COUNCIL OF THE CITY OF PHILADELPHIA
PUBLIC HEARING BEFORE COUNCIL COMMITTEE ON LEGISLATIVE OVERSIGHT

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Room 400, City Hall
Philadelphia, Pennsylvania
Wednesday, 1/31/01
10:25 a.m.

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RESOLUTION NO. 000774 - Authorizing the Council Committee on Legislative Oversight to hold public hearings on the establishment of a rainy day fund for the City of Philadelphia.

PRESENT: COUNCILMAN JAMES F. KENNEY, Chair
COUNCILWOMAN JANNIE BLACKWELL
COUNCILMAN FRANK DICICCO
COUNCILMAN W. THACHER LONGSTRETH
COUNCILMAN FRANK RIZZO
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P R O C E E D I N G S

COUNCILMAN KENNEY: Good morning, ladies and gentlemen. The committee on Legislative Oversight is now in session to hear testimony on Resolution No. 000774, which authorizes this committee of this Council to hold public hearings on the establishment of a rainy day fund for the City of Philadelphia.

First I'd like to apologize for being 15 minutes late. I was caught in another meeting and I appreciate your being here on time and I apologize for my tardiness.

First I'd like to say that I think that over the last eight nine, years, the City of Philadelphia has made tremendous strides in improving its fiscal condition, with help from the Rendell administration, the Street administration, and our City Controller Jon Saidel, and our municipal workforce. I mean, everyone has kind of pulled together to pull the City back from the brink of insolvency in 1991 to a period of time where we're actually experiencing substantial surpluses in our general fund balance.

With that being said, however, there's

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been some concern expressed through certain financial circles and financial analyses that indicate that the country, as a whole, may be experiencing some downturn, or potential downturn, in its economic gains that we've experienced in the last eight years over the next six, twelve, or eighteen months. It is also our understanding through experience that major cities like Philadelphia take a longer time to recover or to benefit from the improvement in the national economy. We're just, at the end of I guess in the last two years or so, really beginning to experience some of the job growth and some of the revenue growth that we hadn't experienced in the six years prior to the last two. We also understand through experience that cities are the first to take a fall or to take a hit when the economy nationally takes a turns to a negative trend.

So with all of the those factors, we thought -- or the committee thought it would be appropriate for us to examine the possibility of the establishment of a requirement to segregate certain portions or a certain percentage of our

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budget into a fund that would be inaccessible for use for other than at times of severe economic need. Rather than having us be required to think about raising taxes, we would potentially have a fund that we could to dip into, similar to what happened in Harrisburg over the last eight years or so, when they established their rainy day fund and had been successful in putting large amounts of money into that fund to cushion the State against potential need to increase tax and the like. So what we wanted to do was begin to explore today the possibility of the establishment of a fund of this nature as a savings account, so to speak, for hard times that may or may not be coming.

And with that, I would like to ask our City Controller, Jonathon Saidel, to take the table and to begin his testimony. I thank him for all his hard work in our fiscal recovery, and also compliment him on the fine writing work that he did in his book on municipal finance in government that came out in the last couple of years.

And good morning, Mr. Saidel, and please identify yourself for the record.

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MR. SAIDEL: My name is Jonathon Saidel, and I'm the City Controller of Philadelphia, S-A-I-D-E-L.

Let me quickly, if I can, Councilman, read my statement this morning and certainly answer any questions that the fine panel has.

I come before you today to offer testimony on the possibility of establishing a rainy day fund for the City of Philadelphia. I applaud Councilman Kenney and City Council for focusing on this important subject.

The very notion that I am here before you today to talk about setting aside surplus in times of plenty speaks to how far we have come as a city in recent years. As you know, we are less than a decade removed from very dark fiscal days. Now we can use the opportunity afforded us by recent economic growth to make a structural change in our budgetary system so that we can avoid crisis in the future.

If we do not fix the problems of today, we will never be able to achieve a vision for a better tomorrow. While Philadelphia currently enjoys the fruits of an ongoing national expansion, recession and decline will eventually come as part of the normal fluctuations of the business cycle. The development and production of spring fades into the inevitable winter.

Efforts to place the City budget and structural balance are damaged by unwise expenditures when a city is flush with revenue; just as they are as harmed by attempts to cut necessary spending when the city faces deficits. Building a lavish recreation center when money is plentiful negatively affects budgetary structural balance if the city will be unable to afford expenditures to maintain the facility in the future. Nonrecurring revenues should, therefore, fund one-time expenses or should be placed in a pool to create endowments to maintain service levels. One-time revenues should not be used to create facilities or programs that will necessitate ongoing city expenditures and negatively alter structural balance.

Similarly, attempts to cut essential social programs or facility maintenance expenditures when budgets are tight may save a few dollars in the short run but will likely result in the need to increase social spending and maintenance expenditures in the future. In both cases, efforts to achieve structural balance or damage as the size of the overall budget increases in way that is not correlated to the rate of increase of long-term growth.

Financial mechanisms can be employed to hold down spending but may accompany the rapid revenue growth characteristic of economic upswings and to stabilize spending during periods of revenue contraction associated with economic downturn. Many states, including the Commonwealth of Pennsylvania, employ rainy day funds to provide reserves to relieve the need to raise taxes or cut spending in times of need and provide a way to cap expenditures in times of plenty. Such mechanisms may include legally obligated triggers for fund contributions or formulaic methods to determine the amounts of fund withdrawals to improve long-term governmental financial conditions.

Cities such as San Antonio, Texas, and Baltimore, Maryland, maintain fund balances as a rainy day fund to cushion against fiscal emergencies and recessions. Legally prohibited from carrying forward refunds from one fiscal year to the next, New York City employs a budget stabilization account to pledge excess current revenues to meet unforeseen future expenses. The budget stabilization account is established by law and funded with revenues when revenue projections for the coming fiscal year will exceed expenditures. If at any time during the fiscal year additional revenue is recognized for that fiscal year in a budget modification, the City is required to allocate 50 percent of the budget stabilization account.

Expenditures from the budget stabilization account must be preceded by a specific request for appropriation, identifying a particular purpose for the funds and must be approved by Council supermajority. Since New York City may not carry forward funds from one fiscal year to the next, expenditures from the revenue stabilization account may be used as a source to prepay future year costs; for example, debt service costs.

Thus, while it is unlike a true rainy day fund since the budget stabilization account must be fully spent each year, the mechanism works because the city can replenish the account in subsequent years, if conditions are favorable.

The creation of a rainy day fund would be an excellent addition to Philadelphia's elected leadership's growing legacy as fiscally conservative managers. By creating a rainy day fund, Philadelphia can increase the likelihood that it will be able to sustain an accepted level of government services over the long run without recurrent need for personnel layoffs, service cuts, or tax increases. Such actions would improve the City's long-term economic outlook and improve its image in the eyes of bond-rating agencies which could help reduce future borrowing costs.

I believe the City should establish a rainy day fund within the Charter-mandated budgetary structure. To enhance budgetary structural balance, such an action could be accomplished by requirements that contributions to a rainy day fund be made when the rate of increase in revenue collections exceeds long-term economic growth rates, and that withdrawals be permitted only when revenue collections fall below long-term economic growth rates.

Alternatively, a budget stabilization account modeled after New York City's account could be created to achieve similar results short of restructuring the City's budgetary framework. With such a mechanism, some of the savings the City achieves in good years could be used to make a lump-sum payment against its unfunded pension liability, to lower payments of future generations. Certainly, with such a mechanism, the City could curtail its ability to spend recklessly when the economy booms and revenue soars.

I thank you for your attention to this matter and again applaud you on your efforts to focus concern on such an important issue.

COUNCILMAN KENNEY: Thank you, Mr. Saidel.

Do you believe that making the rainy day fund and institutional part of our budgeting process eliminates the concern that this effort would somehow be outside the bounds of the Charter?

Some of the arguments we've heard privately is that we need a balanced budget by virtue of the Charter's requirement that we balance our budget every year. The creation of the rainy day fund would be a requirement to move 3 to 5 -- put 3 to 5 percent, say, for example, which is, I think, the minimum that the rating agencies recommend, 3 to 5 percent of our current into that fund.

MR. SAIDEL: Right.

COUNCILMAN KENNEY: Would that not be an institutionalized expenditure that we would be making into the fund and, therefore, get us beyond or around our -- or be in compliance with our balanced budget requirement by virtue of the Charter?

MR. SAIDEL: I think, Councilman, that the rainy day fund could be established within the provisions of the laws that exist today. I always have a problem with amending the Charter because there can be unforeseen events that occur in some future and then a variety of (indiscernible) would occur as to what the real meaning of what our Charter change truly is. And by the time it would happen, if, God forbid, there was a downturn, that money may not be available for us to use if an emergency arises.

One of the things that's always been talked about is enabling legislation out of Harrisburg. I think this is an opportunity for us to have direct local control from the good people in Council and the Mayor to establish an account that would fall within the guide posts of the way our budgetary system works now.

COUNCILMAN KENNEY: What would be your estimation of the -- if in fact State enabling legislation was required, do you think that that would be something that -- I mean, obviously, you're not speaking for the legislature or the Governor, but what's your feeling about their view of us moving forward in this regard, and if we're required to have enabling legislation, do you think that would be successfully accomplished in Harrisburg?

MR. SAIDEL: You know, I can't imagine in Harrisburg, and certainly the rating agencies, thinking that we were doing something improper. I think that a rainy day fund, if structurally sound, giving Council and the Mayor an opportunity under a variety of circumstances to not put additional contributions in, if, God forbid, there's a downturn, that that enabling legislation should to be able to be passed regardless, in a bipartisan way.

We are, I think, showing, as we have continually done over the last number of years with your leadership and the leadership of other members of Council, to be conservative in our estimates and understand that we have a job to do here in Philadelphia, and this would give us additional local control to make sure that we have money set aside for our people in the future if there's a downturn.

COUNCILMAN KENNEY: In other rainy day funds, there's an mechanism for the expenditure from the fund itself. Could you describe what you believe would be sound triggers for the ability of a municipal government like Philadelphia, once establishing a fund, to be able to go in and take money out for what purposes would you think would be appropriate?

MR. SAIDEL: You know, if you look at

San Diego -- excuse me, San Antonio, if you look at New York City, which, as I mentioned in my statement, is not exactly the type that we could set up here, I think what's important is that whatever legislation is passed in City Council and signed by the Mayor, that it gives us all an opportunity to look and see when money should be taken out, when money can be stopped if there's a downturn in the economy.

I think 5 percent, based upon a variety of excesses of revenue. If we project revenue at 3 percent to 3.5 percent, which is a conservative way to go and it's in the Mayor's budget this year, and if it goes to 6, 6.5 percent, it's unanticipated growth that we do not necessarily need for immediate goals and requirements for the fiscal period. We should set aside a percentage of that, we should use a percentage of that to pay down the debt so that future generations don't have to pay for our debt.

On the other hand, what I'm always concerned about is when there's a mandatory set-aside is that if there is downturn, that there is a mechanism in place, say, a supermajority out of Council, the Mayor requesting a supermajority, that funds not be placed in a particular fiscal period because of the downturn of economic growth or unemployment numbers.

