CENTER CITY REPORTS

Investing the Proceeds of Growth:

City of Philadelphia Budget Choices: 2020–2024

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CENTER CITY DISTRICT,
CENTRAL PHILADELPHIA DEVELOPMENT CORPORATION

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After decades of decline, Philadelphia has enjoyed 10 consecutive years of unprecedented economic expansion, adding almost 89,000 jobs since 2009. Growth produced not only more employment, but also rising salaries and more residents; accelerating real estate construction, sales and rentals; and a flourishing hospitality and retail industry. All these contributed to an expanded municipal tax base that, when combined with several legislated rate increases, produced a 39% upsurge in the real value of tax revenues collected by the City during the last decade.

Expanding tax revenues fueled a dramatic growth in municipal spending as the recovery accelerated. From fiscal year 2010, the low point of the recession's impact on City operating expenditures, through 2019, spending from the General Fund, the city's primary operating account, increased by $1.6 billion, a 43% increase (4.0% per year), at a time when the region's Consumer Price Index (CPI) increased on average 1.3% per year. Adjusting for inflation, General Fund expenditures grew by 27% from 2010 to 2019. On an annualized, inflation adjusted basis, that represents an increase of 2.7% per year.

During his first term, starting in 2016, Mayor Kenney focused increased revenues primarily on social inclusion: creating a new City-funded pre-K program, investing in libraries, recreation centers and community schools; boosting support for the School District of Philadelphia; and enlarging funding for social services, addiction treatment and homelessness. As the mayor prepares a new operating budget and five-year plan that will guide his second term, it is helpful to reflect on recent trends and to consider the different policy options Philadelphia now has, especially because economic expansions do not last forever.

Cities are shaped by regional and national economic and demographic trends, by changing programs and priorities of higher levels of government. However, in an era of diminished federal funding for cities, local government must play a greater role influencing what happens within its geographic boundaries.[1] It can do this through program and capital budget expenditures, but also through tax policy. After decades of struggling against the forces of decline, Philadelphia enters the 2020s facing the new opportunities and challenges of managing and expanding the benefits of growth. This report suggests three broad strategies or paths to consider:

Strategy 1: *Enlarge the share of tax revenues devoted to address crime, criminal justice and the city's substantial social and educational needs and disparities.*

Strategy 2: *Place greater emphasis on quality of life issues, infrastructure and economic development to retain and attract more residents and businesses with the means to choose many other regional or national locations.*

Strategy 3: *Invest more of the proceeds of growth in tax reduction, lowering the cost of working and doing business in Philadelphia, to prompt more widespread and inclusive, private-sector job growth.*

1: In the last half-century, federal resources for cities have steadily declined as population has decentralized nationally. While Philadelphia's leaders need to maximize the revenues the city can secure from Washington D.C. and Harrisburg, it is important to underscore that through both recent national Democratic and Republican administrations funding from higher levels of government has declined. The City of Philadelphia now generates 75.5% of its operating budget from tax and other revenues raised from within its boundaries.

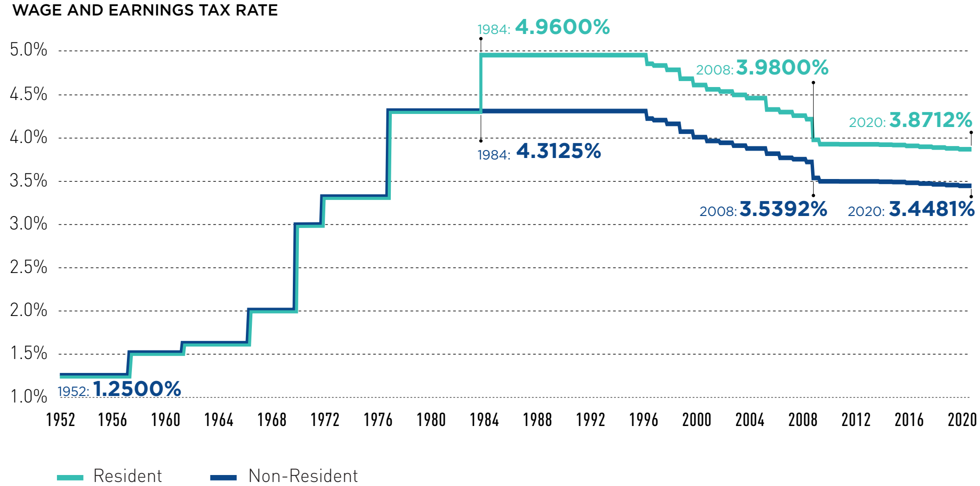
Each of these strategies present viable alternatives, pursued by prior mayors. Each exemplifies a theory of change, focusing on different levers to achieve policy goals. With limited resources however, governing is about choice: not choosing one strategy to the exclusion of another; rather, deciding the appropriate emphasis to place on each and then forging a blended strategy that secures the most prosperous future for all city residents. This report seeks to inform that decision by looking back at the trends and decisions of the last two decades and forward to the paths that might lead to more expansive and inclusive growth.

Legacy from Recent History:

In the 1970s and 1980s, the loss of manufacturing, the decline of federal funding and the departure of working- and middle-class residents left behind physical deterioration, abandonment and growing poverty. To respond to growing social challenges, the City sought to sustain high levels of service through frequent municipal tax increases, even as the tax base was steadily contracting. (Figure 1) A real estate boom in the mid-1980s was followed by a national economic downturn at the end of the decade. A severe, local fiscal crisis ensued in 1990-1991, during which tax collections dropped precipitously. The City struggled to pay bills and meet contractual and budgetary obligations incurred when the economy was still expanding. Bankruptcy was prevented only through state intervention with the creation of the Pennsylvania Intergovernmental Cooperation Authority (PICA), the issuance of PICA-backed bonds to reduce debts, the introduction of a new local sales tax and the establishment of fiscal guardrails as part of a required five-year financial plan. With PICA's authority set to expire in 2023, Philadelphia appears to have turned a corner.

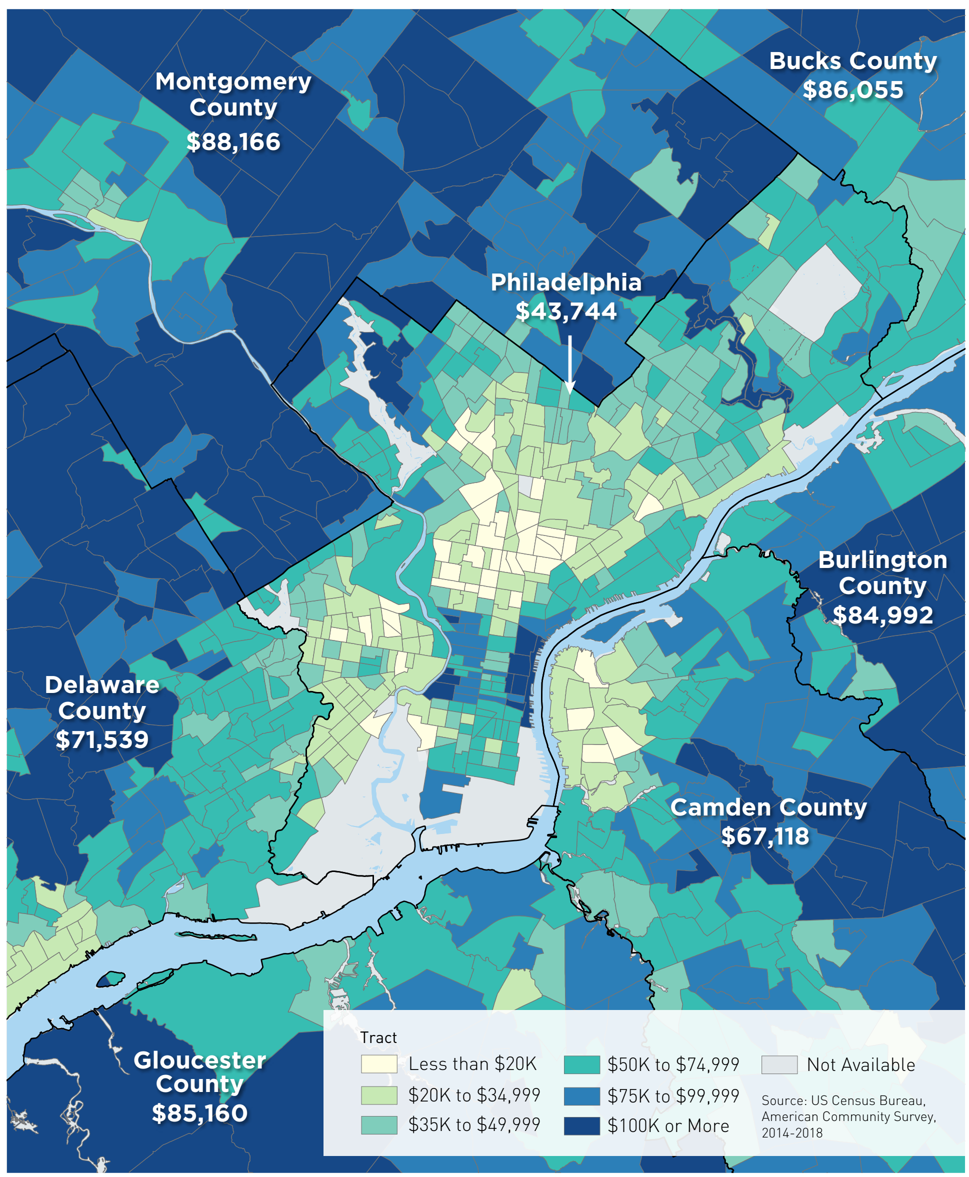
Despite positive trends however, the city still has the highest poverty rate of the 10 largest U.S. cities and the second highest of the largest 25. Too many residents have low incomes that create significant housing affordability challenges. Job growth since

FIGURE 1: WAGE & EARNINGS TAX RATE HISTORY, 1952–2020



Source: City of Philadelphia, Summary Schedule of Tax Rates Since 1952

FIGURE 2: MEDIAN HOUSEHOLD INCOME (CITY & SUBURBS)



the end of the recession, while positive, remains low compared to other major cities. Recent accelerating employment expansion is concentrated disproportionately in low-wage jobs, when compared to other major cities, which are growing a much larger share of family sustaining jobs.[2] Even with the revival of neighborhoods surrounding Center City and University City, housing deterioration and abandonment remain major challenges in many communities.

Despite a few thousand luxury condominiums downtown being added to Philadelphia's citywide inventory of 680,000 housing units, regional wealth remains overwhelmingly concentrated in the suburbs (Figure 2). We are far from reversing the effects of 50 years of decentralization, disinvestment and decline. Philadelphia's median household income is just $43,744. The median household income in Chicago is $55,198; New York City, $60,762; Boston $65,883 and San Francisco $104,552.[3] The assessed value per pupil of city real estate is $241,946, the state average is $489,935; Pittsburgh, $690,347; Lower Merion is $1,503,818.[4] Without broader growth, Philadelphia's low median income and limited assessed value of property outside Greater Center City will leave the City and the School District with a diminished tax base and continuing fiscal challenges (Figure 3).

Looking in the rear view mirror at the recent past, Philadelphia's growth appears impressive. Out the side windows however, we see many peer cities that faced similar challenges, passing by with faster rates of growth, more family-sustaining jobs and significantly lower poverty rates. The sunset of PICA in just three years provides the impetus and opportunity for Philadelphia both to look back and to consider the choices that might produce a more prosperous future.

