, recurring costs of doing business, along with equally important but less quantifiable costs to quality of life in the City.

Proactive planning for climate change can help to reduce many of these costs, both public and private.

Climate change is increasing the intensity of extreme storms, and just one severe hurricane could cause more than $2 billion in damages across the City. The City expects to see more frequent extreme storms with higher winds and more flooding, due in part to sea level rise combined with heavy rains. Depending on severity, each of these storms could cause an estimated $20 million to $900 million in damages in the City.

In addition to increasing disaster costs, higher heat and more precipitation will increase the everyday cost of doing business for the City's government, businesses, and residents. Increased operating costs from climate change across all sectors would result in a significant economic impact in the City. Much of these costs will be borne by City departments in combination with Commonwealth and federal government; others will fall directly on the private sector.

As the effects of climate change take shape in the City, annual costs related thereto are expected to include a variety of increases ranging from energy and maintenance costs to the increasing costs of continuing to provide services. For example, the City expects climate change to (i) increase annual electricity costs due to increased demand for air conditioning; (ii) create additional roadway maintenance costs from precipitation, freeze-thaw cycles, and high temperatures; and (iii) increase the annual cost of running heat emergency helplines to advise callers about how to avoid heat stress and refer those in need of help to emergency services.

The City also expects to face a variety of other increased costs due to climate change, such as (i) costs associated with a variety of respiratory diseases caused by higher levels of ozone (with costs for medical treatment and lost productivity associated with these diseases approaching $20 million by 2050), and (ii) increased regional transportation expenses (increased operational costs and damages from climate change could rise by almost $2 million per year).

In 2016, OOS, along with a cross-departmental Climate Adaptation Working Group, issued Growing Stronger: Toward a Climate-Ready Philadelphia to (i) assess vulnerabilities and preparation opportunities for municipal government; (ii) identify low-barrier and high-impact internal actions that can be taken to reduce risks and decrease stressors on City infrastructure services; and (iii) guide proactive projects with benefits beyond municipal operations. City-wide climate adaptation planning efforts are now also underway.

In addition to participating in planning efforts, City departments are taking action and implementing projects that aim to increase resilience on a broad array of climate issues. The Department of Public Property ensures that emergency generators in City-maintained facilities are well maintained and fueled, which is intended to allow other City departments to continue providing services during emergency situations. During heat emergencies, the Department of

Public Health ensures communication among City agencies and deploys environmental health teams into the community. Philadelphia Parks and Recreation works with citizen scientists to identify forest restoration practices suitable for the City's changing climate. Regarding broader development across the City, the Philadelphia City Planning Commission (the "Planning Commission") requires new facilities located in flood zones to be raised 18 inches above FEMA base flood elevation, and the Philadelphia Water Department (the "Water Department") promotes green storm water infrastructure as a source control measure to minimize flooding impacts.