As well as I think permanent -- permanent investments in the City of Philadelphia should be the criteria that we use in relationship to how we use the rainy day fund, something that is going to last a long period of time that can have a fundamental change in the way we give services to the people of Philadelphia. And I am sure that Council and the Mayor -- and certainly if I'm needed -- can structure the appropriate language to give you and Council the opportunity within the framework and the parameters of legislation to make those decisions in the future.

COUNCILMAN KENNEY: Over the last ten years and more or so, but certainly over the last ten years -- and I know you'll agree with me -- probably one of the most serious problems facing the City has been our loss of population.

MR. SAIDEL: Absolutely.

COUNCILMAN KENNEY: Something like 180,000, maybe 200,000 people in the last decade

-- despite the fact that the City has been doing better in many areas, including its fiscal areas.

Although the budget seems to be growing year by year, despite the fact that we're, in reality, serving less customer/citizens, what's your opinion on that trend? And in some ways, do you believe a rainy day fund would impose required additional fiscal discipline on this government, which would make it look at the way it delivers services, the number of people that deliver those services and what it exactly does and how it does it, to be able to try to find that additional money to put aside, considering our loss of population and our growth of our overall budget year by year?

MR. SAIDEL: You know, the reality is that, as you have espoused for a number of months, is -- we have been in the last eight years in the greatest economic boom in the history of the country. Yet a city like Philadelphia in an urban environment on the East Coast is the last to feel that economic upturn but is the first to feel that economic downturn.

Our budget has increased and our

population of employees have increased, but we have in the last 20, 25 years grown in the services that we have begun to provide in relationship to the population that we serve, that was much different than the population and the services that the City provided when I was born, all those hundreds of years ago.

But the other reality is, to me, a rainy day fund is similar to a pension fund. People don't like their pension plan taken out of their pay but it's mandated so that they have money when they retire and they need additional funds that they might not have normally put away all those years that they were working. And I think it is a discipline, if done in a proper way, giving you and the other members of Council the opportunity to dip into it when it's necessary, to not make a payment when it's going to be prohibitive and stop the services that the City needs, giving you that tool to put money aside for when there is a problem in the City of Philadelphia to meet its current needs and the needs of its people.

COUNCILMAN KENNEY: At this point in

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time, how best -- how well-prepared do you think Philadelphia is today, without a rainy day fund, in current economic situation to handle an unforeseen or an unanticipated economic downturn, say, in the next six months to a year?

MR. SAIDEL: I think if you look at the problems that all of us have been discussing for the last certainly number of weeks -- the problems with the gas company, the problems with the school system -- that if not for the increase in our revenue projections this year, that $45 million would not have been available, the over $40 million to the school system would have not been available. If they are one-time expenditures, then we could be prepared and move forward next fiscal period.

If the 80 to $85 million deficit in the school system is not eradicated, if draconian measures are not taken at the utility and additional funds are necessary and the $45 million loan is not paid back in two years, and if there is, coupled with that, a national downturn which would affect Philadelphia in a dramatic fashion, you know, I think we have our problems laid out.

And if fix those problems, we'll be all right, but if don't fix those problems in two years and there's a downturn, I think we're going to be in some serious trouble.

COUNCILMAN KENNEY: Thank you. I have no more questions for you. I'd like to thank you for your insight and for your cooperation in this process. And I would hope, and I know you will work with us as we moved forward and try to publish this goal, and we'll be relying on you and staff for the technical expertise necessary to help us.

MR. SAIDEL: And let me thank you, Councilman, for this hearing and for your continuous movement for the discipline that our budget needs. Thank you, Councilman.

COUNCILMAN KENNEY: Thank you.

The Chair recognizes Councilman Rizzo.

COUNCILMAN RIZZO: Thank you, Controller. In your remarks, your presentation, you talk about, I'll call it, "a cap." How much money would -- how would you -- how would we come to the top amount of money, the top dollars that we would keep in a rainy day fund?

MR. SAIDEL: Well, when I talk about a cap, I actually mean the percentage that we would set aside. I don't -- you know, there's argument back and forth, Councilman, as to what that total cap number would be. Certainly, you know, a city like Philadelphia doesn't need to have a billion dollars set aside, but it certainly would be great to have more than $50 million set aside over a period of years.

I think it would be-- I would rather not see a cap in the true sense of a dollar amount as much as giving Council their authority, as the elected representatives of the people of Philadelphia, to make decisions year by year. But I think a 5 percent set-aside every year, based upon revenue expenditures and revenue estimates, appropriation expenditures, a variety of different calculations could be made, but I'd rather not see a dollar amount, because dollar amounts change. You know, what was a dollar when you and I were children is certainly not worth a dollar today.

COUNCILMAN RIZZO: And you still have that dollar, sir.

(Laughter.)

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COUNCILMAN KENNEY: There's a man of experience talking there.

COUNCILMAN RIZZO: He knows I'm just kidding.

In conversation with people about this, they said that there could be -- there could be a negative impact in having too much money in -- what a luxury that would be, but could you describe what the negative impact could be of having too much money in the rainy day fund?

MR. SAIDEL: I think whatever negative impact there would be is that we, for some reason that I don't see in the foreseeable future, have a boom, continually to prosper, and then there becomes some emergency nature that we have to respond to the people of Philadelphia in a very quick and timely manner, but yet we have the amount of funds set aside in the rainy day fund, that the procedures to draw down on that rainy day fund are so complex and it takes such a long period of time to draw down on those funds, that the emergency then is then exacerbated by the inability of all of us to come together to pass the appropriate legislation of the supermajority to get at the money. That's the only time I can see that.

The other thing is for all of us to remember that when you put money aside, it is for in compilation of if there is a point in time when it is necessary, that we all have to be adult enough to say that it is necessary this year and the City's not doing as well as it used to be.

COUNCILMAN RIZZO: Thank you very much.

MR. SAIDEL: My pleasure, Councilman.

COUNCILMAN RIZZO: Sure.

COUNCILMAN KENNEY: Are there any other questions for the Controller?

Councilmember Longstreth?

COUNCILMAN LONGSTRETH: I just wanted to make a quick comment: I'm so impressed, Mr. Saidel, with your expertise and knowledge in this area that we're discussing, of a rainy day fund, that I put my hearing aid in.

MR. SAIDEL: Thank you.

COUNCILMAN KENNEY: Which means all the other times you were here, it was all --

(Laughter.)

COUNCILMAN KENNEY: Thank you.

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MR. SAIDEL: That will be the quote tomorrow.

COUNCILMAN KENNEY: Thank you, Mr. Saidel. I really appreciate your help.

MR. SAIDEL: Thank you.

COUNCILMAN KENNEY: Thank you very much.

The Chair now calls Mr. Vignola.

(Witness comes forward.)

COUNCILMAN KENNEY: Good morning.

MR. VIGNOLA: Good morning, Mr. Chairman, Councilman Kenney, President Verna, and the members of the Legislative Oversight Committee. My name is Joseph C. Vignola, and I am the Executive Director of the Pennsylvania Intergovernmental Cooperation Authority known as "PICA."

I am pleased to testify this morning regarding the adoption of a rainy day fund for Philadelphia. Much of my testimony this morning is a summary of PICA's White Paper No. 9, "Philadelphia's Fiscal Challenge: Finding a Way to Save," copies of which I have distributed to City Council this morning.

Despite the City of Philadelphia ending Fiscal Year 2000 with a positive fund balance for the eighth consecutive year, PICA continues to stress the City's needs to proactively prepare for identifiable and unknown threats that may impede fiscal stability and prosperity. Factors such as high poverty concentrations, a high local-tax burden, and a shrinking population make Philadelphia especially vulnerable to a national recession.

Rainy day funds are created to serve as an alternative to raising taxes, cutting services, increasing debt, practices that most municipalities, and in particular Philadelphia, resorted to in the past when faced with economic recessions. Forty-four of 50 states and many large municipalities, as Controller Saidel has testified, have created either a rainy day fund or some type of stabilization reserve. Philadelphia must take advantage of the present situation in which unemployment rates remain low, consumer spending is high, inflation remains fairly steady, and workers' productivity continues to improve.

The central concerns that I believe

City Council needs to consider are: can the City create a rainy day fund? and what parameters should be adopted for contributing monies and utilizing monies in a rainy day fund?

The most often cited obstacle, Mr. Chairman, as you pointed out, to the creation of a rainy day fund is that the Philadelphia Home Rule Charter, which has been interpreted to require a balanced budget. PICA staff strongly recommends that the City reinvestigate the legal potential for creating the rainy day fund as a component of the balanced budget. The Five-Year Plan, as mandated by the PICA Act, may very well be a catalyst to the creation of such a fund.

In its proposed Five-Year Plan for Fiscal Year 2002 to 2006, which Mayor Street presented to this Council last week, the City indicated an attempt to save $127.5 million through the end of Fiscal Year 2002. The City designated the savings as a "Funding for Future Obligations." In previous plans, it was titled "Funding for Contingencies."

This process presumes that a short-term emergency fund is legal. However, since this fund can only be used for any purpose, regardless of the emergency status, it really doesn't rise to the level of a rainy day fund that is designed with, as Controller Saidel pointed out, some sharp restraints.

I believe that if it is feasible for the City to plan to save money in the Five-Year Plan, then it is within the City's means to create a savings plan with the same intent and restrictions as a rainy day fund. The City, in conjunction -- meaning the Administration -- in conjunction with this Council could develop legislation to guarantee that funds are carried over from year to year.

The City can withdraw the money on many different municipal models that have averted violating balanced budget requirements while accumulating surpluses to be used in the event of a recession. Philadelphia must be creative in its thinking and capitalize on the current strong economy.

At the same time, it is incumbent on the City and City Council to establish parameters determining the annual percentage of general fund dollars to be allocated to the fund, the purpose for which the monies can be spent, and the maximum amount of monies that can be accumulated in the fund.

Monies could be allocated into a rainy day fund through year-to-year appropriations or transfer ordinances approved by City Council. A prudent option would be to allocate a certain percentage of total expenditures each year into a fund or to simply direct each year's positive fund balance into a rainy day fund as a reserve. With many diverse interests pushing and pulling on the City's funding capabilities, contributing to a rainy day fund may be sidetracked if year-to-year appropriations must be made by this administration, this Council, or future administrations and future Councils.

Most municipalities decide to set maximum limits on the amount of dollars in a rainy day fund so that levels in a rainy day fund are justifiable over such decisions as reducing taxes and directing dollars towards other operating expenses.

The most critical set of parameters

concern withdrawals. Exacting limitations should be placed on withdrawals to assure use only in times of emergency, economic downturns, or revenue shortfalls. Varying mechanisms include majority vote of the legislative body before funds may be withdrawn, formulas that determine when a rainy day fund may be utilized, or utilizing a mutual party to operate the rainy day fund.