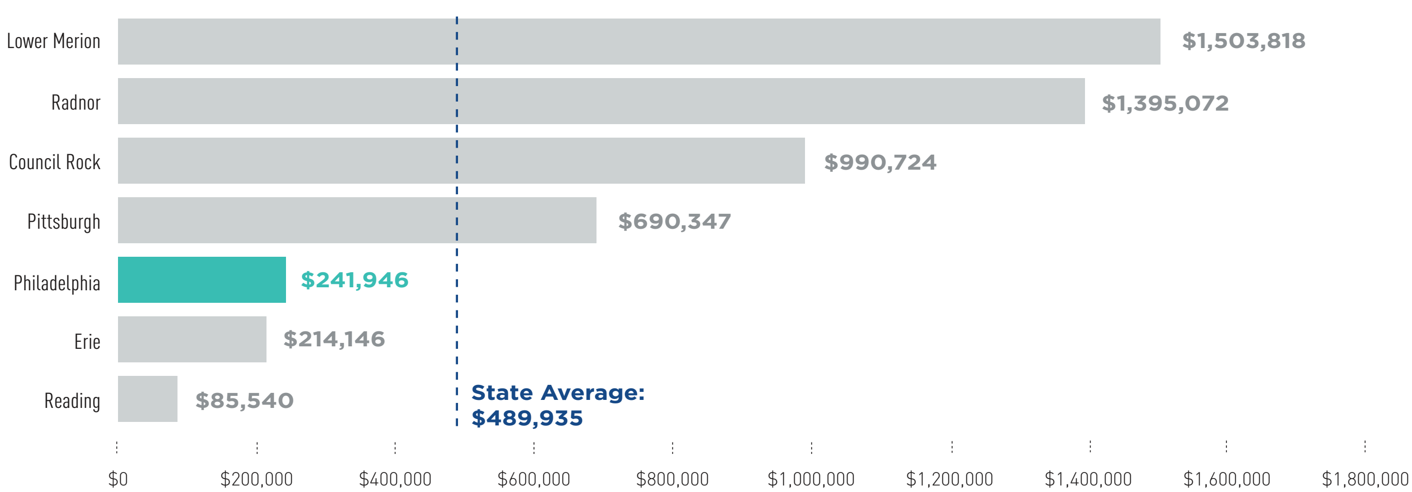
Fiscal Trends of the Past Decade:

After reaching a peak in 2008, just before the Great Recession, the City's General Fund expenditures fell to a low point in 2010 and then rebounded dramatically over the next nine years, with real (inflation-adjusted) total spending increasing by $1.1 billion by 2019, a 27% increase (Figure 4).[5] This translates into an average annual real increase of 2.7%.

A recent analysis by The Pew Charitable Trusts found that Philadelphia's growth in per capita government expenditures from 2008 to 2018 is comparable to other major cities. However, the analysis did not examine the specific categories that grew, nor did it ask if there are alternative ways for Philadelphia to allocate or invest these unprecedented proceeds of growth.[6] That is a central focus for this analysis.

Expansion of the Base: With more jobs, higher salaries, increased business volume and sales, population growth and new construction, there is more to tax, even without an increase in rates. An expanded municipal tax base is a huge dividend of growth. From 2009 to 2019, adjusting for inflation, the base for the wage and earnings tax grew by 27%; the sales tax base expanded by 18%, while the real estate transfer tax base jumped by 131%.[7]

FIGURE 3: ASSESSED VALUE PER PUPIL: 2017 MARKET VALUE/2017-18 ENROLLMENT



Source: PA Department of Education

2: *Growing More Family Sustaining Jobs in Philadelphia*, Center City District, October 2019.

3: US Census Bureau, American Community Survey, 2018 five-year estimates.

4: CCD calculations based on PA Department of Education data.

5: This calculation includes Department of Human Services expenditures within the grants revenue fund to account for the transfer of DHS grant funding to that fund in fiscal year 2012.

6: *How Philadelphia's Expenditures Have Increased in Recent Years,* The Pew Charitable Trusts, December 2019.

7: Wage and earnings tax base growth calculation includes PICA tax revenues.

FIGURE 4: CITY OF PHILADELPHIA ADJUSTED GENERAL FUND EXPENDITURES, FY 1998 – FY 2019 (2019 DOLLARS IN BILLIONS)

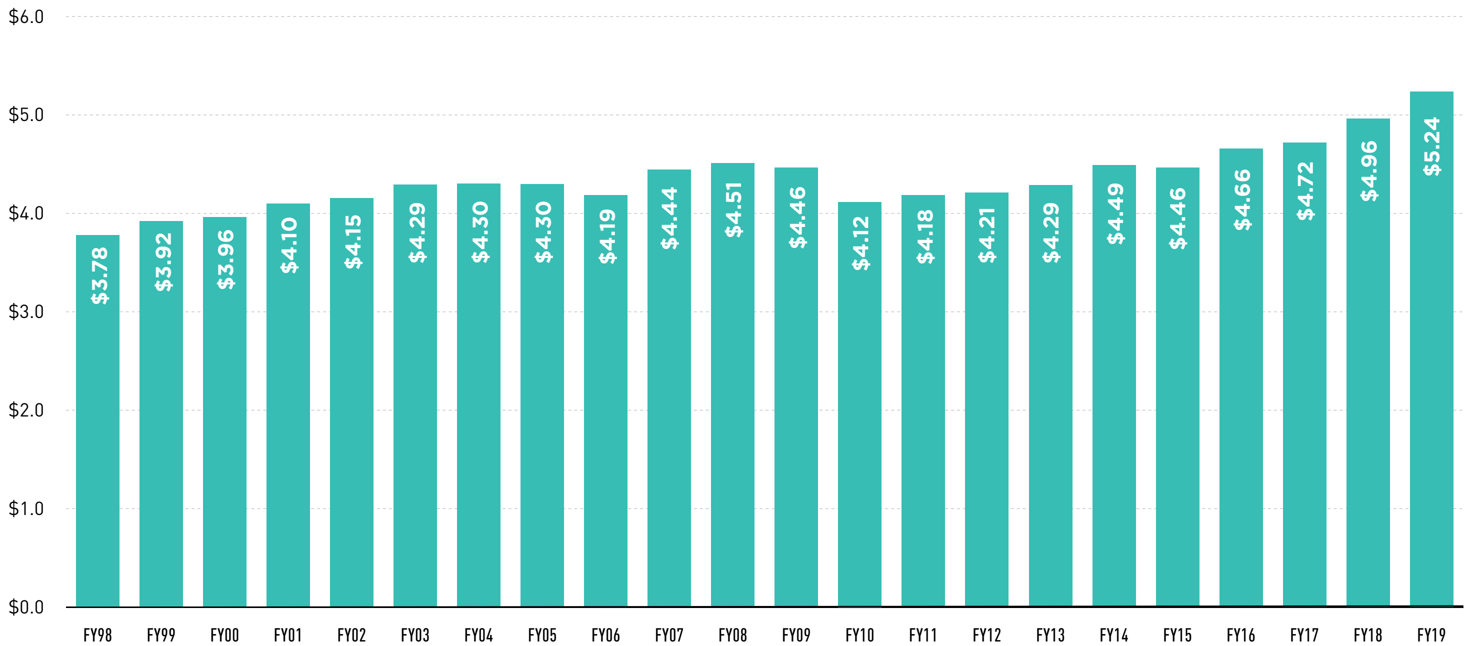
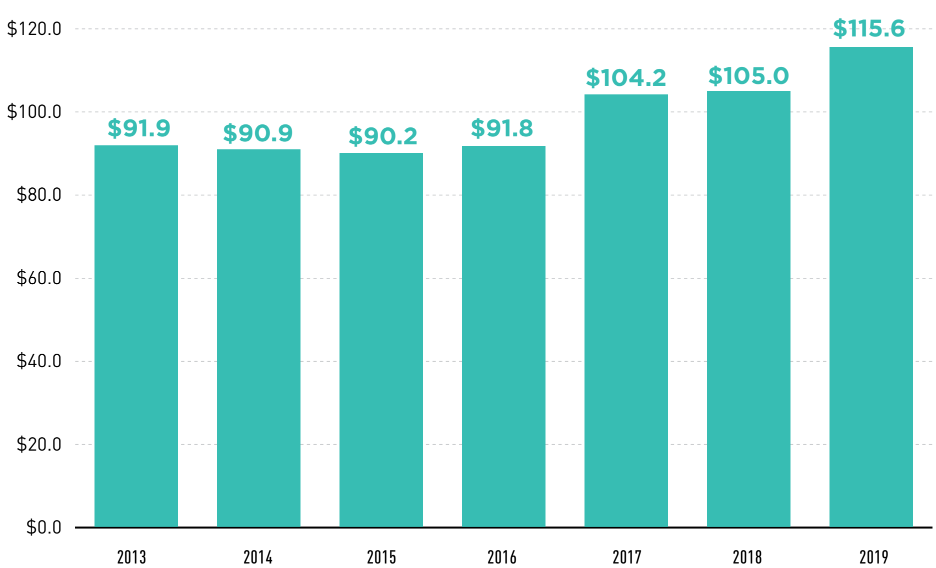


FIGURE 5: CITY OF PHILADELPHIA TAXABLE ASSESSED VALUE OF PROPERTY TAX YEAR 2013 – 2019 (DOLLARS IN BILLIONS)



Following the implementation of the Actual Value Initiative (AVI) in 2013, total taxable assessed value increased from $91.9 billion to $115.6 billion in 2019, an 18% increase after adjusting for inflation (Figure 5).

On top of a growing *base* came several legislated *rate* increases for use and occupancy, sales, parking and real estate transfer taxes. The real estate tax rate increased from 8.264% in 2010 to 9.771% in 2013, prior to the citywide reassessment under the AVI. Rates then increased again from 1.34% in 2014 (after AVI) to 1.3998% in 2016.

As a result, the yield from every major City tax rose (in inflation-adjusted dollars) from FY09 to FY19. Wage and earnings tax revenues were up 25%; real property tax revenues were up 53%; business income and receipts revenues were up 23%; net profits tax revenues rose by 158%; sales tax revenues increased by 54% and real estate transfer revenues were up 152%.

In total, municipal tax revenues increased from $2.95 billion to $4.11 billion during this period, an increase of 39% in real terms.[8] City tax revenue increased every year for the past 10 years, with the exception of 2015, when state legislation required the dedication of $120 million in local sales tax revenues to the School District. (Figure 6)

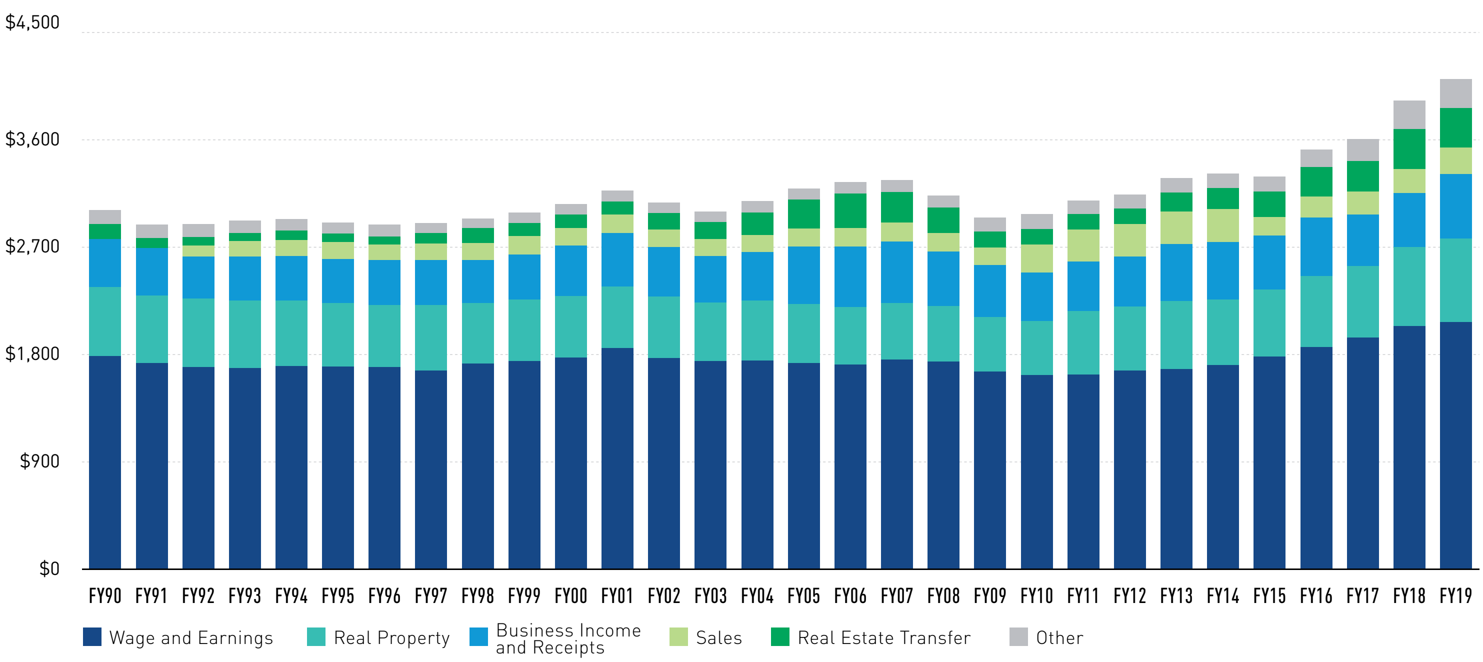
Curtailment of Rate Reductions: The growth in revenues also reflects a significant, additional policy choice, discussed in detail below: the City did not continue the substantial annual, across-the-board reductions in the wage and business taxes that began in 1996 and continued for 14 consecutive years during the Rendell and Street administrations and the first two years of Mayor Nutter's term.