One example is the Tax Stabilization Fund of the Commonwealth. The Commonwealth accumulates dollars into a rainy day fund through the General Assembly appropriation. The legislation adopted by the General Assembly of Pennsylvania could serve as a starting point for similar consideration of similar legislation.

Philadelphia can prepare for future fiscal uncertainties by creating a rainy day fund. Other municipalities under the same Charter constraints as Philadelphia have found ways to put funds aside for seemingly inevitable future downturns in the economy.

The question for Philadelphia is not, can this be done, but does Philadelphia want to take the strides to get it done in a timely manner.

With that, Mr. Chairman and members of the committee, I conclude my testimony, and welcome any questions you may have.

COUNCILMAN KENNEY: Thank you very much Mr. Vignola. I appreciate your testimony and your presence here today.

The question I have relative to the Charter issue is if the Charger requires a balanced budget, why have we been able to carry surpluses year to year? I mean, it would seem to me that the Charter in itself implicitly requires that we have a rainy day fund because we need to take the surplus that we're projecting and create a balanced budget and move that surplus into a fund that could be used for future savings or future problems.

MR. VIGNOLA: Mr. Chairman, your question is also your answer. I agree.

When I look at the word "balanced budget," a balanced budget doesn't mean that everything has to be zeroed out. A balanced budget, I believe, means no deficit. So that if you have a surplus -- and as I pointed out in my testimony, we're going to have a contingency fund of $127.5 million this year -- that's appropriated. As long as this Council, through its ordinances, appropriates monies into funds, then the money is appropriated, and as long as that appropriation doesn't create any deficit, then you're flying with a balanced budget.

COUNCILMAN KENNEY: Two questions I have and maybe you can expound a little bit.

If we require the rainy day fund to be funded at a certain percentage level, that that becomes an institutional part of our expenditure process and, therefore, is something that is part and parcel of a no-deficit budget, correct?

MR. VIGNOLA: Correct.

Let me give you four scenarios, and what I'm going to do is try to give you four scenarios, but given in a real-world context exactly what happens since Fiscal Year 1996, when the City regained its bonds rating status and, you know, we saw that surplus were continued.

One possibility is that if we take 50 percent -- if we took 50 percent of all of the tax revenues received over budget, so every year

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we appropriate money and, you know, if we take 50 percent of what we actually received over budget, from 1996, Fiscal Year 1996 until Fiscal Year 2000, those amount of monies, without interest, would have totaled $128 million. That's just taking 50 percent of the excess.

What that would have left -- you could you say, Well, Mr. Vignola, what would it have done to our cumulative surplus? Well, our fund balances, our cumulative surplus, would still be an astonishing $166 million. And that's just 50 percent of the revenues.

But what if we do another thing; what if we decide to take 100 percent of the operating surplus. And, again, I'm not talking about the full-budget surplus; I'm just talking about the operating surplus. Well, Mr. Chairman and members of the committee, from '96 and '97, we didn't have an operating surplus; operationally, we spent more money than we took in. But for years 1998, 1999 and 2000 astonishingly, we come up with $128 million. And that's taking 100 percent of the operating surplus. That still leaves us $166 million left over as cumulative surplus.

What if we decided to say, Well, let's do a mixture of those. What if we say the rainy day fund would take 100 percent of the annual operating surplus and 50 percent of the excess revenues, whichever is lower. Well, that would have put in a rainy day fund $73 million, leaving a cumulative surplus of $221 million.

And what if we said we'll take the rainy day fund of 100 percent the operating surplus or 50 percent of the excess revenue, whichever is higher. Well, the rainy day fund would now be $183 million, without interest, leaving a cumulative surplus of $111 million.

So what I'm suggesting by these four examples is that there are ways of doing it and still keep your mandate to continue reducing the wage taxes, you'll fund programs that need to be funded, you could have money in the rainy day fund, and still have ongoing cumulative operating surpluses. And this is if we started doing this in 1996.

Again, I'll use my disclaimer that we read on all prospectus and since we see two fellows from rating agencies there, past performance is no indication of future performance, but nonetheless, it's doable.

COUNCILMAN KENNEY: The other angle I would like you to comment on a little bit is the issue relative to the rainy day fund acting as a catalyst to require us to look at our budgeting process in a different way. Again -- and you heard the question that I asked Mr. Saidel, over the last decade, we've lost close to 200,000 people. However, the budget of the City of Philadelphia has continued to grow, despite the loss of people, with a lot less people that we're serving.

Granted, there are other needs that have expanded in that regard, but I guess the question I have is that if we were required theoretically to put 5 percent at least of our overall budget in a fund, regardless of the mechanism, whether it's excess revenues, whether it's half the surplus, or whether it is, God forbid, cutting the size of the City government; would that not create a discipline within the government that it's not naturally willing to do? And that is spending less or spending it in different ways, or providing services in different ways?

MR. VIGNOLA: The answer to that is yes. My scenario is that PICA staff try to, you know, suggest to this committee is that there are ways of doing it and still continue, you know, your close scrutiny of the budget process that you still do now without really impinging on it, without forcing my former colleagues on City Council to sometimes make a real tough decision, you know, about whether we fund this program or not.

What we're doing is, we're looking at things based on the year as it progresses, and that's why I used those two scenarios, is that the year is over and you have an operating surplus, the year is over and you had a windfall in revenue collections. So, that yes, it's always good, you know, to hold your feet to the fire and make those tough decisions, but also, it's very difficult when you have constituents who come to you and say, Well you're put thing money away for a rainy day fund but you're, at the same time, you're causing the juvenile justice system to be under-funded or the police to be under-funded. And that sometimes becomes a very difficult vote to make.

This is a discipline that puts the money in place, but it also gives you the opportunity, if the money's not there, to appropriate additional money to it.

COUNCILMAN KENNEY: My suggestion is not that we underfund any particular area of governmental service, but that we are required to look at the way that service is delivered and the cost that we undertake to deliver it.

I guess it's like a personal example. When I was working in high school and my parents required that I pay a certain amount of board right from my check from the restaurant where I was a busboy and a dishwasher. So they would take that money off me whether I liked it or. Now, the $25 or so a week that they took from me, I could have spent that in a myriad of different ways, and it would have been very, very attractive to me to be able to spend it the way I wanted to spend it, on things that I thought were priorities.

At the end of a four-year period or so,

when I went to college, my parents returned that board to me, in an effort to help fund some of my higher education. I didn't like it at the time, and there were a lot of things I wanted to do with that 25 bucks a week that I couldn't do with it, but at the end of that four-year period, I realized, with more maturity and more foresight and more understanding, that that was a good thing.

Now, we're not much different as a government or as a Council or as an administration than I was when I was 15 or 16 years old. There are certain things that we force ourselves to do that we don't want to do. But at the end of a period of time, we recognize the importance of doing it.

And I think if the government is asked naturally to do it, naturally to cut services or to do services in a different way, to try to streamline or save money so that we can put away, it's unlikely that we're going to naturally do that, unless it's 1991, God forbid, and we're forced to do it because of a catastrophe.

I guess it's when we're doing decently,

why don't we just force ourselves to do the right thing in case, three or four or five years from now, we have that kind of a situation?

MR. VIGNOLA: Mr. Chairman, I agree, and with all due respect to your parents is that you didn't elect your parents.

COUNCILMAN KENNEY: Right, right. No, I didn't.

MR. VIGNOLA: And your parents --

COUNCILMAN KENNEY: But I would have if I had the --

MR. VIGNOLA: If your parents are like my parents, the household was an autocracy, not a democracy.

COUNCILMAN KENNEY: Right.

MR. VIGNOLA: So, you know, you had no choice.

I'm trying to be realistic, knowing that you and the Mayor are elected, are responsible to a constituency, and, you know, the constituency is diverse.

I never -- I never thought I would agree with Governor Whitman on a lot of things she said, but yesterday, in giving one of her farewell interviews, she said, you know, how are -- they asked her, How are you going to do with the EPA? She said, Well, as Governor, I realized that would get complaints whether I was cutting a tree or planting a tree. You know, you're going to get complaints.

So -- and I'm not saying what you want to do is wrong. You could do that, you know, on top of what is there. But knowing that there is a mechanism there that is almost automatic, and you could say to anybody that comes in, We're not jeopardizing the sanctity of the budget process because this is here, and we're going to take advantage of it.

You could also say, when you said, in the event that it's not here and we want to put money in a rainy day fund to the extent that there's room under whatever gross cap there is, we could do the tough appropriations matter and sell it to our constituency.

COUNCILMAN KENNEY: Well, I agree with you on the diversity of needs and the diversity of our constituency. But the one thing I'm sure they're never universally agreed on is they never want to be in the situation we were in in 1991 again.

MR. VIGNOLA: That's true.

COUNCILMAN KENNEY: And that includes people in the community and people in the municipal workforce. I mean, I would imagine that maybe someone in the municipal workforce would have a criticism about this effort. Unless there's a situation that arises three or four years from now, where I don't have to lay that person off because I have the ability to dip into a fund of savings that maybe they disagreed with today but would see the efficacy of three or four years from now.

MR. VIGNOLA: And one of the problems that you all are confronting at City Council, especially with the recent labor negotiations, is that they're looking at this fund balance of $295-plus million and saying, you know, why can't you pay me more, why can't you do more for my benefits? And you heard the Controller testify exactly, you know, some of the concerns that he has ongoing. If it's not the School District, it's PGW; if it's not PGW, it may be the downturn

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in the economy.

So you're quite right, Mr. Chairman.

COUNCILMAN KENNEY: Thank you very much.

Are there any questions from members of the committee?

(No questions.)

COUNCILMAN KENNEY: Thank you very much for your help.

MR. VIGNOLA: Great. Thank you.

COUNCILMAN KENNEY: State Treasurer Barbara Hafer.

(Witness comes forward.)

MS. HAFER: Good morning.

COUNCILMAN KENNEY: Good morning. How are you? Thanks for coming.

MS. HAFER: Great, good. Good to be here.

COUNCILMAN KENNEY: Please identify yourself for the record and proceed with your testimony.

MS. HAFER: Barbara Hafer, State Treasurer. And with me is Vince Lowery, who's the State's Financial Advisor at the Treasury.

Good to see all of you.

COUNCILMAN KENNEY: Thank you. Please proceed.

MS. HAFER: Mm-hmm. I have some prepared remarks and also some corrections, and I'll point them out as I go. I think you have copies.

Chairman Kenney and members of the Legislative Oversight Committee, before I begin, let me just tell you how glad I am to be here. I congratulate you on the idea of inviting people from the State to come and discuss with you very, very important issues.

And as I said, this is Vince Lowery, who is with the Philadelphia office of Solomon Smith Barney. He is our Treasury Financial Advisor, and Vince has helped us structure our investment portfolio, including the so-called rainy day fund.

From the verge of bankruptcy just ten years ago, you have come to a point where you now consider how best to deal with surplus revenues. This is really a remarkable achievement. The Commonwealth of Pennsylvania followed a similar

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trajectory from red ink to robust health, and our State story may prove instructive to you as you consider Philadelphia's fiscal future.

In 1990, Pennsylvania was broke. I happened to be Auditor General and engaged in a gubernatorial contest, and the only thing that anybody remembers of that race, I believe, is I predicted that there would be a billion dollar deficit.

To get back into the black, the legislature had to enact the largest tax increase in the history of Pennsylvania -- I know you felt it also here -- a $3 billion tax increase. That tax increase had a devastating on Pennsylvania's economy and on every community in the State, Philadelphia included. It made it harder for working families to make ends meet and it discouraged employers from locating here.

The State spent all of the 1990s in a long, difficult climb back to prosperity. And we've taken an important step to make sure we never again face such a grave crisis. With Governor Ridge's leadership, we have replenished Pennsylvania's tax stabilization reserve fund, better known as the rainy day fund. Today, the rainy day fund, which is managed by the State Treasury, stands at more than $1.1 billion. I think it would be beneficial for any level of government to have such a fund.

Since I am not familiar with the details of the City finances, however, I cannot advise you on whether now is the right time for the City of Philadelphia to create a rainy day fund. I know there are pressing needs in education and in other areas. Only you can determine whether you have sufficient resources to both meet those needs and create a reserve fund.

What I can do is provide you with some information on the structure and benefits of the State's rainy day fund. And let me begin with the benefits.

COUNCILMAN KENNEY: Treasurer, can I just interrupt you for one second?

MS. HAFER: Yes.

COUNCILMAN KENNEY: 'Cause we do have guests in the room today. I just would like to recognize them and thank them for being here.

We have the teachers and students from

Christ the king School in Northeast Philadelphia. We'd like to welcome you to our chamber today and just give you one little minute of what we're talking about here, 'cause sometimes people come into our chamber and they hear us talking and really don't know what it is we're talking about.

We're trying to discuss today the opportunity for the City to set aside some of its money, like your parents do to save for your education or to save for a summer home or to save for a new car or improvements to your house. So what your parents do when they come home and they deal with their finances, mom or dad, and deal with their paychecks, they pay all their bills, they buy food for the house, they buy clothes for you guys, and then they may have a little bit left over.

And what we're deciding is what we do with that leftover money -- whether we put it in a saving account or in an account in the bank so that we can save it for times when maybe we need a new roof or we need to fix up our home or we need to pay for a college education for the kids.

So that's what we're talking about here

now. And the lady at the table in the red jacket is the State Treasurer of the whole State of Pennsylvania. And he's coming in here to give us some advice as to what the State did in an effort to create that kind of fund for itself and what we can do to try to do it for ourselves in the City of Philadelphia.

So we welcome you here, we hope you come back again, and good luck to you in your education and your schooling. Thank you.

TEACHER: Thank you.

COUNCILMAN KENNEY: I'm sorry, please proceed.

MS. HAFER: That's perfectly all right. Very good explanation.

COUNCILMAN KENNEY: Thank you.

MS. HAFER: The goal of the tax stabilization reserve fund, as stated in the authorized legislation itself, is "to minimize future revenue shortfalls and deficits, provide greater continuity and predictability in the funding of vital government services, and minimize the need to increase taxes to balance the budget of the Commonwealth during periods of economic distress."

In short, one of the benefits is in the event of a downturn in the economy, the State will be positioned to avoid a tax increase that would only make things worse. Yet there are those who argue, even now, that the State should not carry such a substantial reserve, who say the State should either spend all of the money it takes in or reduce taxes to take in less, who say tax money should not be placed in a reserve fund, where, to their way of thinking, it's not doing any good.

Well, one answer is that Pennsylvania has both increased spending and cut taxes. In addition to saving for the rainy day, it has not been an either/or position.

But the better answer, the better justification for carrying a large reserve lies in our bond ratings. The fact that Pennsylvania has a robust reserve fund greatly strengthens the Commonwealth's bond ratings. That reserve is helping every Pennsylvanian right now, today, by lowering the borrowing costs.

Just last fall, Moody's Investor Service once again raised Pennsylvania's bond

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rating this time to AA2. In doing so Moody's cited our rainy day fund as helping to justify the higher rating. We're now rated at least AA by every major agency and have been since 1997. Before that, you have to go back 30 years to find a time when Pennsylvania enjoyed an across-the-board AA rating.

And the rainy day fund is helping us to sustain those ratings. For instance, if after this hearing you were to log on to Standard & Poor's Web site and look up S&P's rationale for giving Pennsylvania a AA rating, you would see that part of it says, "Since the early 1990s, Pennsylvania has been building financial reserves to insulate it from economic downturns. This change in philosophy is evidenced since 1991, when the Commonwealth was faced with rising taxes following a deficit. The commitment is evident in both the executive and legislative bodies since surpluses have been used to build reserves rather than to expand the budget."

So a reserve fund is not just an expensive fire escape, useful only in economic emergencies; a healthy reserve is stairway to a higher bond rating and a higher level of fiscal security.

In creating a rainy day fund, there are three key considerations:

First, make sure money goes into the fund. A fund with a zero balance won't do you any good;

Second, make sure the money stays there until it really is needed. You have to guard against the all-too-human urge to raid the piggy bank;

And, third, you have to make sure that when the money is needed, it's available. At least a portion of the fund has to be both highly secure and highly liquid.

Here's how Pennsylvania has addressed these challenges. Pennsylvania's rainy day fund was created in 1995, so it was in existence at the time of the 1990 deficit. But there was so little money in the fund -- just $136 million -- that it was not sufficient to diffuse the crisis, even though virtually all of it was tapped.

Originally, State law required that 10 percent of any year-end surplus must go into the rainy day fund. At Governor Ridge's urging, that has now been increased to 15 percent.

Even more importantly, in addition to meeting the minimum statutory requirements, Governor Ridge and the legislature have appropriated an additional $400 million to the fund over the last several years.

To ensure that the money is used only in a true emergency, our legislation requires a two-thirds vote of both the House and the Senate for any appropriation from the rainy day fund. Every legislative session sees new proposals to spend the rainy day fund on one thing or another, but the two-thirds requirement provides a bulwark against those spending impulses.

The management and investment of the rainy day fund is the responsibility of the Pennsylvania Treasury. Historically, the fund has been invested almost entirely in U.S. government securities. However, as a result of two recent developments, we have now added equities to the investment mix. One development was the passage of Prudent Person legislation that for the first time authorized us to invest in equities. The

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other development was the growth of the fund past the billion dollar mark. With so much money on hand, we, in consultation with our financial advisors, deemed it prudent to shift a substantial portion of those assets into equity.

As of the close of last quarter, there are 57 percent of the rainy day fund was invested in equities and 43 percent was invested in a variety of fixed-income instruments, and we have a chart. The chart is correct but the text that you have is wrong, and you may want to correct those numbers. That is, 57 percent of the rainy day fund is invested in equities and 43 percent is invested in a variety of fixed-income instruments.

We believe that the inclusion of equities will, over the long term, result in higher average annual returns, further strengthening the fund. At the same time, we will continue to maintain a substantial portion of the funds in secure, liquid fixed-income assets.

The chart, a copy of which is attached to my prepared testimony, provides additional detail on the fund and particularly on the makeup of fixed-income portion.

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We think this is an appropriate mix, given the long-term nature of the rainy day fund, the size to which it has grown, and the restrictions on withdrawing funds from it.

In summary, Pennsylvania's tax stabilization reserve fund serves the Commonwealth well, strengthens our balance sheet now, while remaining available and growing for a future rainy day. I believe a similar fund could be a great benefit to the City of Philadelphia, if your fiscal situation will allow for meaningful funding and if you provide adequate safeguards.

Chairman Kenny, that concludes my prepared testimony. It was a pleasure to appear before all of you. Many of you I know very, very well. And I hope that we can help you develop a strategy to further strengthen Philadelphia's much-improved fiscal posture.

Mr. Lowery and I would be very, very happy to answer any questions at all.

COUNCILMAN KENNEY: Thank you very much, and your appearance here today is a help in giving us some institutional history on where the State was and how the State got to where it is

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today relative to the establishment of this fund.

Have there ever been any allocations to date from this fund, from the State's fund?

MS. HAFER: No.

COUNCILMAN KENNEY: None?

MS. HAFER: No.

COUNCILMAN KENNEY: And can you give me examples of what some of the requests are or some of the ideas are for what the fund should be spent on?

MS. HAFER: Anything from day care, health care, prescription drugs. All of the things that you are requested to provide for your constituents have been looked at. And every year, there are -- there is -- there are attachments to the budget. But because of the two-thirds requirement, that really is the safeguard. And the fund just keeps growing and it's there.

COUNCILMAN KENNEY: And you believe without the two-thirds requirement, there would have been opportunities to raid the fund.

MS. HAFER: Right. It would have been raided. Although the State is in very, very good shape at this point, as you know.

COUNCILMAN KENNEY: Can you give some indication as to what some of the actual savings have been relative to the cost of borrowing that has been decreased as a result of the State's robust rainy day fund?

MS. HAFER: I don't know what the -- do you know, Vince?

MR. LOWERY: I guess you really have to talk about the cost of --

COUNCILMAN KENNEY: Could you --

MR. LOWRY: I'm sorry. My name's Vince Lowery, and I'm with Solomon Smith Barney.

The best way I think I can answer that is that we have, at the direction of the Treasurer, to set a long-term investment program for this fund. We separated from her other 150 funds. And we've set an investment objective of over five years of just north of 9 percent, keeping a good eye on what the risk is and maintaining a very substantial liquidity pool in the event some unforeseen event were to occur. That is up from short-term investments of 5.2, which is about a little more than 40 million a year, which could be more than a quarter of a billion over five years in the coffers.

So when you take that number and look at having to borrow at some point in the future, you typically -- most governments are placed in a position of having to borrow at the top part of the interest rate level. So you could see even at a tax rate having to borrow at 6, so that's a turnaround of about 16 percent on a billion dollars -- and you can do the calculation yourself -- of 160 million a year.

COUNCILMAN KENNEY: Sure.

MR. LOWERY: So the idea of having this long-term fund is such a substantially good idea for long-term preservation of capital so that you can meet unexpected needs in the future. And I can't say enough about it.

COUNCILMAN KENNEY: What is done with the revenue generated from the investment of the fund? Is that plow back into the --

MS. HAFER: It's put back into the fund.

COUNCILMAN KENNEY: Is there any -- would there be any -- if the fund theoretically -- say we established a fund in Philadelphia and it got to be a sizeable amount if possible, would there be any sense in utilizing some of the revenue generated from the investment to go back in other services, or that would be a choice that we would make?

MS. HAFER: You should make that yourself and you should anticipate that those funds, compounding itself, will roll up pretty quickly en.

COUNCILMAN KENNEY: Right. Is there a cap on the State's fund?

MS. HAFER: No.

COUNCILMAN KENNEY: Do you-- what's your opinion of a cap? Is there any sense to a cap, or is there any negative impact of a cap that you're aware of or that you have an opinion about?

MS. HAFER: I don't know.

Do you know, Vince?