Increased Benefits to the School District: Because the School District of Philadelphia is not an independent taxing authority, the City of Philadelphia also collects taxes for the benefit of its public schools. Each of those major taxes also increased significantly in real terms from fiscal 2009 to fiscal 2019. The rise in real estate taxes resulted in an increase of 18% in the revenue received by the School District from this source.[9] Use and occupancy tax revenues were up 38%, while school income tax revenues rose by 70%. In addition, the District began receiving $120 million annually in revenues generated by the local sales tax, beginning in fiscal 2015. Overall District tax revenues increased 46% in inflation-adjusted dollars over the past decade.

Other Revenue Sources:

For a complete understanding of the City's overall financial picture, it is essential to consider not only the General Fund, the City's largest operating account, but also other sources, such as federal and state grants and funds dedicated to specific purposes. Besides the General Fund, the City also manages a Grant Revenue Fund, the Hotel Tax Revenue Fund, the Community Development Fund, the Housing Trust Fund, the Car Rental Tax Fund, a Special Gasoline Tax Fund and a County Liquid Fuels Tax Fund. Together, these constitute all local tax, non-tax and grant revenue sources that pay for the programs that are largely within the discretion of local decision-makers. By comparing these over time, it is possible to track how priorities have changed between fiscal year 1998 and 2018, the most recent year for which complete data is available.[10]

FIGURE 6: CITY OF PHILADELPHIA TAX REVENUES BY CATEGORY, FY 1990 – FY 2019 (2019 DOLLARS IN BILLIONS)



8: These calculations include wage, earnings, and net profits taxes dedicated to the Pennsylvania Intergovernmental Cooperation Authority (PICA). These are effectively local taxes although they are dedicated to PICA and used to cover debt service payments on PICA debt. The amounts of PICA taxes not required for debt service are transferred to the City General Fund.

9: The real estate tax of 13.998 per $1,000 of taxable assessed value is divided in 2020: 6.317 goes to the City and 7.681 goes to the School District.

10: Funds excluded from the analysis are the city's "enterprise" funds: the Water and Aviation funds, which are financed primarily by user charges, the HealthChoices Behavioral Health Fund, which finances Medicaid behavioral health services though federal and state dollars, and the Acute Care Hospital Assessment Fund, which holds tax funds received from local hospitals that are returned to the state to finance the Medicaid program. These latter funds were established relatively recently, and excluding them allows for comparisons over long time periods, the focus of this report.

In fiscal year 2018, the sum total of revenue received by these funds was $5.74 billion with tax revenues being the largest share, accounting for 68.5% of all revenue[11] (Figure 7). Other local sources, besides taxes, include fees for licenses and permits, emergency medical services, trash collection and court filing fees, interest earnings, and code violation fines. These constitute another 7.0% of revenue. Together, they add up to 75.5% of City operating revenue – all generated locally, based on decisions made locally. The other large source of funding is grants from federal and state governments and other entities, which make up 23.4% of revenues.

Figure 9 shows how these revenues are allocated by broad program categories. Public safety and court costs form the largest category at $1.51 billion; health and human services is next at $1.45 billion; employee benefits is third at $1.38 billion; economic development, culture and recreation comes next at $593 million; governance and administration totals $502 million; debt service and other consumes $338 million; and education receives $158 million.[12]

Expenditure Trends Over Two Decades:

Figure 10 looks at longer-term trends, comparing total City expenditures from fiscal year 1998 to 2018. Total expenditures, expressed in constant 2018 dollars, increased 26% over the 20-year period, from $4.71 billion to $5.94 billion. Real spending declined in only six of the 20 years.[13]

The City's spending growth began to accelerate after fiscal 2015, increasing $529 million or 10% in real terms from 2015 to 2018. This represents an average annual increase of 3.2%.

While data for all operating expenditures in fiscal 2019 is not yet available, rapid growth appears to have continued. General Fund spending increased 6.3% in FY19, and is projected to increase an additional 7.7% in fiscal 2020, at a time when inflation is less than 2% annually.[14]

Changes in Priorities Over Two Decades:

Overall, real spending increased by $1.22 billion or 26% from fiscal 1998 to fiscal 2018. Some portions of the city budget grew while others declined, reflecting not only the priorities of different mayors and city councils, but also mandated pension contributions and declines in some categories of federal funding. However, some clear patterns emerge over the last two decades.

Figure 11 compares expenditures (in constant 2018 dollars) in 1998 to expenditures in 2018 in seven broad program categories. In six out of seven, spending increased. The largest categories – public safety, health and human services, and employee benefits – all increased substantially, by 23%, 12%, and 91% respectively in the last two decades. The largest dollar increase was in employee benefits, rising by $657 million in real terms, representing more than one-half of the total, real increase in spending in all categories. Education spending increased by more than

FIGURE 7: CITY OF PHILADELPHIA REVENUES IN MAJOR FUNDS, BY FUND AND TYPE FISCAL YEAR 2018, (DOLLARS IN MILLIONS)

REVENUES BY SOURCE		
LOCAL TAXES		
General Fund	$3,856	67.2%
Hotel Room Tax Fund	$69	1.2%
Car Rental Tax Fund	$6	0.1%
TOTAL	$3,931	68.5%
LOCALLY-GENERATED NON-TAX	$403	7.0%
GRANTS		
Federal	$401	7.0%
State	$881	15.3%
Other	$63	1.1%
TOTAL	$1,345	23.4%
INTERFUND TRANSFERS	$55	1.0%
OTHER	$8	0.1%
TOTAL	$5,742	100.0%
REVENUES BY FUND		
General	$4,556	79.4%
Grants Revenue	$1,017	17.7%
Community Development	$33	0.6%
Hotel Room Tax	$69	1.2%
Car Rental Tax	$6	0.1%
County Liquid Fuels Tax	$9	0.2%
Special Gasoline Tax	$37	0.6%
Housing Trust	$14	0.2%
TOTAL	$5,741	100.0%

Figure 8 shows all these revenue sources in pie chart form.

11: The tax amount includes local wage, earnings and net profits dedicated to the Pennsylvania Intergovernmental Cooperation Authority (PICA). The amount shown is PICA taxes net of the cost of PICA debt service.

12: A detailed listing of how City departments and agencies were assigned to these categories is presented in the Appendix.

13: The reasons for declining expenditures were: **Fiscal 2005 and 2006.** Reduced spending reflected austerities due to the City's deteriorating financial position. The fund balance had declined from $295 million in fiscal 2000 to $14 million in fiscal 2004. Increasing pension costs were also a factor, because the pension fund incurred significant losses in the recession of the early 2000s. **Fiscal 2009 and 2010.** Spending declined due to the recession, which caused significant reductions in most major tax revenues. The City cut spending through a hiring freeze, efficiencies in criminal justice and child welfare programs, adopting self-insurance for employee health care benefits, and state-authorized deferrals of pension contributions. **Fiscal 2013.** City spending declined modestly ($9.1 million) due to lower spending in economic development, housing, health, and human Reinvestment Act (ARRA) of 2009. **Fiscal 2015.** Spending in fiscal 2015 was lower due to two unusual factors that had increased costs in 2014: repayment of deferred pension payments, and retroactive wages for City firefighters that were paid in fiscal 2014 but represented prior year wages, due to a delayed contract settlement.

14: Quarterly City Managers Report, Period Ending September 30, 2019, City of Philadelphia Budget Office, November 15, 2019.

FIGURE 8: CITY OF PHILADELPHIA REVENUES BY TYPE MAJOR FUNDS, FY 2018

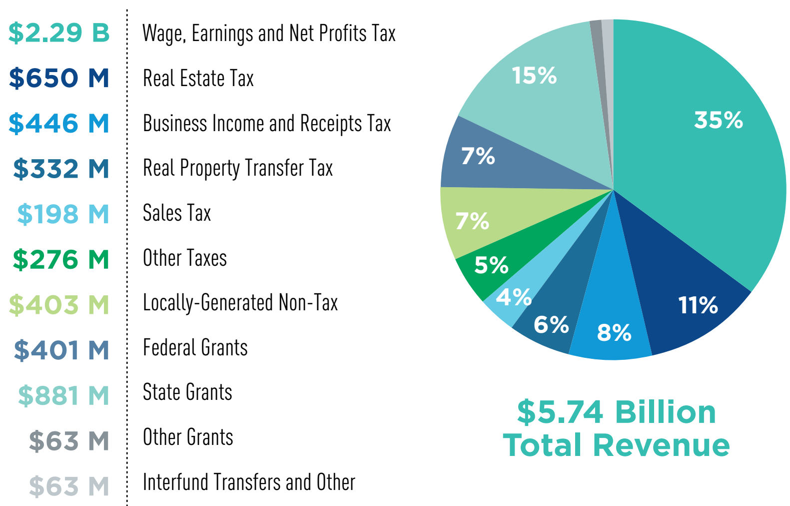
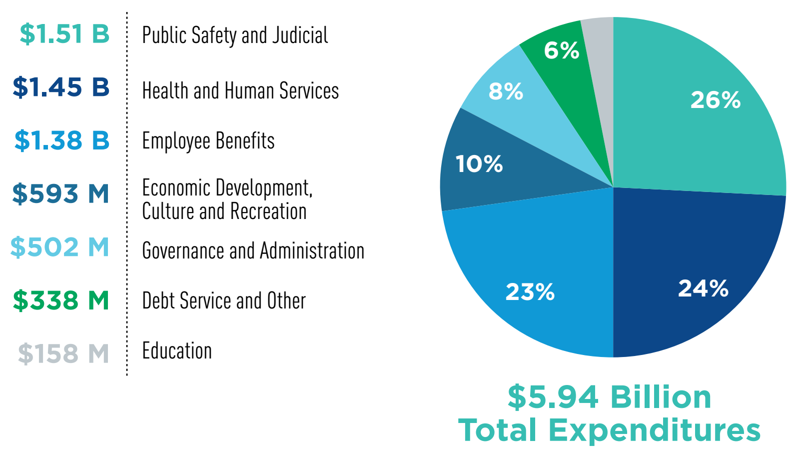


FIGURE 9: CITY OF PHILADELPHIA EXPENDITURES BY PROGRAM CATEGORY MAJOR FUNDS, FY 2018



200%, primarily due to higher contributions to the school district and new community schools and pre-K programs established by the Kenney administration. The only broad category that declined was the economic development, culture and recreation, which decreased by 18%.

Appendix 1 contains a brief overview of changes in those major spending categories and various subcategories of spending. The discussion that follows below focuses on the one category that decreased: *Economic Development, Culture and Recreation.*

During the last two decades, reductions occurred for the Free Library (-$4.4 million); Parks and Recreation (-$8.3 million); City support for the Pennsylvania Convention Center (-$29.1 million); housing and planning programs that recently consolidated under the Department of Planning and Development (-$90.7 million); the City's operating subsidy to SEPTA (-$0.7 million); and the Streets Department (-$33.1 million).