Just on one point. The fact that the Governor has put more money into the fund to bump it up, I think, indicates the health of the State but also the real commitment, that when -- he didn't need to do that, the legislature didn't need to do that, the 400 million extra. So they could have spent that. They decided to save it.

So I -- everyone is in agreement -- not everyone, but the leadership is in agreement on both sides of the aisle that this is a good thing for the State.

But I don't know -- do you know about the cap?

MR. LOWERY: The only comment I would have is just a little past history that I'm aware of, being the financial advisor here, and that was the unforeseen events, I never think you can really have enough. And, you know, Governor Casey was in a position around 1993 or so where he had to bail out the savings and loans, and he had to go through -- you wouldn't believe the acrobatics to find $300 million dollars, which at that point in time, with the economy, was not easy.

MS. HAFER: Well, in fact, he raided the State Workers' Insurance Fund --

MR. LOWERY: I was going to let you say that.

MS. HAFER: -- which is still a bone of contention, and has been a real problem for the

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State Workers' Insurance Fund.

MR. LOWERY: And you probably want to avoid placing yourself in that situation. So to answer your question, I personally believe, and my advice is to allow this to get large enough to handle these incredibly unbelievable events that can occur over time.

COUNCILMAN KENNEY: What are the statutory triggers that allow the expenditures from the fund? What are the -- is there a downturn or an up-tick in the unemployment rate Statewide? There was a number of different trigger that kind of set up the opportunity to go into the fund and consider the -- whatever use it is that we're trying to deal with.

MS. HAFER: Well, it has to be the two-thirds vote and --

COUNCILMAN KENNEY: Right.

MS. HAFER: And originally, there was such little amount of money in that fund that the House and Senate just voted to take out the 136 million.

But I think if you saw a downturn and you didn't want to raise taxes, corporate taxes, personal income taxes, and other taxes, that you would use that. And it's really a safeguard for those roller coaster economic times.

COUNCILMAN KENNEY: Okay. Two-thirds majority of both Houses?

MS. HAFER: Yes.

COUNCILMAN KENNEY: I had read that in other rainy day funds, there were certain general happenings -- an increase in inflation rate, an increase in the unemployment rate, a certain percentage in under-realized revenue projections that kind of set up general mileposts as to the ability to get into the fund despite -- and in addition to the two-thirds vote.

Does anything like that exist in the State?

MR. LOWERY: You know, I think what you're asking, I understand, is more political. I think that the Treasurer's situation is to set this long-term investment goal, so she can convey this to the legislature and understand what the objectives are investment-wise in terms of returns each year. That would then allow that them, that flow of information allows the general body that's elected to make those decisions.

I think that's her -- the Treasurer's goal here, to --

MS. HAFER: Yeah, they would have to have an agreement, whatever those indices are, and then have to convince two-thirds. And if they were indices that you indicated, everybody probably would agree, that it is the alternative to a tax increase, especially in an election year.

COUNCILMAN KENNEY: Right. That's always important to -- Councilman DiCicco.

COUNCILMAN DICICCO: Thank you. And thank you think for being here, ma'am.

Not to be critical, I'm just curious. Earlier, I was thinking, like, it's very difficult, as you know, in most cases to get a two-thirds majority on any issue. What my concern for spending and where I think the money is needed may differ from my colleagues, and that generally is the case. Again, without being critical, is there anything you see with the State and the rainy day fund that you might suggest be changed, whether it's the two-thirds majority vote or, as Councilman Kenney stated, when there's a turndown in the national economy? Is there anything that you would like to see different than what is in here today, based on your experience, which is a phenomenal achievement for the State to be in that position.

(Inaudible.) So I kind of spent every nickel I ever had, and some. And from a personal standpoint, I was in financial straits for a long period of time in my life, but I learned, the hard way.

But is $2 billion enough, is 3 billion enough? When do you reach a point when you say, Hey, you know, we have -- maybe you need to start putting money back into reducing State taxes on the citizens of the Commonwealth, or when do we start putting more money into education throughout the 67 districts in the State? I understand the legislature may want to come up and propose that, but if you don't get that two-thirds, then hypothetically, you can be putting money into the rainy day fund forever and not be taking any of it down.

MS. HAFER: Well, you could, but I think the thinking, and the intent, is to get a healthy surplus and, of course, the rate could be changed. You could go from 15 percent back down to 10 or even 5, and that's -- that would be for the legislative process and for the Governor's process.

Everyone knows how much money is in that fund. And when I testified at the appropriation hearing, that -- people will question that, and that is a point of discussion, how much is too much. But, again, the mechanism of two-thirds, I believe, is really the fail-safe mechanism.

Otherwise, if it's a simple majority, you would have -- that money would be gone. It would go to education, it would go to all kinds of other needed things. There's never enough money.

On the other hand, I think we have to take a common sense-approach. A billion dollars for a state, for the Commonwealth, is not a lot of money. We can certainly put much more money in, and in a few years, we'll have significant -- we'll have billions instead of just 1.1 billion.

As you know, half of the budget goes to education. That's expensive. Day care. There are tremendous demands, all the demands that you have on you, and they're important, they're important to your constituents, but somebody has to make the decision in saving for that rainy day, which will come and -- it will come, it will come.

COUNCILMAN DICICCO: No question about it.

MS. HAFER: It will really be -- our -- our -- we may be long-gone, but they will bless us and think we were prudent public servants by providing for the future.

COUNCILMAN DICICCO: Thank you.

COUNCILMAN KENNEY: Councilman Rizzo.

COUNCILMAN RIZZO: Thank you, Mr. Chairman.

It's good to see you today, Madam Treasurer.

MS. HAFER: Good to see you.

COUNCILMAN RIZZO: In the beginning of -- on the cover of your presentation, it says, regarding the Pennsylvania tax stabilization reserve fund -- could you describe how the rainy day fund in Harrisburg -- we constantly hear about the pot, I'm thinking of the word that the

Governor's always talking about and people are always pointing to, the Governor's. . .

COUNCILWOMAN TASCO: Slush fund.

COUNCILMAN RIZZO: No, not the slush fund.

(Laughter.)

COUNCILMAN RIZZO: Yeah, the -- Sammy what was that word?

STAFF PERSON: The surplus.

COUNCILMAN RIZZO: Yeah, the surplus. Is the surplus and the rainy day fund two separate pots? Does the Governor have --

MS. HAFER: You mean the --

COUNCILMAN RIZZO: The surplus that we always hear referred to.

MS. HAFER: The old WAMs (ph.)?

COUNCILMAN RIZZO: No, not the WAM, just the surplus.

MS. HAFER: Well, the surplus goes into the rainy day fund. When there is excess money, he divides it into certain funds. Some funds, like the State Workers' Insurance Fund, needs more money and is owed money. So the surplus is divided into other funds.

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COUNCILMAN RIZZO: But the Governor -- presently, there's a -- the administration in Harrisburg has a surplus that's separate of the rainy day fund, obviously.

MS. HAFER: That's correct.

COUNCILMAN RIZZO: So how do you decide whether to go after --

MS. HAFER: Well, there's a formula, there's a formula. The -- 15 percent of the surplus goes into the rainy day fund, and then they kicked in another 400 million extra because there were surpluses.

So, again, the general fund would just keep the surpluses, and they would be allocated, and our costs have gone up every year.

COUNCILMAN RIZZO: Is there any -- is there a process where you go after the surplus first before the rainy day fund since the surplus is there?

MS. HAFER: Oh, yeah.

MR. LOWERY: The two funds that the State, coming under the Office of Management and Budget, is the general fund, and that's where all the tax receipts are placed, and then the general

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expenditures come from that. So as the tax receipts come in, at the end of each year, they have an idea of what is happening, and that's where they make the decisions. But as of right now, the general fund is fully funded.

I think the best way I can explain this to you, in the early '90s, they would have to issue tax anticipate tax notes because the general fund was down to zero. Now the general fund is a multi-billion dollar funds, but they still have many expenditures to go.

So it's -- we -- the Treasurer is constantly trying to get cash-flow projections from the Office of Management and Budget to determine exactly what she needs to have available, and that's what we do every year. So she wouldn't be able to answer that clearly for you because of the big fluctuation that has occurred with tremendous revenues coming in versus years where there's not as many revenues coming in.

That's the best way I think that that can be answered.

MS. HAFER: We pay 55,000 bills a day,

you know, so we have a short-- every night, we sweep all of the accounts and we invest that money overnight. So we're making money so that we don't have to increase taxes. The more the treasury can make by putting it into equities and putting and longer -- into longer investments, the better for the State, the better for Philadelphia, the better for the taxpayers because we're making money on that money.

So we have many, many accounts, and the short-term investment pool is about $100 billion.

COUNCILMAN RIZZO: Once this fund -- obviously it's going to grow and grow and grow, and since you referred to the stabilization reserve fund, the tax stabilization reserve fund, at some point, I think the people of Pennsylvania want to see something happen that benefits them other than just stabilizing taxes, like Chairman Kenny said. Eventually, I would like to see here and in Pennsylvania a reduction in taxes, not just is a stabilization.

MS. HAFER: The State has reduced State taxes for the past six years.

COUNCILMAN RIZZO: Based on this?

MS. HAFER: Based on the revenues coming in, we've given rebates, we've given tax cuts over the last six years. So just as the funds are growing, we have also cut taxes. And the State is very, very healthy, but it will change. We know that. It will change. We're hoping that it doesn't change for the next few years, but it will change, and we will need this those revenues.

COUNCILMAN RIZZO: Thank you. Thanks for coming down today. Thanks, Vince.

COUNCILMAN KENNEY: Councilwoman Tasco.

COUNCILWOMAN TASCO: Good morning.

MS. HAFER: Good morning. Nice to see you.

COUNCILWOMAN TASCO: We've been talking to a number of the individuals who are participating in the welfare-to-work program, and their concern is that some of the funding that could have gone -- or probably should go to expanded day care is going into the rainy day fund.

What we'd like to see is probably not money coming from the stabilization fund, rainy day fund, but in the appropriations during the budget process that that area, the day care area, receive more of the general fund prior to establishing what the amount would be to go into the rainy day fund.

MS. HAFER: I -- I agree with you, it should not come out of the rainy day or tax stabilization fund; it should come out of the general budget at appropriation time. And we've worked very, very hard on all of those issues especially child care, which is absolutely essential -- it's a national issue, it's a State issue, it's a local issue. And I would be all for supporting more money going into day care, but not out of the rainy day or tax stabilization fund. It should come from the general budget and be appropriated by the legislature.

COUNCILWOMAN TASCO: At what point -- I mean, we are at $1.13 billion. How far is that going to grow? I mean, we could get $5 billion. Is there a cap?

MS. HAFER: 1.1 billion is the rainy day fund.

COUNCILWOMAN TASCO: Right. Is there a

cap on how much --

MS. HAFER: There is not a cap, but what will happen is that as the State goes through its appropriation process and I testify and give these amounts of money, they'll look across the board. And, again, they can lower the percentage. The -- under Governor Ridge, he kicked the percentage from 10 percent of the surplus to 15 percent and then another $400 million in addition to that. That helped make a healthy surplus and that money is making money.

If we get too high, whatever that money is, it could be 2 billion, it could be 1.2 billion, whatever that money is that the Governor and the legislature decides, they either could change the rate back to 10 percent and not give additional money, but it was prudent at the time to cut taxes as well as have a healthy rainy day fund, which really helped our bond rating.

And we still have to borrow money in anticipation because tax revenues come in at various times of the year. So we're still borrowing but we borrow at a lower rate, which is good for the taxpayer and it's just good for -- just good everybody.

COUNCILWOMAN TASCO: Well, I know this is not a question for you, you're the keeper of the funds, but I guess my question is, what services have we cut or are not providing to the citizens of Pennsylvania to accumulate a surplus and then to increase this rainy day fund?

MS. HAFER: Well, that's -- you know, that's -- that's a point of discussion.

COUNCILMAN KENNEY: Well, I guess the other question, though, is -- the reverse of that question is, what services won't we have to -- will we not have to cut in the event that a year or two from now or three years from now, the economy in the national government goes into the tank? We will have a source of funds available to continue to provide a level of service without raising taxes.

MS. HAFER: Well, that's --

COUNCILMAN KENNEY: So I guess that's the other side of the ledger.

COUNCILWOMAN TASCO: But at some point, I think that you reach a balance of how much you have and how much you might need against what you're cutting.

Thank you.

COUNCILMAN KENNEY: Councilman Rizzo.

COUNCILMAN RIZZO: Just a thought. Has the fund ever been used to finance any State projects rather than going out and borrowing money? Has the fund ever -- have we ever been able to borrow money from the rainy day fund --

MS. HAFER: No.

COUNCILMAN RIZZO: -- and pay interest to it for projects?

MS. HAFER: No.

COUNCILMAN RIZZO: That's not part of -- so if you had a -- I just heard the word "stadium" --

COUNCILMAN KENNEY: What a wonderful word.

MS. HAFER: No, it's -- we wouldn't recommend that either, we would not recommend borrowing from the rainy day fund. You know how governments are; you borrow and sometimes it never comes back.

So it really is better for us to invest

wisely and prudently and have a diversified portfolio and go out and borrow. And that fund allows us to go out and borrow at a lower rate. So. . .

COUNCILMAN KENNEY: Okay, thank you.

MS. HAFER: We're on an even keel.

COUNCILMAN KENNEY: Thank you very much.

Councilman Longstreth.

COUNCILMAN LONGSTRETH: I'm curious about the makeup of the people who direct the course of the rainy day fund. Is that a -- is it like a PICA setup? Do you have people who are appointed by an authority?

MS. HAFER: It's under the treasury, Councilman.

COUNCILMAN LONGSTRETH: This comes under your aegis?

MS. HAFER: Under our area, mm-hmm.

COUNCILMAN LONGSTRETH: And then you would direct the steps that have to be taken?

MS. HAFER: Yes.

COUNCILMAN LONGSTRETH: This entails, I presume, dealing with investment firms who act in a consulting capacity?

MS. HAFER: Correct. This is Vince Lowery, who is our financial advisor from Solomon Smith Barney here in Philadelphia, and he helps us make the determination of what our long-range goal is and what we want to see, how much money we want to make out of that fund. And then we divide the assets into equities and then fixed income.

COUNCILMAN LONGSTRETH: You obviously have these people advising you and apparently, they're doing very well. How long have we been into stocks and bonds and things of that sort?

MS. HAFER: We just received Prudent Person legislation just a few years ago and just this past year. We now have --

COUNCILMAN LONGSTRETH: How have you done during the last six months?

MS. HAFER: We've had some rough sledding.

COUNCILMAN LONGSTRETH: Uh-huh.

MR. LOWERY: We did pretty well. In terms of the last six months, we moved -- when the market went down recently, we took advantage of the fact that the market was done and the fed is beginning to drop rates to move substantially into the equity market. Because historically, on average, right after the fed begins to ease, within the next ten months, you do about 18 percent in the equity market. So if probabilities stay on our side, we should do pretty well next year.

COUNCILMAN LONGSTRETH: Thank you.

COUNCILMAN KENNEY: Thank you.

Thank you very much. Thank you for your testimony.

MS. HAFER: Thank you.

COUNCILMAN KENNEY: Mr. Grossman and Mr. Larkin, please.

(Witnesses come forward.)

MR. GROSSMAN: We work for separate outfits.

COUNCILMAN KENNEY: No, that's okay. I wanted to bring you both up together. I know you've been waiting a long time, and we appreciate your patience, and we always want to keep agencies happy.

MR. GROSSMAN: Dick Larkin and I used to work together for many years.

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COUNCILMAN KENNEY: Thank you again for coming here today. And whoever would like to start first, please identify yourself for the record.

MR. GROSSMAN: Hyman C. Grossman, Managing Director, Public Finance Ratings, at Standard & Poor's.

I was last here about in 1990, at just the beginning of the hint of the crash in Philadelphia. We got in close contact with the City Treasurer at the time, cash flow was disappearing, and we had to lower our rating at the time, as some of you may recall, down somewhere close to the basement of rating categories.

But since then, after several years of new administrations and the general economy doing better, things are better. So it's good to be here, under happy circumstances.

COUNCILMAN KENNEY: Thank you.

MR. GROSSMAN: And my prepared remarks are short, they're brief. I'd be glad to elaborate through Q and A.

Rainy day funds have taken hold in many

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states and local governments over the last ten years or so, since the last recession, in particular, where governments began to look at how they can conserve resources for a rainy day. Rainy day funds, or budget stabilization funds, work to stabilize fiscal planning and execution so that governments may avoid the stops and starts that would otherwise affect spending and accompanying service cuts. For example, one may avoid sudden or large layoffs to keep budgets on an even keel. When you have these funds and can shore them down, they can soften what otherwise might be a significant jolt to the budget.

We want to point out at the outset, however, that budget stabilization funds in and of themselves are not a panacea nor create improved debt ratings by themselves. I know you've heard reference to citation of budget stabilization funds, but only in the overall context of fiscal performance. Budget stabilization funds are a management tool that, if established and maintained and used prudently -- notice those words -- are an indicator of better management, which, with other factors, such as moderating debt, not increasing your debt but lowering your debt, a growing economy, and positive financial results, can lead to improved ratings. Those factors have to be moved together.

As others have said -- I'm not going to get involved in some of the mechanics on how you can create one and keep it and draw it down. Those are pretty well established and you can choose whichever way you want to go or a combination of what's already been accomplished.

Pennsylvania, Virginia, Florida, Michigan, and Illinois are some of the states that have implemented budget stabilization funds. And I've attached some write-off that we did at Standard & Poor's last year about best management practices, and one of them is establishing a rainy day funds.

Most cities have a less formal rainy day fund policy, but as mentioned, New York City has developed a mechanism within their charter to in effect create surpluses or cushions by prepaying towards the end of the year sometimes debt service pensions and those key expense numbers. But most cities have managed to adopt a

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fiscal policy of maintaining a cushion in one form or another from 3 to 5 percent year after year.

And why does 5 percent seem to be a magic number? I can remember in 1978, when the State of California voters adopted what was then called Proposition 13, a very strict limitation on tax increases from year to year, no more than 2 percent from year to year, based on property values. And yet, they allowed what they called "a prudent surplus," and that was the defined as 5 percent of the budget so to speak.

And the Commonwealth of Pennsylvania is also a good example of the need to establish the fund. And as the Treasurer admitted earlier on, for a while, they skipped providing the necessary funding. Pennsylvania established such a fund in the mid-1980s but neglected to appropriate the necessary resources from time to time. They followed several years of unbalanced results, and the Commonwealth later augmented the fund with "serious money," as I call it, after being cautioned about its financial (indiscernible). For the last decade, Pennsylvania's credit outlook has improved and been reflected in the better credit rating of AA at Standard & Poor's.

To make the rainy day fund work over the long term, provisions must be made to replenish the fund to a predetermined level in, say, two to three years. Provisions should be made so that any draw-down is certified -- in Philadelphia probably by the Mayor and the Controller together and, some people suggested, a two-thirds majority of the City Council or the Appropriations Committee Chair. I had in my prepared remark mentioned the Council President or the Appropriations committee Chair.

Well-managed cities will have ongoing reserves in addition to rainy day funds -- we've already mentioned that. And they should used not be used for simple budget balancing but for unforeseen emergencies.

In Florida, the state has a budget stabilization fund established by the people in the form of a Constitutional amendment. It's fully funded at 5 percent. In other words, when you reach 5 percent, you don't have to keep adding to it. That's an option you can look at as well.

In New Jersey, they have a certain

percentage of the surplus that goes in, and after a while, a predetermined number, they can stop adding to it.

Sooner or later gentlemen and ladies, you may get a tax revolt of people saying, Hey, there's too much money sitting around, and that's a political you all will probably face sooner or later. In the past, tax revolts have come out of too much revenue going in by way of taxes or spending. So that's something you need to keep your eye on down the road.

In addition, in Florida, not only do they have a budget stabilization fund, but they have what they call "a working cash fund" and other reserves that, together, they now face over a billion dollar overrun on Medicaid and social services, so they're going to have to deal with that in the upcoming budget by the Governor, Jeb Bush, who's a relation to you-know-who, over the next two years.

In Texas a number of years ago, they established a budget stabilization fund but it was only to be funded from surplus revenues coming out of gas-related taxes. And you know what happened

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in the 1980s, gas revenues fell apart, in contrast to what we have now. So they never really funded the budget stabilization fund until much later.

So the rainy day fund is established from serious money, number one. It should be drawn down under unique circumstances and replenished in no later than four to five years. That's my suggestion.

For example, you can -- Philadelphia apparently doesn't get tobacco money from the settlement, so you don't have some of these windfalls that other cities and counties have gotten and some states that in some cases, they've used that windfall to establish a rainy day fund to a certain level -- let's say 5 percent of the budget -- and then draw it down under certain restrictions.

In summary then, a rainy day fund is a good idea that will enhance fiscal balance if established and maintained in a prudent fashion. However, if a city adopts an escalating borrowing problem when its underlying resources are not growing in tandem, a rainy day fund's benefits will quickly evaporate.

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I have attached, as I indicated, some additional papers that we have published.

The State of Maine, by the way -- I didn't have time to put it into the prepared remarks, the news item this week that the rainy day fund in the State of Maine has grown from $6 million to $143 million, and there's very strict control on protecting that rainy day fund because the Governor there is concerned about the economy as well.

So I'll stop here and prepare to answer questions.

COUNCILMAN KENNEY: Thank you very much. What I would like to do is ask Mr. Larkin to give his testimony and then open it up to questions for both panelists.

MR. LARKIN: Thank you, Councilman Kenney.

COUNCILMAN KENNEY: Thank you. Could you for identify yourself for the record, please.

MR. LARKIN: Okay. Hy Grossman is the only thing person from another rating agency that I would defer to. I've known him a long time and whatever he said goes ditto for me.

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I have a few other points. I'm not going to repeat a lot of what Hy said. John Hawkins, I think, has given you copies of my prepared remarks. I'm going to try to highlight some other points which may not have come up yet.