The reasons for lower spending vary by category. In the case of parks, recreation and libraries, reductions are primarily due to a decline in real General Fund spending. Grants revenue for operations in these areas has kept up with inflation. Notably, there was a significant *capital grant* from the William Penn Foundation in 2016 of up to $100 million for the Rebuilding Community Infrastructure Initiative ("Rebuild") to transform city parks, libraries, recreation centers and playgrounds. The decline in the City's support for the Pennsylvania Convention Center reflects the state's assumption of additional financial responsibility for the Center following its expansion in 2011.

Reduced spending in Planning and Development results primarily from cuts in the federal Community Development Block Grant (CDBG) and related programs, but also reflects some reduced local taxpayer support. These reductions were partially offset by new local funding through the Housing Trust Fund, which receives dedicated revenue from real estate recording fees.

The reduction in the Streets Department primarily results from declines in local support. State grant funding from the county liquid fuels and special gasoline tax grants has largely kept pace with inflation. However, Mayor Kenney has signaled his intention to increase spending for sanitation services in the coming fiscal year.

The only subcategories within the economic development category that increased during this period are arts and culture (+$4.5 million) and the Department of Commerce (+$34.1 million) (Figure 12).
The last increase is entirely due to growth in the special-purpose Hotel Room Rental Tax, which supports the City's convention sales and tourism marketing agencies. This investment of industry-specific tax dollars has supported efforts to expand the hospitality industry and fill the increased number of hotel rooms, resulting in significant job growth in entry-level positions in hotels, restaurants and food services.

Changes in Local Funding Over Two Decades:

Because federal and state funds may rise or fall, a different way to frame this analysis is to look at just the priorities for local tax dollars. The picture remains largely the same. From fiscal 1998 to 2018, local tax support through the General Fund for every major spending category increased in real terms, with the exception of economic development, culture and recreation programs. The largest increases were in employee benefits ($584 million), and public safety, and judicial programs ($287 million). Economic development, culture and recreation programs declined $63 million (Figure 14).

In sum, City budget priorities during the past two decades shifted toward employee benefits and to those activities termed in the introduction as *Strategy 1 priorities: expanding support for public safety, the judicial system and for social needs like health, human services, and education.* Emphasis shifted away from *Strategy 2 priorities: improving quality of life across all neighborhoods, facilitating commerce, helping attract and retain residents and businesses.* Where the City has invested in economic development in the last decade, it has yielded significant dividends, though primarily focused on lower wage sectors.

FIGURE 10: CITY OF PHILADELPHIA EXPENDITURES, ALL PROGRAM CATEGORIES MAJOR FUNDS, FY 1998 – FY 2018 (2018 DOLLARS IN BILLIONS)

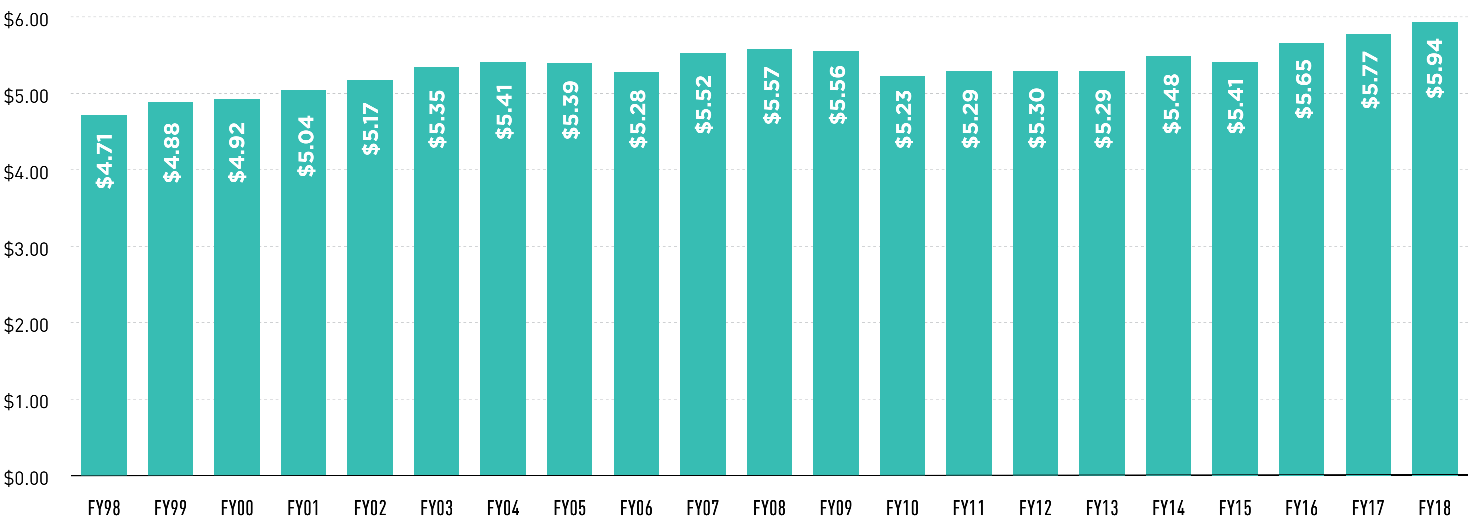
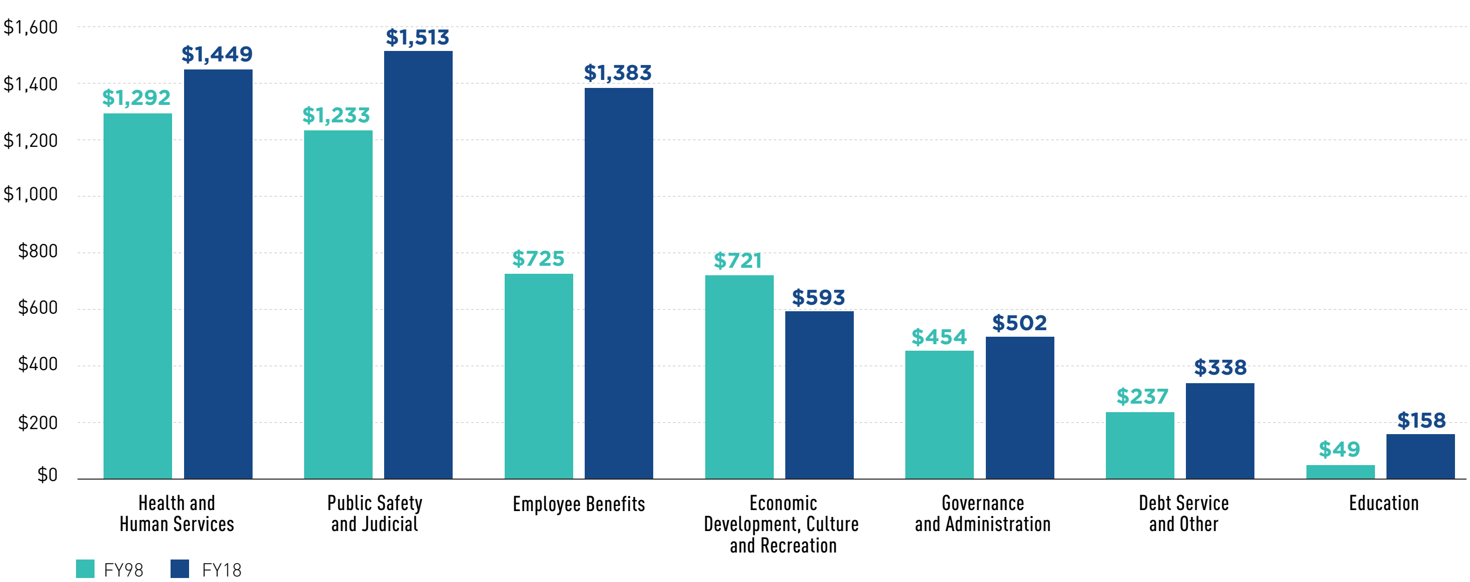


FIGURE 11: CITY OF PHILADELPHIA EXPENDITURES BY PROGRAM CATEGORY MAJOR FUNDS, FY 1998 AND FY 2018 (2018 DOLLARS IN BILLIONS)



Given compelling local need and the decline in federal funds to facilitate inclusion, it is understandable why City priorities have moved in this direction. Public safety is an essential focus in a city where crime rates remain high. Quality public education is key to lifting children out of poverty and increasing workforce participation.

Avoiding Either/Or Choices:

Still, quality of life factors like clean and pothole free streets, reliable transit, and well-maintained parks are critical to ensuring that Philadelphia remains an attractive place to live, locate a business and to work. However, absent more funds from higher levels of government, the City must rely on its own municipal tax base, which remains relatively small in comparison to other major cities and to adjacent counties, whether measured in terms of property values or income. This constrains Philadelphia's ability to fund all programs and creates the risk in the event of an economic downturn of having to choose between cutting services or increasing taxes. Cutting services in a recession will be devastating to those in need. Raising tax rates will be counter-productive to the retention and attraction of business and the growth of family sustaining jobs.

Philadelphia has already found creative ways to avoid these either/or choices. During the past 20 years, the largest

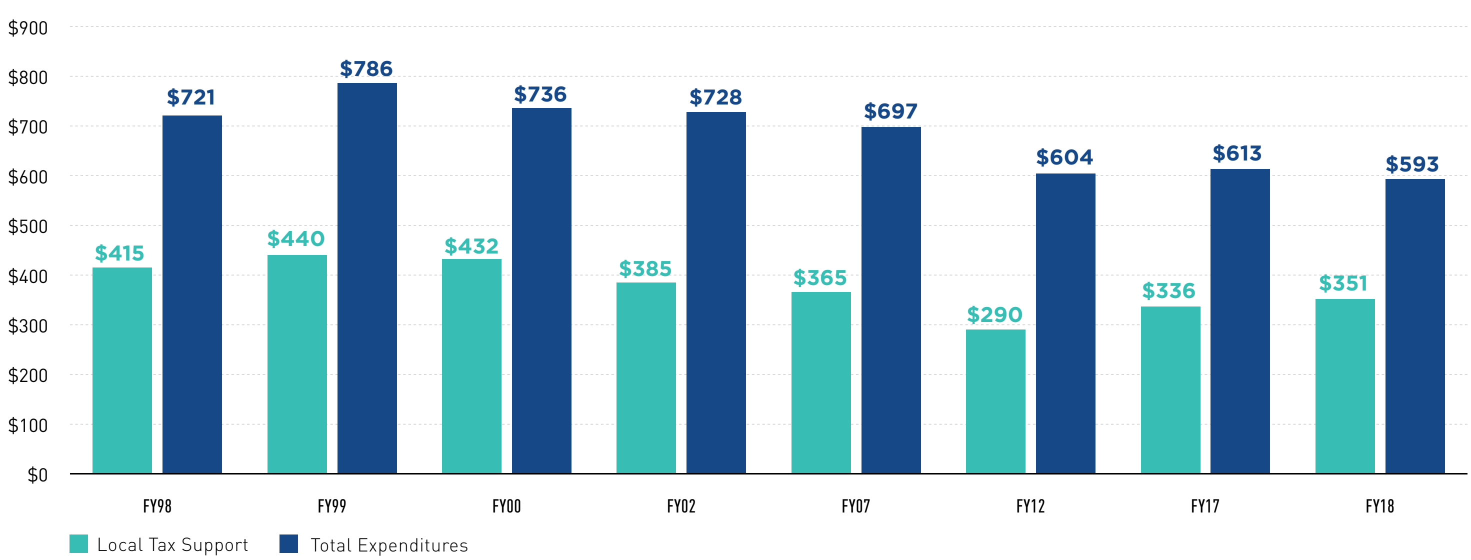
FIGURE 12: CITY OF PHILADELPHIA EXPENDITURES FOR ECONOMIC DEVELOPMENT, CULTURE, AND RECREATION PROGRAMS (2018 DOLLARS IN BILLIONS)

PROGRAMS	FY98	FY18	AMOUNT CHANGE	PERCENT CHANGE
Arts and Culture[1]	$4.5	$8.9	$4.5	100%
Free Library	$54.5	$50.1	($4.4)	-8%
Parks and Recreation[2]	$81.5	$73.2	($8.3)	-10%
Commerce/City Representative	$51.4	$85.5	$34.1	66%
Convention Center Subsidy	$44.1	$15.0	($29.1)	-66%
Planning and Development[3]	$171.1	$80.4	($90.7)	-53%
SEPTA Subsidy	$82.7	$81.9	($0.7)	-1%
Streets	$231.2	$198.1	($33.1)	-14%
TOTAL	$720.8	$593.1	($127.7)	-18%

Notes:

1. Includes Art Museum subsidy, Office of Arts and Culture and the Creative Economy, Atwater Kent Museum subsidy, Civic Center subsidy, and Mural Arts Program.
2. Includes Camp William Penn.
3. Includes Office of Housing and Community Development, Department of Planning and Development, City Planning Commission, Historical Commission, and Zoning Board of Adjustment.

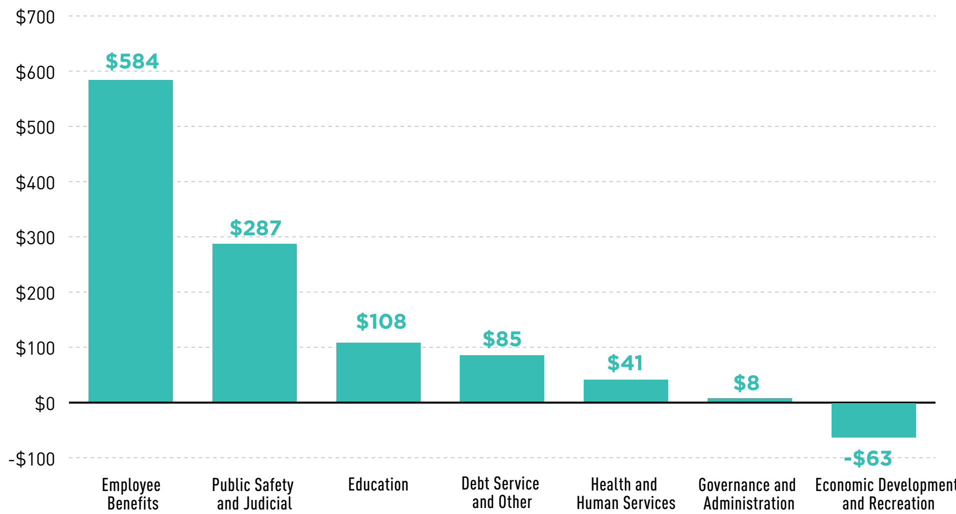
FIGURE 13: ECONOMIC DEVELOPMENT AND RECREATION PROGRAMS LOCAL TAX SUPPORT AND TOTAL SPENDING, FY 1998 – FY 2018 (2018 DOLLARS IN BILLIONS)



reductions in federal funding have been in the area of community development – not resources to address homelessness, but funding to rehabilitate existing homes, reinforce stable neighborhoods and improve housing quality and options for working families whose incomes are constrained. The City has increased local funding for housing and community development by *harnessing the proceeds of growth*: committing expiring abatements from market rate development to affordable housing, providing density bonuses (not exactions) in return for contributions to affordable housing and dedicating transfer taxes to the Housing Trust Fund. These are promising ways to align, rather than juxtapose, the momentum of the market with the need for affordable housing, so long as they are not achieved by adding even more costs onto development. Other cities also augment constrained capital budgets by making greater use of tax increment financing (TIF) *districts* to capture the proceeds of local growth for broader capital, transit and public area improvements that in turn prompt additional private investment.

There is also a lot of evidence that quality of life investments, like cleaning, greening and gardening on abandoned lots in low income neighborhoods, improve community confidence and home values and have a positive effect on Strategy 1 objectives, reducing crime and enhancing perceptions of safety.

FIGURE 14: CHANGE IN GENERAL FUND TAX SUPPORT FOR PROGRAM CATEGORIES, FY 1998 – FY 2018 (2018 DOLLARS IN BILLIONS)



Public services in general, such as sanitation, public safety and education, and physical projects, like playgrounds, recreation centers and street paving produce *visible results*. They signal progress toward stated goals. They build the public's confidence in government and send positive signals to those who seek to invest.

However, **41.2% of all working residents of Philadelphia reverse commute to jobs outside the city.** At the same time, our two largest employment nodes, Center City and University City hold 53% of all of Philadelphia's jobs and are easily accessible at the center of the regional transit system. Therefore, as Philadelphia invests in education, job training and services for those of limited means and mobility and seeks to stabilize moderate-income neighborhoods, it must simultaneously prompt faster employment growth. Only in this way will there be sufficient opportunities in the city for those seeking to enter the workforce and to enjoy the benefits of growth. Only the creation of more family-sustaining jobs will persuade those with the option to leave that there are promising reasons to stay.[16] This leads to a consideration of *Strategy 3: Expanding employment by lowering the cost of working and doing business in Philadelphia.*

FIGURE 15: CITY AND SCHOOL DISTRICT OF PHILADELPHIA TAX RATES

	WAGE TAX		BIRT				
YEAR	RESIDENT	NON-RESIDENT	GROSS RECEIPTS	NET INCOME	REAL ESTATE	USE AND OCCUPANCY	REAL ESTATE TRANSFER
1995	4.9600%	4.3125%	3.25 mills	6.50%	8.2640%	4.6200%	3.000%
2000	4.6135%	4.0112%	2.65 mills	6.50%	8.2640%	4.6200%	3.000%
2005	4.3310%	3.8197%	1.9 mills	6.50%	8.2640%	4.6200%	3.000%
2010	3.9296%	3.4997%	1.415 mills	6.45%	8.2640%	4.6200%	3.000%
2015	3.9200%	3.4915%	1.415 mills	6.41%	1.3400%	1.1300%	3.000%
2020	3.8712%	3.4481%	1.415 mills	6.20%	1.3998%	1.2100%	3.278%

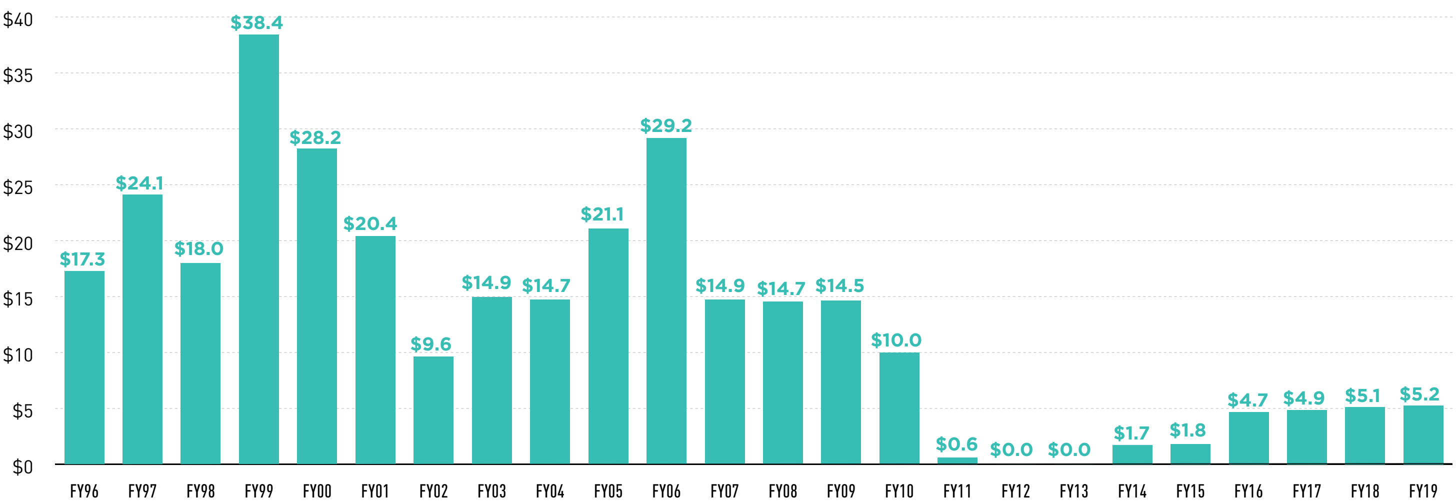
Tax Policy, An Historical Perspective:

When Philadelphia thrived with a vibrant manufacturing economy in the early 20th century, anchored by railroads and rivers, the majority of jobs in the region were concentrated in the city. Local government supported itself primarily through the real estate tax. In 1939, a decade into the Great Depression when property values plummeted, Philadelphia received authority from the Commonwealth to levy a temporary 1% wage tax. By the 1960s, as the city lost its industrial base and jobs and residents accelerated their movement to the suburbs, the City doubled the wage tax to 2% and added new business taxes.

In the 1970s, additional rate increases were levied on a steadily declining tax base to support generous municipal employee labor contracts. In that decade, the wage tax was raised multiple times from 2% to 4.3% (Figures 1 & 15). Further increases in the 1980s brought it to 4.96%, as Philadelphia became a very highly taxed municipality, compared to competitor cities and nearby suburbs. Today, despite recent reductions, our wage tax still remains almost four times as high as most surrounding municipalities and our business taxes can add a 20% to 30% premium to locating in the city compared to adjacent suburbs.

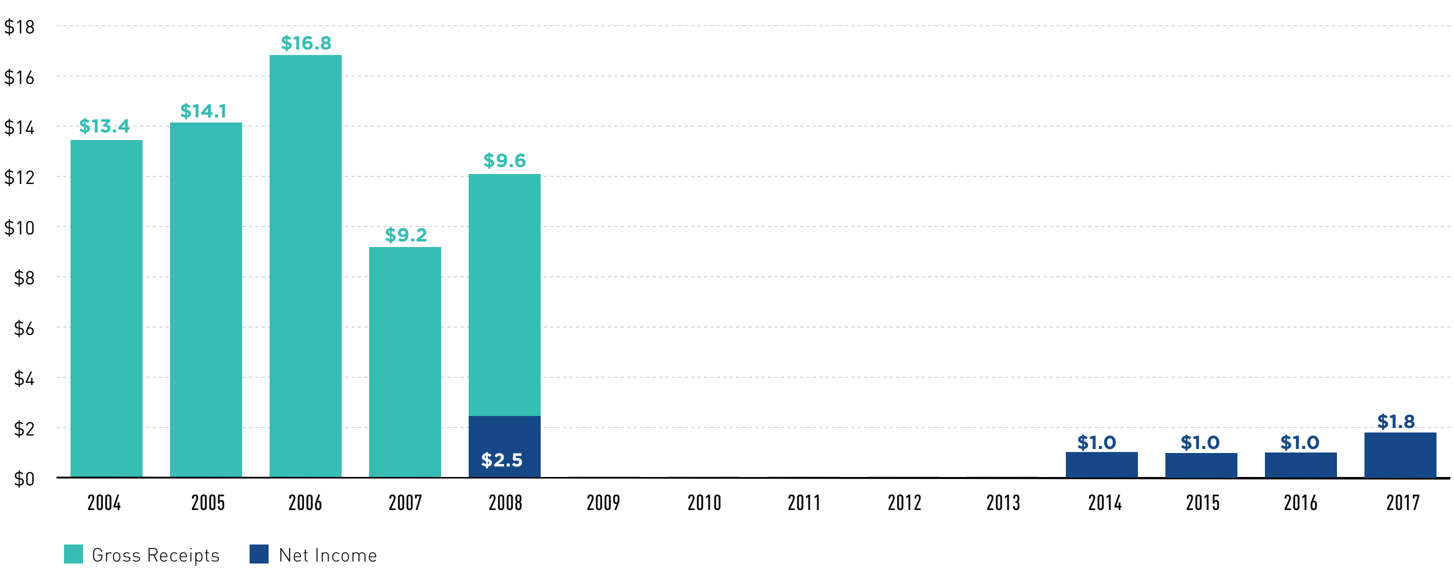
In an era when post-industrial firms and

FIGURE 16: FISCAL IMPACT OF WAGE AND EARNINGS TAX RATE REDUCTIONS (2019 DOLLARS IN MILLIONS)



Note: The most significant wage cuts over this period occurred at the beginning of FY09, when the resident wage tax declined from 4.219% to 3.98% and the non-resident tax from 3.7242% to 3.5392%. The FY09 reductions were financed primarily by a large infusion of $86.5 million in state gaming proceeds, a funding stream that the City has continued to receive at a much reduced rate over the past decade. (In the figure, the $14.5 million reduction in FY09 represents the amount of the reduction financed by local taxpayers.) In all other years, the primary source of reductions came from the decision not to spend every tax dollar collected for services.