I don't think any rating agency will ever say that a rainy day fund by itself will always result in a higher debt rating. If that's the case, then you may be justified in asking how much value does a rating agency place on such a fund. On that question, I believe Fitch has taken the most definitive position.

Fitch views the formal establishment and maintenance of rainy day emergency funds as one of the two most important financial-management best practices that a city can utilize to achieve high ratings. This practice is discussed in a Fitch report dated May 4th of last year, entitled "Impact of Management Practices on Municipal Credit." I've given John a copy of that, and if you're interested in that, I'm sure he can make copies.

The report was part of a major overhaul of our criterion standards for rating city GO bonds and prompted a review of all of Fitch's ratings in spring of last year. As a result of that review and putting more weight on management practices like rainy day funds, we upgraded about 27 percent of all of our GO ratings and almost 50 percent of our water and sewer ratings.

In that review, Fitch upgraded Philadelphia's bond ratings for both GO and water-sewer bonds from BBB+ to A- in May and June of last year. As far as I know, Fitch is currently the only rating agency that has Philadelphia's bond ratings in the A category.

When we upgraded Philadelphia to A-, we cited a number of positive financial management practices, including multi-year budgeting, contingency planning, and the maintenance of these financial reserves as a result of the City's eight consecutive operating surpluses. We recognized then that there was no policy, no formal policy for maintaining the City's fund balances at current levels. We do believe, however, that the City is not likely to spend down these fund balances and these hard-earned reserves in a short period of time, given the City's last ten years'

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track record. Formally adopting working capital and emergency reserves will help to cement the A- rating that Fitch currently has on Philadelphia. As for other rating agencies, I think you can ask Mr. Grossman that question.

Other entities that have rainy day funds. Washington D.C. Is required to include a budgeted reserve of $150 million under its Fiscal Recovery legislation. The city of Detroit targets a buildup of emergency reserves to a level of about 15 percent of annual spending. In Detroit, which tends to be very cyclical, the surplus generally builds up in good times, designed to be drawn down in recessions, when taxes fall short.

Finally, the North Carolina local government commission, which is a division of the State Treasurer's Office, requires under law localities to maintain minimum fund balances equal to 8 percent of annual expenditures. Issues that fail to conform with this guideline run the risk of having their bond issuance plans rejected or postponed by the commission, which it has the power to do.

There are other benefits of having a

rainy day fund. Rainy day funds are sometimes "called working capital funds" or "rainy day funds" or "tax stabilization funds" or "budget stabilization funds." When they're properly used, they can allow a city to not only maintain a stable tax rate but also continue the smooth provisions of essential services in a volatile environment where normal tax collections are below projections.

I think one of your Councilwomen talked about day care being in the budget. I would like to believe that if the City had the financial cushion and the revenues fell short, the City wouldn't automatically have to cut back on programs like day care if it had a cushion to fall back on.

These rainy day funds could also represent a pot of money that could be brought to bear to take advantage of unusual economic development opportunities. I believe there was some questioning of the State Treasurer as to whether or not they've ever used the fund to do good things with it. I believe the State of Pennsylvania also has something called "the Sunny

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Day Fund," which is used for just that purpose. I think it's much smaller in size but it's basically there in case the State needs the short-term funds to take advantage of unusual economic opportunities that might occur like during the year.

Rating agencies are frequently asked how high do we like to see these rainy day funds. There are several benchmarks I think your should consider. First, you should set as a reserve against budgetary volatility. This amount would represent the likely general fund shortfall that could occur because of normal budgetary forecasting error and economic downturns, which can cause budget shortfalls or unusual expenditure requirements. Rating agencies in the past have usually cited targets of about 5 to 10 percent as a reasonable cushion.

Keep in mind that chronic deficits and over-budgeting of revenue led to an accumulated fund balance deficit in Philadelphia of over $150 million, and that was as recent as 10 years ago. So $150 million might be used as a benchmark for the City.

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There's one other consideration I think the City ought to take into account. Some cities like Philadelphia need to borrow short-term to pay salaries and normal daily expenses early in the fiscal year because the much of the revenue comes in the later part of the year, particularly property taxes in March. While this revenue anticipation note borrowing is a regular practice, it is my observation that an issuer that can fund its operations without having to resort to short-term note borrowing is stronger than one that does.

At a minimum, it is common practice for rating agencies to consider upgrades when an issuer curtails its seasonally cash flow borrowing or eliminates it. When a city starts to run deficits and the short-term borrowing goes up, it's usually a leading indicator of financial trouble and sometimes contributes to a rating downgrade. The establishment of a working capital or emergency reserve which helps to reduce or eliminate Philadelphia's need to borrow with short-term notes would certainly be viewed favorably at Fitch, and I believe it would be

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viewed favorably reviewed by the two other rating agencies.

The last comment I have has to do with trying to depoliticize the rainy day fund and it has to do with your questions along the lines of when do you dip into it. I agree with the State Treasurer that there ought to be some guidelines, and I think the City ought to be the one that sets them, but they ought to be extraordinary guidelines. They should be something other than normal business as usual. I think a simple-majority vote of the Council to appropriate makes the rainy day fund no different than any other funds and probably would cause the rainy day fund to be depleted fairly quickly. I suggested a two-thirds vote requirement, I would think, even though it's hard to get a two-thirds vote, if there was an extraordinary need, I would think the Council would probably be able to muster the two-thirds. It doesn't have to be two-thirds but I think it should be something stronger than a normal majority needed for any appropriation.

That's the end of my remarks.

COUNCILMAN KENNEY: And perhaps in

addition to the two-thirds, you know, a signoff from either the Controller or PICA or some other independent --

MR. LARKIN: There are other entities that have something like that. Others, as the other Councilman talked about, there could be economic triggers which would perhaps allow a simple-majority vote if unemployment went above a certain level. Under those circumstances, maybe you can sort of lower the bar for the two-thirds if you can point to something that's objective and not simply, We got up this morning and decided to spend money.

COUNCILMAN KENNEY: It would seem to me hindsight being 20/20, that perhaps this city should have established something like this three or four years ago. But in your opinion, it's never too late to establish this type of mechanism.

MR. LARKIN: You can never be too good-looking or too rich.

COUNCILMAN KENNEY: Okay.

MR. LARKIN: No.

MR. GROSSMAN: No, it's never too late,

no. Right now, we're in fairly good times, comparatively good times, so now is the time to do it because two years from now, we may be in a serious downturn.

COUNCILMAN KENNEY: I raised the question with the Controller and I'd like to raise it with you, and if you feel you don't have enough experience with this particular city's budgeting and --

MR. LARKIN: Hy has been following this city for 25 years at least.

COUNCILMAN KENNEY: One of the things that has kind of spurred me on to pursue this has been this ongoing serious concern over the depletion of our residents. As compared to cities like New York and Chicago and Boston, Houston, L.A., there's been an out-migration of domestic residents out into the surrounding region outside the City limits, without a replacement population. I think New York, in the last seven years, has replaced about almost a million people that have out-migrated to the surrounding region, with legal immigrants, for example, and maintained its tax base and economic vibrancy.

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The City of Philadelphia has lost 180 to 200,000 people, say, in the last ten years and has had a steady growth in its budget in the same period of time. So we're actually spending more money -- a lot of it has to do with the cost of doing business, the expanding social needs that major cities like Philadelphia have to deal with.

But it troubles me that the formula that we seem to be applying here is a self-defeating formula in that as our tax base decreases and our expenses of running the government continue to increase, albeit not at a skyrocketing rate but at a steady rate, we're almost at $3 billion, and in this coming budget, it's 0.9 billion.

Is that formula a troubling formula for people like yourself, who are looking at municipal governments? And do you believe that the requirement of a 5 percent set-aside, for example, of our revenues, a mandated set-aside, would in some way impose upon us -- and we're politicians so it's hard to impose upon us fiscal discipline because we'd like to serve everyone and we'd like to provide day care for everyone and we'd like to provide increased funding for education for everyone. We'd like to do a lot of things but we're almost unable to do it because we are government.

And I'm wondering -- I would like your comment on the first part of my question, which is the decline of the population without replacement and the continuing increase of the budget.

MR. GROSSMAN: I'd like to attack that. It's a very serious sociopolitical economic-base issue.

The City of Philadelphia is faced with thousands of people leaving. And those that are left are those that some people refer to as the "high-cost citizens." You know, those are the lower-income people who need the services, can't work, are sick, disabled, and they need to be taken care of one way or another. You can't just let them in the streets. And that's the burden the City of Philadelphia has had for many years.

It's been ameliorated a little bit in the last few years with the growing economy, but by far, you still have not attacked in a decent way the housing situation -- there's still too much abandoned, inefficient housing. Education, it's not under your direct control, but the City's School District situation cries for help, reform.

I suggest you look at the City of Chicago's Board of Education. I spent a lot of time with them. They have reformed it, it's making a tremendous difference. You can't grow the economy without a viable or improving school district, public school district. Very, very important.

So I entreat you to look at the City of Chicago's public schools. And they'll be glad to help you out, if you haven't looked at it. They've restructured the governing to a CEO in Chicago, and I know him pretty well. And they'll be glad to help.

So that's what's dragging the City's rating with us a little bit. Fitch has a better rating, we're a little below. It's that economic base and the lagging of the economy and the educational situation that needs to be addressed.

Job creation is important. Why has New York City done better? Jobs have grown. Outside people have come in and invested billions of dollars of dollars. The Times Square area, major. Sure enough, they got tax incentives and so forth. You need to incentivize.

You have natural resources here, you have the waterfront, you have the historic districts and things like that. You should take advantage of that. The Convention Center facility is drawing some people. Fortify that as well. I think that's the major drag on the City of Philadelphia that you all haven't done enough in those areas.

COUNCILMAN KENNEY: The issue -- the other part of the question was the expansion of the budget and seemingly the suspension of the government. We're probably about --

MR. GROSSMAN: That needs a hard look. I haven't looked at the City of Philadelphia myself in a while, but you need to look at what are we doing and why, and can someone else do it better. You know, one day, you're going to have to face the question of whether the City is the employer of last resort. I leave that to you to make that judgment call.

COUNCILMAN KENNEY: The question with

the $3 billion, almost $3 million budget.

MR. GROSSMAN: Right.

COUNCILMAN KENNEY: A requirement of 5 percent or so or 3 to 5 percent.

MR. GROSSMAN: Move towards that. That's my suggest. You don't have to create it like that. Two or three years.

MR. LARKIN: If I can make a comment.

COUNCILMAN KENNEY: Yes, please.

MR. LARKIN: Once you establish this rainy day fund, it doesn't require another 5-percent-a-year appropriation. The appropriation really is made once to build it up. As long as then thereafter, the City lives within its means on a year-to-year basis, matches its expenditures with its ongoing revenue, you don't have to keep on building that up.

The only time you'd really have to reappropriate it would be if you had to dip into it temporarily, in which case then, when good times come back, you ought to replenish it.