FIGURE 17: FISCAL IMPACT OF BUSINESS INCOME AND RECEIPTS TAX RATE REDUCTIONS (2017 DOLLARS IN MILLIONS)



employees are highly mobile, one way to measure the City's commitment to economic growth is the extent to which it takes the *less visible* steps to improve its attractiveness through tax competitiveness. Effective and equitable tax policy is more than geographic or industry-specific, targeted inducements, abatements or incentives. Rather, it should be a citywide effort to create a competitive setting for the growth of jobs of all kinds.

Beginning in 1992, with the infusion of new revenues from PICA, with their requirement for a balanced budget, a five-year plan and the provision that all municipal labor contracts take into account their impact on the municipal budget, the City regained financial stability. Following decades of rate increases across most of the city's major tax sources, in 1996 the Rendell administration began a multiyear plan of reductions in wage and business taxes, recognizing their deleterious effect on local growth. Significant reductions continued through eight years of the Street administration and the first two years of the Nutter Administration. They were temporarily suspended during the recession and resumed at a much slower rate beginning in FY14. (Figures 16 and 17)

The city's resurgence in the past decade builds upon the national economic expansion, upon favorable demographic trends and a growing national preference for walkable, transit-oriented, live-work settings with diverse cultural amenities. Local strengths include professional and business services; education, health care with a growing focus on biomed innovation; a burgeoning technology sector, small business formation and a vibrant restaurant and startup scene.

The stage was set for growth in the 1990s by major investments in quality of life and hospitality; by sustained, well-funded public space management programs and enhancements in Center City and in University City; by citywide tax abatements to jump-start development; by 14 years of sustained and predicable tax reduction and by long-term municipal financial stability, courtesy of the guidelines and guardrails established by PICA.

Philadelphia 2020 — A Tale of One City Growing Too Slowly:

The rebound from decades of manufacturing decline, however, is far from complete. Philadelphia has the highest poverty rate of the 10 largest U.S. cities. More than 200,000 city households, that make $50,000 or less, devote 30% or more of their incomes to pay for housing. While job growth has been positive since the end of the recession, it remains low compared to other major cities. Philadelphia has added jobs at the rate of 1.5% per year since 2009; the 25 largest cities have achieved growth rates of 2.3% per annum. Cities like Boston, New York and Washington D.C. have exceeded their 1970 job levels. Philadelphia still has 23% fewer jobs than in 1970. Recent accelerating employment expansion is concentrated disproportionately in low-wage jobs, when compared to other major cities, which are growing a much larger share of family sustaining jobs. High school and college graduation rates outside of Greater Center City remain very low in comparison to our suburbs and many other cities.

2020 and Beyond — Choosing the Path Forward:

In 2020, Philadelphia has an extraordinary opportunity created by the 39% increase in the real value of tax revenues received by the City during the last decade. As Mayor Kenney begins his second term, he has the ability to adjust spending priorities to focus more on key quality of life challenges, garner new support for investments in schools and, by revisiting tax policy, he can set in motion more expansive and inclusive growth trends, leaving a legacy that bears fruit long after his second term in office ends.

To consider Strategy 3, it is necessary first to pose the question: *How large a portion of the proceeds of growth should be invested in tax reduction, lowering the cost of working and doing business in Philadelphia, to prompt more widespread and inclusive, private-sector job growth?*

To answer, it is important to underscore that 14 years of significant, annual tax reduction implemented by Mayors Rendell, Street and Nutter from 1996 to 2010 was not primarily achieved by securing new sources of revenue to pay for tax reduction (though new gaming revenues did have a significant impact in one year). Wage and business tax reduction occurred largely because n*ot every tax dollar collected by the City was devoted to salaries and services. Instead, some was reserved to enhance competitiveness.*

The Slowdown of Tax Relief: As shown in Figure 16, the amount of collected revenue not spent on services, but dedicated to wage tax reductions, in constant 2019 dollars, ranged from **$9 million to $38 million per year** for 15 consecutive fiscal years, from 1996 to 2010 for an average of **$19.3 million per year**. Continuous wage tax reduction came to a halt with the recession. There was no reduction in fiscal 2012 and 2013. Beginning in fiscal 2014, the City resumed the reductions, but at a much lower level, with reductions since that time averaging **just $5 million per year**.

From fiscal years 1996 to 2010, the revenue forgone due to tax cuts in any single year was never more than **1% of total General Fund obligations**. The actual revenue impact of the tax rate reductions ranged from 0.23% to 0.98% of General Fund spending, and averaged 0.47% of the budget. When the rate cuts resumed in FY14, they were significantly smaller, never exceeding one-tenth of one percent of General Fund spending.[15] Had Philadelphia devoted the same amount to wage tax reduction from 2014 to 2019 as the average committed from 1996 to 2010 ($19.3 million per year) rather than $5.2 million per year, the wage tax for city residents would have been

15: These calculations include Department of Human Services' obligations in the Grants Revenue Fund to allow for comparisons over time. Beginning in fiscal year 2012, the City shifted the majority of that department's spending from the General Fund to the Grants Revenue Fund.

reduced to **3.6881%** rather than **3.8809%**. For suburban residents working in the city, the rate would have dropped to **3.2863%** rather than **3.4567%**. If cuts in this range were projected forward for the next four years, by 2024 the wage tax could be reduced to **3.5148%** for city residents and to **3.1323%** for suburban residents who work in Philadelphia.[16]

There were also significant reductions in the Business Income and Receipts Tax (BIRT) beginning in 1996, with the gross receipts portion reduced each year from 1996 to 2008, cutting the rate from 3.25 mills to 1.415 mills (a 56% reduction) (Figure 17). The rate reductions ceased during the recession and in 2011, the City adopted a new policy approach, maintaining the gross receipts tax at 1.415 mills, implementing instead modest reductions to the net income portion of the BIRT. This rate dropped from 6.45% in 2013 to 6.4% in 2014, and has been reduced subsequently in annual increments of 0.05% to 6.20% in 2020. The rate is scheduled to decline to 6.0% in 2023.

While the fiscal impact of the gross receipts cuts ranged from $9 million to $17 million from 2004 to 2008, since resuming in 2014, the reductions in the net income portion have not cost more than $1.8 million per year. If reductions beginning in 2020 were funded at the same annual dollar commitment between 2004 and 2008, ($13.1 million/year), the net income portion of the BIRT could be reduced to 5.15% by 2024.[17]

The Shifted Tax Burden: Since the recession, the City also altered the structure of the BIRT, changing how revenues within and outside the city are apportioned for tax purposes to favor all businesses located in Philadelphia. In addition, new regulations exempted the first $100,000 in gross receipts from the BIRT tax base (along with a proportionate reduction in taxable net income), reducing the tax base but not the rate. This exemption has mitigated the impact of BIRT on thousands of small businesses, removing more than 50,000 from the tax rolls, while shifting the burden to larger businesses. A 2018 CPDC analysis of Department of Revenue records found that office-using firms account for 21% of citywide jobs, but shoulder 57% of the BIRT burden. When added to Use and Occupancy charges, these taxes place a premium from 20% to 30%, depending on the type of firm, on the cost of locating within the city compared to the surrounding suburbs. As a result, while the exemption was helpful to many small neighborhood businesses, it shifted the burden onto precisely those firms with the greatest ability to leave the city.

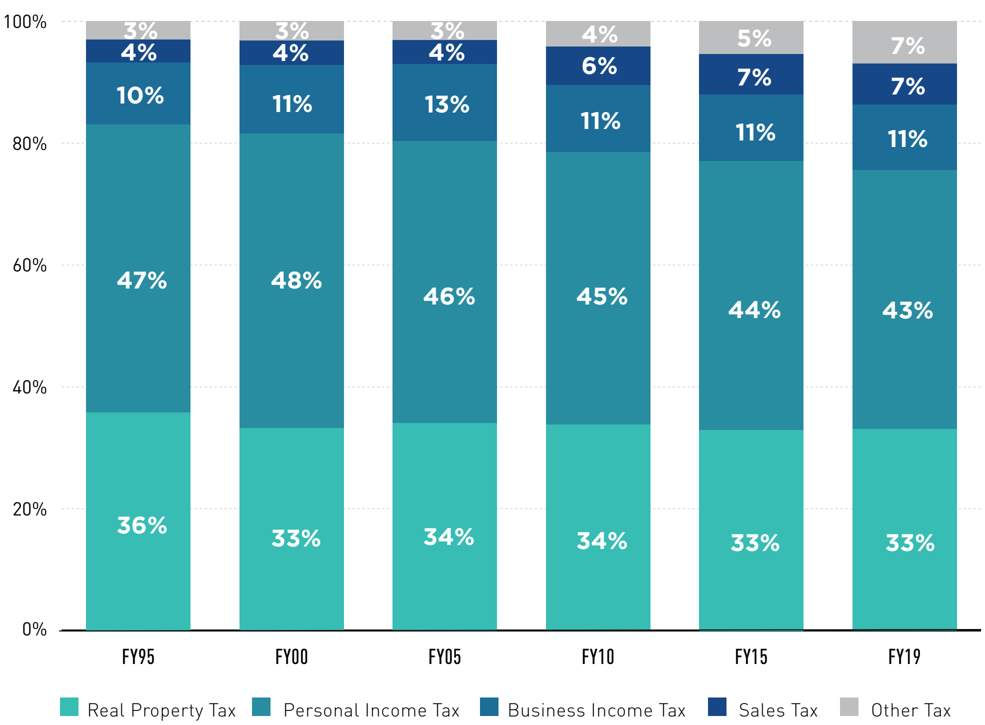
The Case For Tax Reform:

Those who defend the diminished size of reductions suggest that it is all the City can "afford," given other compelling needs and cuts that were made during the Great Recession. They frequently cite the cumulative, multiyear total of the reductions from 1996 to the present, rather than the actual annual amount of the commitment in relation to the overall size of the General Fund. Nor do they weigh the positive impact on business decisions by firms considering 10 to 15 year leases, if the City's five-year plan provides reassurance that occupancy costs due to business taxes will go steadily down, narrowing the gap between city and suburban occupancy costs.

The core argument for tax reduction, on the scale of the Rendell, Street and first few Nutter years, is that it constitutes an investment in citywide job retention and expansion, putting more income into the hands of wage earners, while making the city a more competitive place for businesses of all sizes to grow.

A further justification for wage and business tax reduction, first advanced in the Rendell years and reaffirmed by two independent

FIGURE 18: CITY AND SCHOOL DISTRICT OF PHILADELPHIA TAX REVENUE DISTRIBUTION BY TAX CATEGORY, FY 1995 – FY 2019



16: This calculation assumes that the wage tax base will increase at the rates projected in the City's FY20-FY24 *Five Year Financial Plan*, and that the value of the City's annual investment in wage tax cuts increases by 2.5% annually through 2024.

17: This calculation assumes the BIRT net income tax base will increase at rates projected in the City's five-year plan, and that the annual investment in BIRT reduction will increase at 2.5% annually.

tax reform commissions, one in 2003 and another in 2009, is that the overall mix of taxes that Philadelphia levies is counter-productive. It is not that Philadelphia taxes too much; Philadelphia disproportionately taxes the wrong things.

Considering all local taxes (including those levied by the City and on behalf of the School District), wage and business taxes in fiscal year 2019 comprised half of all local tax revenue, while real estate taxes (including the use and occupancy tax) made up just 31%. The sales tax and real estate transfer tax each generate 6% of revenue, while other levies (including taxes on parking, amusements, liquor, cigarettes, and sweetened beverages) make up the remaining 6%.

The basic share of City tax revenue that comes from these different sources has not changed significantly since 1995. Excluding the volatile real estate transfer tax, wage and earnings taxes have declined modestly, from 47% to 43% of all tax revenue. Business tax revenue has increased from 10% to 11% of the total (Figure 18).

Despite recommendations of the two tax commissions that the city should increase its reliance on the real estate tax (taxing what cannot easily move, rather than taxing highly mobile businesses and employee salaries), revenues from the property tax have actually *declined* from 36% to 33% of total taxes. This occurred despite the enactment of the AVI, which held the promise of realizing increased real estate tax revenue in growth areas (and lower taxes in areas that were struggling) assuring that assessments would more closely reflect market values. The 2009 tax commission specifically recommended dedicating a portion of increased revenue from rising real estate taxes to lowering the rates for wage and business taxes. However, increases in the real estate and the use and occupancy tax rates during the past decade have not been sufficient to cause real estate taxes to constitute a larger share of local tax revenue, nor were they used to offset and reduce the burden of other taxes. What needs to occur is growth in the base as more businesses choose to expand, develop and lease more real estate. Growing demand for office and workspace produces rising rents and more property used for business purposes, yielding higher assessed values and a greater share of real estate tax revenues from commercial properties. What little change in the proportional weighting of Philadelphia's tax portfolio that has occurred during the past quarter century has been largely due to the increase of sales and parking tax rates and new taxes on cigarettes and sweetened beverages.

A recent analysis by the Pew Charitable Trusts found that, among the 30 largest US cities, Philadelphia's overall reliance on the property tax in 2015 was the lowest – at only 25% of tax revenue raised by local government. That study also concluded that Philadelphia ranked second highest out of 30 major cities in the percent of total local revenues derived from business taxes and third in its dependence on the wage tax.[18] In 2020, Philadelphia's very high reliance on wage and business taxes still makes us an outlier among competitor cities.

Options and Choices For the Next Four Years:

Put simply, funding for schools, recreation, housing and social services is essential to meet the needs of Philadelphia's residents. However, it is not *sufficient* to secure a future with more of the well-paying job opportunities.

Wage and Business Tax Reform: To realize more expansive and diversified growth, as is occurring in other large cities, Philadelphia should reaffirm its commitment to a more competitive tax structure by making significant, predictable, ongoing reductions to wage and business taxes. Philadelphia's unique mix of taxes is an outlier compared to other cities, and, because wage and business taxes are avoidable through relocation within the region, they have the most significant negative economic impact.[19]

Each day, as 41.2% of Philadelphia's workforce reverse commutes to jobs in the suburbs, they work alongside colleagues who live in the suburbs, paying no more than their locality's 1% wage tax. Since state law obligates suburban employers to withhold the 3.8% wage tax from city residents, there is a significant incentive (a 2.8% salary increase) for reverse commuters to find homes closer to their jobs. The amenities and lifestyle of Philadelphia have a strong appeal, but they are pitted each day against pocketbook issues that Philadelphia has the direct ability to address.

Philadelphia can perhaps continue to levy these taxes at *rates* significantly higher than the region and other cities and still achieve modest levels of growth during periods of economic expansion, as we are currently doing, because of significant amenities and locational advantages. However, slow growth and low wage jobs will never generate sufficient revenues locally to meet needs unless the tax *base* grows. Nor will it create sufficient well-paying jobs for those with the education and means to leave. Both can achieved best by lowering wage, business and use-and-occupancy tax barriers more aggressively, bringing them in line with other cities and nearby suburbs.

What is an appropriate wage tax rate? One can compare Philadelphia rates to other major cities with local income taxes. With the notable exception of New York, America's largest city and one with global reach, no other large U.S. city levies a local resident income tax at a rate that exceeds 3.05%, the rate in Baltimore. (Notably, their commuter income tax is only 1.25%, and other Maryland counties typically levy income taxes at similar rates.) Most business leaders interviewed as part of the 2009 tax commission process suggested a

18: *The Cost of Local Government in Philadelphia*, The Pew Charitable Trusts, March 2019.

19: Other factors that may account for Philadelphia's slow job growth rate and the disproportionately small share of family-sustaining jobs created since 2009 are outlined in CPDC's October 2019 report, *Growing More Family-Sustaining Jobs*. However, local tax policy looms large and is largely within local control.

reasonable goal for Philadelphia would be to get the wage just below 3%. Other cities with income taxes include Indianapolis (2.02%), Detroit (2.4%), and Columbus (2.5%).

The annual commitment to wage tax reduction can be incremental, because the cumulative impact can be significant. Since 1996, the resident wage tax has declined by more than a percentage point (from 4.96% to 3.87%), and the gross receipts portion of the BIRT has declined by 56% (from 3.25 mills to 1.415 mills). The principle of continuous, reliable, predictable and fiscally responsible reductions should be a cornerstone of the city's fiscal policy. **Rather than lock in a schedule of rate reductions that may be not achievable in time of contraction, Philadelphia could adopt simple rule: expressing its commitment to competitiveness as a percentage of total annual expenditures.** If tax revenues and budgeted spending rise, so does the amount committed to tax reduction. If they fall, the dollar amount of tax reduction would be curtailed.

A moderate tax reform strategy, based on the experience of the last two decades, would commit **0.5%** of the budget to wage and business tax rate reductions. A strong tax reform strategy would set the annual investment in tax competitiveness and economic growth at **1.0%** of budgeted spending. Based on projected spending growth rates in the current five-year financial plan, the moderate scenario would result in a $28 million allocation to tax cuts in 2021, an amount that would increase to $30 million by 2025. The stronger scenario would result in a $56 million investment in tax reduction in 2021, increasing to $61 million by 2025. Based on the proportional revenue generated by the wage tax and the BIRT, a reasonable allocation would be to devote 70% of the funds allocated to competitiveness to the reductions in the wage tax and 30% to BIRT reductions.

The moderate strategy would reduce the resident wage tax from **3.8712%** in 2020 to **3.7072%** in 2025 and the non-resident tax from **3.4481%** in 2020 to **3.3023%** in 2025. The stronger strategy would result in a resident rate of **3.5433%** and a non-resident rate of **3.1566%** by 2025. For BIRT, if the entire competitiveness investment were allocated to lowering the net income tax, under the moderate scenario the rate would drop from **6.20%** in 2020 to **5.50%** in 2025. Under the stronger scenario, BIRT's net income rate would be lowered to **4.81%** in 2025.

Predictability is particularly important for businesses and office tenants considering long-term leases. If current wage and business tax rates are committed to a downward trajectory in the five-year plan, this provides confidence to businesses that tax rates and higher-than-suburban occupancy costs will steadily decline. Considering how many regional and national firms currently have small outposts, clustered in coworking spaces on short-term agreements, Philadelphia has a significant opportunity to lock in for a longer term many expanding businesses who value our workforce, but are concerned about our costs.

Expiration of PICA and Opportunities for Change. The expiration of PICA in 2023, the last year of Mayor Kenney's second term, will occur as many candidates will be positioning to run for Mayor. This creates another significant opportunity for change.

When PICA was created in 1991, it was given the authority to receive a portion of City tax revenues to pay debt service on bonds that it issued to ease the City's fiscal crisis. The City decided to allocate to PICA the first 1.5% of the wage tax paid by City residents. Since FY92, PICA has used this revenue to pay debt service and returned the remainder to the City's General Fund. Currently, PICA's share of the wage tax revenue exceeds $550 million annually. Because the debt service was structured in large declining tranches, unlike the level debt service of a typical home mortgage, the amount currently devoted by PICA to retire the bonds has declined to just $47 million per year, with the balance annually transferred to the City in form of a grant to supplement the operating budget.

PICA will sunset in 2023. City and state officials and civic leaders are beginning to discuss whether to reauthorize its oversight powers and/or its ability to issue debt for some new purpose; whether its oversight powers might be increased or decreased; or if it simply goes out of business.[20]

If the Authority's debt issuance powers are renewed, the PICA portion of the wage tax could also be reauthorized. (However, given how little is currently devoted to debt service and how much flows into the City operating budget, only modest amounts could be borrowed, unless the City restructured its sources of operating income.) If the bonding capacity of PICA is not reauthorized, the resident portion of the wage tax will automatically drop by 1.5% (currently that would achieve a reduced resident rate of 2.3%). Alternatively, in 2023 the City will have to increase the wage tax rate for residents by 1.5%, largely to stay even with wage tax revenues, while not having a visible impact on taxpayers. Regardless, the decision represents a major landmark for the City that should not be taken lightly, if only because its implications need to be represented now in the coming five-year plan.

FIGURE 19: STRONGER TAX REDUCTION SCENARIO: PROJECTED WAGE AND BIRT RATES, 2021–2025

	2020	2021	2022	2023	2024	2025
Wage Tax Resident Rate	3.8712%	3.8035%	3.7368%	3.6713%	3.6067%	3.5433%
Wage Tax Non-Resident Rate	3.4481%	3.3879%	3.3286%	3.2704%	3.2130%	3.1566%
BIRT Net Income Rate	6.20%	5.93%	5.65%	5.37%	5.09%	4.81%

20: *The Future of Fiscal Oversight in Philadelphia*, The Pew Charitable Trusts, January 2020.

However, there is also an immediate choice Philadelphia faces. As debt service has steadily declined, most Philadelphians have been oblivious to the volume of PICA revenues that have simply flowed into the City's operating budget. Because debt service will drop from $47 million now to zero in FY24, the annual PICA fiscal "dividend" could be consciously programmed. Should it fund specific services, be deposited in the "rainy day" fund, or be earmarked for wage and business tax reduction?[21]

Conclusion:

There are other key issues pending, such as School District and regional transit funding, the containment of pension costs and the City's overall debt capacity that must be addressed in the next four years. However, the most effective way to lift 400,000 residents out poverty; the most effective way to support schools, needed services and investments in quality of life; the most effective way to retain working- and middle-class families, as well as recent college and university graduates, is not to raise local taxes more, but to rebalance our out-of-kilter tax mix in order to accelerate private sector job growth. In the end, the City must pursue all three strategies outlined at the start: safety, education and social inclusion; quality of life investments that retain and attract mobile residents and businesses; and comprehensive tax reform, prompting the robust job growth needed locally to expand the tax base, fully-fund strategies 1 and 2, while creating family-sustaining opportunities for all.

Appendix I: 20-Year Trends in Expenditure Growth

Appendix Table 1 presents detailed comparisons of expenditures by category in fiscal year 1998 and fiscal year 2018. Figures shown are for major funds, and represent constant 2018 dollars.

Public Safety and Judicial: Overall spending increased 23% in real terms between fiscal 1998 and fiscal 2018, with the largest increases in Police, up $139 million (24%) and Fire, up by $81 million (41%).[22] Prisons costs increased by $89 million (52%). City support for the Defender Association increased $13 million (35%). Expenditures for the court system declined $41 million (20%), while District Attorney's Office spending declined $1 million (2%) in constant dollars.

Health and Human Services. Health programs (including programs operated by the Department of Public Health and the Department of Behavioral Health and Intellectual Disability Services) increased $68 million (10%). Department of Human Services programs increased $76 million (15%). Homeless services increased $40 million (96%). Community Service programs declined $27 million (62%).

Education: The primary growth in this category reflects the City's contribution to the School District, which increased from $22 million to $104 million. Another factor was the creation of new programs for pre-K and community schools under the Kenney administration. These programs cost $23 million in FY18. The city's subsidy to Community College of Philadelphia increased $3 million (11%) in 2018 dollars.

Economic Development, Culture, and Recreation: Overall expenditures in this category declined $128 million (18%). Spending in most areas declined, including in the Free Library, which declined $4 million (8%), Parks and Recreation, down $8 million (10%), and the City's subsidy to the Pennsylvania Convention Center Authority, which declined $29.1 million (66%). Spending in Planning and Development declined $91 million (53%). Streets Department expenditures declined $33 million in real terms, a 14% decline. Spending within the Commerce Department increased $34 million (66%), primarily as a result of increased Hotel Tax revenues that are dedicated to tourism promotion. The Arts and Culture category increased by $4 million (100%).

Employee Benefits: Employee benefits spending increased by $657 million, a 91% increase in inflation-adjusted dollars. Pension contributions increased $440 million (131%), representing two-thirds of the overall increase in employee benefits spending. Health benefits increased by $191 million (78%). Other categories increased modestly or declined.

Governance and Administration: This category increased by $48 million (11%). The largest increase was in the Other Administration category, which includes the following agencies: Managing Director's Office, Office of the City Administrator, Office of Human Resources, Civil Service Commission, Law Department, Office of the Inspector General, Board of Ethics, and Records Department. Some of these agencies were recently created, which contributed to the increase.

Debt Service and Other: Total spending increased $101 million (43%), reflecting higher debt service costs. Spending within the Department of Licenses and Inspections and related agencies declined $14 million (29%). This category also includes $30 million in General Fund support for capital projects in fiscal 2018.

21: Another fiscal dividend lies on the horizon as well. The City will complete payment of debt service on its 1999 pension obligation bonds in 2029. The debt service on these bonds, which currently exceeds $100 million per year, will be provide additional budgetary flexibility, and could potentially be used to address the city's tax competitiveness issues.

22: The full cost of police and fire services is significantly higher than these amounts since they do not include the cost of employee benefits. The City budgets and reports benefits costs for all employees in the Finance Department budget. If instead these costs were allocated to departments, costs and growth trends would be different than those reported here, with the greatest differences in departments such as police and fire where personnel costs represent the largest percentage of overall spending.

APPENDIX TABLE 1: CITY OF PHILADELPHIA EXPENDITURES BY CATEGORY, MAJOR FUNDS (2018 DOLLARS IN MILLIONS)

PUBLIC SAFETY	FY98	FY2018	AMOUNT DIFFERENCE	PERCENT DIFFERENCE
Fire	$197.6	$278.4	$80.8	41%
Police	$577.9	$717.1	$139.3	24%
District Attorney	$42.3	$41.6	($0.8)	-2%
Court System	$208.9	$168.0	($40.9)	-20%
Defender Association	$36.1	$48.8	$12.7	35%
Prisons	$170.1	$259.0	$88.8	52%
Total	$1,233.0	$1,512.9	$280.0	23%
HEALTH AND HUMAN SERVICES				
Health	$690.7	$758.4	$67.8	10%
Human Services	$515.5	$591.7	$76.1	15%
Homeless Services	$41.8	$81.9	$40.1	96%
Community Services	$43.9	$16.7	($27.3)	-62%
Total	$1,291.9	$1,448.6	$156.8	12%
EDUCATION				
Community College Subsidy	$27.3	$30.4	$3.1	11%
Community Schools and Pre-Kindergarten	$0.0	$23.1	$23.1	—
Contribution to School District	$22.0	$104.3	$82.3	373%
Total	$49.3	$157.8	$108.5	220%
ECONOMIC DEVELOPMENT, CULTURE, AND RECREATION				
Arts and Culture	$4.5	$8.9	$4.5	100%
Free Library	$54.5	$50.1	($4.4)	-8%
Parks and Recreation	$81.5	$73.2	($8.3)	-10%
Commerce/City Representative	$51.4	$85.5	$34.1	66%
Convention Center	$44.1	$15.0	($29.1)	-66%
Planning and Development	$171.1	$80.4	($90.7)	-53%
SEPTA Subsidy	$82.7	$81.9	($0.7)	-1%
Streets	$231.2	$198.1	($33.1)	-14%
Total	$720.8	$593.1	($127.7)	-18%
EMPLOYEE BENEFITS				
Pension Contribution	$335.8	$775.8	$440.0	131%
Employee Health Benefits	$244.1	$435.4	$191.4	78%
Disability and Workers Compensation	$58.3	$57.1	($1.2)	-2%
Social Security Payments	$72.7	$80.4	$7.7	11%
Unemployment Compensation	$3.1	$2.7	($0.4)	-14%
Other	$11.4	$31.2	$19.8	174%
Total	$725.4	$1,382.7	$657.3	91%
GOVERNANCE AND ADMINISTRATION				
Governance	$20.6	$22.1	$1.5	7%
Financial Administration	$85.1	$94.0	$8.9	11%
Other Administration	$75.8	$97.4	$21.6	29%
Internal Services	$272.9	$288.7	$15.8	6%
Total	$454.4	$502.2	$47.9	11%
DEBT SERVICE AND OTHER				
Debt Service	182.8	271.5	$88.7	49%
Licenses and Inspections	$50.5	$36.1	($14.4)	-29%
Capital Funding	$0.0	$30.0	$30.0	—
Other	$3.4	$0.1	($3.3)	-97%
Total	$236.7	$337.7	$101.0	43%
GRAND TOTAL	**$4,711.5**	**$5,935.2**	**$1,223.7**	**26%**

Appendix II: Methodology

This report's analysis of City expenditures by program category, and General Fund tax support by program is based on agency-level revenue and expenditure data contained in the *Supplemental Report of Revenues and Obligations*, an annual report published by the Office of the Director of Finance.

Certain funds (the Aviation Fund, Water Fund, and Water Residual Fund) were excluded from the analysis because they account for enterprise activities that are not financed through taxes. The HealthChoices Behavioral Health Fund and Acute Care Hospital Assessment Fund were also excluded. The HealthChoices Behavioral Health Fund accounts for federal and state Medicaid funds that support behavioral health services provided by the City under the Medicaid program. The Acute Care Hospital Assessment Fund accounts for proceeds of a tax levied on Philadelphia hospitals that is collected by the City and transferred to the state to support Medicaid services. Expenditures within these two funds were excluded because they account for programs not financed by broad-based local taxes. In addition, the Acute Care Hospital Assessment Fund was established in 2009, so that including spending within this fund would distort the comparison of spending trends over the 1998-2018 period.

The expenditure analysis classifies agencies and budget line items into seven broad categories, and multiple subcategories. Appendix Table 2 presents the classification.

Two adjustments were made to the expenditure data reported in the *Supplemental Report*. Department of Behavioral Health and Disability Services expenditures were increased from the *Supplemental Report* amount by $288.7 million in fiscal years 2010 to 2018. This adjustment was made to account for a reduction in state funding that reflected the state's taking over the administration of certain services beginning in fiscal 2010. In addition, the City's contribution to the School District was reduced by $45 million in fiscal 2014. In this year, the City received a $45 million state grant that was passed through the General Fund and granted to the District. The adjusted figure for fiscal 2014 represents the amount of City tax dollars contributed to the District, and is comparable to the amount in other years.

Local tax funding by program category was calculated by subtracting from total General Fund expenditures the amount of non-tax funding received by agencies within these categories, including locally-generated non tax revenue and revenue from other governments, as shown in the *Supplemental Report*. Certain revenue categories were excluded from this calculation because they were not directly generated by agency activity or restricted to funding agency programs. These categories included cable television revenue (Department of Public Property and Office of Innovation and Technology), interest earnings, state retail liquor license, and state utility tax refund (City Treasurer's Office), parking revenue (Department of Revenue), Philadelphia Gas Works rental (Department of Public Property), and state wage tax relief funding, state gaming local share adjustment, and parametric loan repayment (Office of the Director of Finance).

All adjustments for inflation were made using the Consumer Price Index for All Urban Consumers (CPI-U) for the Philadelphia-Camden-Wilmington, PA-NJ-DE-MD region published by the US Bureau of Labor Statistics.

Estimates of tax base growth and the impact of past and projected tax rate changes are based on tax rate and revenue data contained in City and School District publications. In addition to the *Supplemental Report*, they included: City of Philadelphia, *Mayor's Operating Budget in Brief*, various years; City of Philadelphia, "Quarterly City Managers Report for the period ending September 30, 2019"; "Summary Schedule of Tax Rates Since 1952," available at www.phila.gov/documents/tax-rate-schedule/; Department of Revenue, "Summary of Business Income and Receipts Tax Revenues," available at www.phila.gov/documents/business-income-and-receipts-tax-by-sector/; and School District of Philadelphia, Consolidated Budget, various years.

Authors

This report was written by Paul R. Levy, President and CEO, and Stephen Landis, Vice President of Policy and Research, Center City District. Landis has previously analyzed Philadelphia's fiscal policy issues in positions at the City, the Pennsylvania Intergovernmental Cooperation Authority, and The Pew Charitable Trusts.

APPENDIX TABLE 2: CLASSIFICATION OF CITY AGENCIES AND BUDGET LINE ITEMS BY PROGAM CATEGORY

PUBLIC SAFETY	
Fire	Fire Departmnet
Police	Police Department
District Attorney	Office of District Attorney
Court System	First Judicial District of Pennsylvania, Office of the Sheriff, Clerk of Quarter Sessions, Register of Wills, Juror Fees
Defender Association	Legal Services
Prisons	Department of Prisons
HEALTH AND HUMAN SERVICES	
Health	Department of Public Health, Department of Behavioral Health and Disability Services
Human Services	Department of Human Services
Homeless Services	Office of Homeless Services
Community Services	Office of Community Services, Commission on Human Relations, Office of Community Empowerment and Opportunity.
EDUCATION	
Community College	Subsidy to Community College of Philadelphia
Community Schools and Pre-Kindergarten	Office of Education, Mayor's Scholarships
Contribution to School District	Contribution to School District of Philadelphia
ECONOMIC DEVELOPMENT, CULTURE AND RECREATION	
Arts and Culture	Philadelphia Museum of Art subsidy, Office of Arts and Culture and the Creative Economy, Atwater Kent Museum, Civic Center, Mural Arts Program
Free Library	Free Library of Philadelphia
Parks and Recreation	Fairmount Park Commission, Department of Recreation, Department of Parks and Recreation, Camp William Penn
Commerce/City Representative	Department of Commerce, Office of City Representative
Convention Center Subsidy	Subsidy to Pennsylvania Convention Center Authority
Planning and Development	Historical Commission, City Planning Commission, Office of Housing and Community Development, Zoning Board of Adjusment, Office of Planning and Development
SEPTA Subsidy	Subsidy to SEPTA
Streets	Department of Streets
EMPLOYEE BENEFITS	
Pension Contribution	Pension Payments
Employee Health Benefits	Employees Welfare Plan
Employee Disability and Workers Compensation	Disability Benefits and Workers Compensation Payments, Regulation 32 Payroll
Social Security Payments	Social Security Payments
Unemployment Compensation	Unemployment Compensation
Other	Other Employee Benefits
GOVERNANCE AND ADMINISTRATION	
Governance	Office of the Mayor, City Council
Financial Administration	City Controller's Office, Board of Revision of Taxes, City Treasurer's Office, Office of the Director of Finance, Office of Risk Management, Procurement Department, Office of Property Assessment, Department of Revenue
Other Administration	Board of Ethics, Capital Program Office, Office of Chief Administrative Officer, Office of City Commissioners, Civil Service Commission, Office of Inspector General, Office of Labor Relations, Law Department, Office of Managing Director, Office of Transportation, Office of Human Resources, Records Department, Office of Sustainability, Tax Reform Commission, Youth Commission, Zoning Code Commission
Internal Services	Office of Fleet Management, Department of Public Property, Office of Innovation and Technology
DEBT SERVICE AND OTHER	
Debt Service	Sinking Fund Commission
Licenses and Inspections	Department of Licenses and Inspections, Board of Licences and Inspections Review, Board of Building Standards
Capital Funding	Capital Projects Fund Transfer
Other	Hero Awards, Indemnities, Payments to Philadelphia Gas Works, Refunds, Witness Fees

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