MR. GROSSMAN: I agree with Mr. Larkin's point.

COUNCILMAN KENNEY: But my hope

theoretically is that we look at a $3 billion proposed budget today and hypothetically say, We're going to take 5 percent of that and 5 percent of doing business differently, of cutting areas in some way, privatizing areas in some way, doing other things that create the ability for us to take 5 percent of what's being proposed today and move it to a segregated fund that none of us can touch, and to do it on a regular basis.

MR. LARKIN: I would suggest to a certain extent it's already being done, as one of our earlier -- I think it was Jonathon Saidel that mentioned the budget in the past that included an appropriation for contingencies. The appropriation for contingencies, for all intents and purpose, is a safety valve in case one of these things goes wrong or the revenues fall short.

So to me, the City taking that step to create a formal rainy day fund wouldn't be totally new appropriations; it would take the contingency and roll it into that. Because, for all intents and purposes, when we're talking about a rainy day fund, that's what we're talking about, a contingency fund in case something goes wrong.

COUNCILMAN KENNEY: But the difference, I think, between a contingency fund and a rainy day fund is it keeps our hands out of there without extraordinary circumstances.

MR. LARKIN: That's where you ought to set your own rules as to how to keep your hands out of the pot.

COUNCILMAN KENNEY: What I fear is recent problems that have arisen in the government; i.e., the Philadelphia Gas Works, which I'm sure is something that both of these agencies are watching. I mean, we've been asked recently and have approved a $45 million loan split up in 25 and 20, you know, and we've just given the other part of the loan.

I mean, what I fear is that a contingency fund, a fund balance, a surplus is more accessible, readily accessible for problems like PGW. And I expect -- and I anticipate, I don't expect, I anticipate that sometime in April, the government may be back to ask Council for additional money for PGW or for some other crisis situation.

My feeling is if that contingency fund was transformed to a rainy day fund, we wouldn't be able to get to it without a two-thirds vote theoretically or hypothetically a two-thirds of the Council, signoff from the Controller, signoff from PICA, and more likely to be able to keep that fund out of our hands. And that's, I guess that's what my real fear is and that's my real catalyst for this effort.

MR. LARKIN: There would be such a thing as perhaps be setting the bar too high. You do want the fund to be available for true emergency purposes. I mean, you know, people make a joke that a rating agency will look at the rainy day fund, and if you establish it, it's good, but the moment you touch, we're going to downgrade you. That's -- no one can speak for Hy on that.

MR. GROSSMAN: No.

MR. LARKIN: If that were truly an emergency and the rainy day fund was drawn upon for a true temporary problem, Standard & Poor's nor Fitch would automatically take the rating down.

However, you're exactly right. If the rainy day fund was really looked at as a nice pot of money, let's get our hands on it and take care of this problem, frankly, we wouldn't give much credit to it at all if it was established and used that way.

COUNCILMAN KENNEY: But am I wrong to think that the rainy day fund could be a forceful way to make us reexamine our budgeting priorities and process? Is that a wrong --

MR. LARKIN: It could help, sure.

MR. GROSSMAN: Sometimes that's not a bad idea.

Let me just add something. The other side of this budget-making situation, even with a rainy day fund. If you establish it and provide some wording that, you know, if you artificially inflate the budgets in estimates, you know, let's say you say, Hey, the Commonwealth's going to give us another hundred million dollars, put that in the budget --

COUNCILMAN KENNEY: We did that in '89,'90.

MR. GROSSMAN: I remember that. We

downgraded that when it happened, 'cause we checked with the State and they said no, that's not going to happen.

So, you know, if you do that and then you're short and you say, Okay, the rainy day fund's here, let's do it. So you need certain restrictions against that sort of, you know, phony --

MR. LARKIN: California did that in the 1990s. What we thought was a good thing actually just started to be used just like anything else. They would appropriate a 3 or 4 percent reserve, but the revenue estimates were unrealistically high, so that reserve was spent four months into the fiscal year, and they still ended up with a deficit.

So, you know, one goes hand in hand with the other.

COUNCILMAN KENNEY: Fine, thank you.

Any questions?

(No questions.)

COUNCILMAN KENNEY: Thank you very much for your patience and for your insight, and we appreciate.

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MR. GROSSMAN: Thank you. I'll be able to catch my train.

COUNCILMAN KENNEY: Thank you very much.

MR. GROSSMAN: Good to be here.

COUNCILMAN KENNEY: Thank you.

Mr. Dubow?

(Witness comes forward.)

COUNCILMAN KENNEY: Mr. Dubow, thank you. I appreciate your patience. I apologize for not calling you up sooner. Between the visitors from Harrisburg, and I know these gentlemen probably have to get back to New York, I knew you'd be here, but I appreciate that, and I didn't want to make you that there was any insult to it. We just -- the way the witness list worked out, you wound up being last, but I do appreciate your patience, and I know you understand some of the problems we face in these hearings in getting people in and out all on their schedules.

MR. DUBOW: And I agree with you, it's good to keep the rating agencies happy.

COUNCILMAN KENNEY: Yes, thank you. Please identify yourself for the record.

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MR. DUBOW: I'm Rob Dubow, I'm the City's Budget Director. And a lot of what's in my testimony has already been said so I'll try to just skip over some of that.

The Administration strongly supports the spirit of this resolution in developing conservative fiscal measures for ensuring the stability of the City's finances for the years to come. And in that spirit, I'd like to offer several recommendations I have regarding the development of a rainy day fund.

While the fund would provide the City with added disciplining, in many ways, the City's target budget process is served as an informal rainy day fund. Now, as you know, each year, we give departments spending targets that are below their approved budget levels. The difference between those targets and the approved budgets provides us with a reserve that's used as a contingency against any anticipated events. In the past, that contingency has helped us meet needs created by a number of emergencies, including Hurricane Floyd and 1996's blizzard.

A rainy day fund would formalize the

City's current fiscal practices with a mandate to accumulate savings at a predetermined level. The target spending process, combined with management initiatives and a thriving economy, has helped the City produce it's record $295 million fund balance at the end of FY '00. This achievement was made all the more meaningful in light of the precarious financial position the City was in throughout the early '90s. Despite this impressive financial achievement, the City's financial condition remains precarious and we are committed to remaining vigilant, especially in light of recent indications that the national economy may slow down.

As was noted by the Mayor during his budget address last week, the Administration is dedicated to creating efficiencies within government, even as we continue to cut costs and lower expense. The 1.5 percent cut in budgeted personnel costs in virtually every department was one of the initiatives that we'll pursue to make sure that spending does not grow beyond our means.

The creation of a rainy day fund would

be another tool that could help Philadelphia reinforce its fiscal approach. Rainy day funds are a proactive vehicle that help cities prepare for budgetary problems. The fund could serve an important purpose by enforcing discipline savings, and I'd like to make some recommendations regarding the establishment of such a fund for Philadelphia.

One of the things that all of the witnesses today have talked about are methods for making a contribution, and in the testimony, I list some of them, but instead of going through, I'll just talk about the recommendation, which is that we establish the fund by using a percentage formula based on operating surpluses.

And then the second point that we've gone over a few times today is how money's withdrawn. I mean, we would recommend two criteria. One would be if there's some emergency event that created expenditures equal to 1 percent or more of our budgeted revenues, that that would draw -- that would kick a draw. And then the second is looking at economic indicators, and if economic indicators declined for two consecutive

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quarters, that would also allow a draw from the fund.

As I state, the Administration generally supports the concept surrounding the establishment of a rainy day fund, and I'm happy to answer any questions from the panel.

COUNCILMAN KENNEY: What would you suggest would be the percentage that would be acceptable to the Administration relative to --

MR. DUBOW: To surplus --

(Unintelligible, parties talking over each other.)

MR. DUBOW: I would say 20 percent.

COUNCILMAN KENNEY: So that would be whatever we projected in that particular fiscal year. At the end that have year, if there was a surplus of those revenues or an excess of the budgeted revenues, that 20 percent of that would go into the fund?

MR. DUBOW: If there was an operating surplus.

COUNCILMAN KENNEY: An operating surplus.

MR. DUBOW: Surplus. So looking at

revenues and expenditures.

COUNCILMAN KENNEY: Of the $295 million in Fiscal 2000 --

MR. DUBOW: Right.

COUNCILMAN KENNEY: -- how much of that remains?

MR. DUBOW: The Five-Year Plan projects that at the end of'01 --

COUNCILMAN KENNEY: No, how much -- I'm sorry. How much -- if the two -- if the budget surplus was $295 million at the end of Fiscal Year 2000, what is the surplus as we speak today?

MR. DUBOW: Well, we track it at the end of the year because of the way revenues and expenditures flow in. So as of today, I don't have a number. I can tell you what we project for the end of the year.

COUNCILMAN KENNEY: Okay.

MR. DUBOW: Which is 150, roughly.

COUNCILMAN KENNEY: 150.

MR. DUBOW: Yes.

COUNCILMAN KENNEY: What would you -- what would account for the reduction from 295 to 150?

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MR. DUBOW: One thing is, we're projecting a slowdown in the economy in the second half of the fiscal year. Another is the loan to PGW, which, in the plan, we project comes back in two years. And then the other is we project the $45 million payment to the School District.

So between those three things, they account for those of that decrease.

COUNCILMAN KENNEY: Theoretically, if we did not have the surplus dollars available for PGW and the schools and that money -- we had had a rainy day fund, for example, in the past couple years, and a bulk of that money was already in that fund, and we were required, if we saw fit, to loan PGW the money and to provide additional money for the schools on top of the other dollars we've been providing over the past six, seven years, how would we go about finding that money? Would we not have to find it somewhere in the budget itself?

MR. DUBOW: Well, I think under any circumstance, any of the proposals that we've talked about today, we would not have used all of our surplus our rainy day fund. And I think, under all of the scenarios that Mr. Vignola laid out, we would have at least 90 million sitting in surplus still. I think we still would have had the ability to do that.

COUNCILMAN KENNEY: But we would have looked at it in a different way, I guess, because 90 million versus 295 certainly makes you a little more tighter-fisted with your surplus.

MR. DUBOW: Right, yeah. And I agree with your general principle that if there was a rainy day fund, it would put more pressure on our budget and force us to look at things differently.

COUNCILMAN KENNEY: Let me stick with the theoretical for the moment, but it does apply in some ways directly to the City, and you've heard this question, I've asked it of three different witnesses before. We have 200,000, 180,000 less people --

MR. DUBOW: Can I guess what the question's going to be?

COUNCILMAN KENNEY: A budget that has slowly been growing, serving theoretically less people but agreeably more needy people.

MR. DUBOW: Mm-hmm.

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COUNCILMAN KENNEY: And.

MR. DUBOW: Right. Less people to shoulder the burden of need.

COUNCILMAN KENNEY: Should not the budget, in theory, be going down as opposed to up?

MR. DUBOW: If you looked strictly at population, you would come to that conclusion. The reason that that hasn't happened in large part is because of increasing social service and criminal justice needs.

So if you were talking about the same type of population as we had ten years ago, and I think that's right, but I think, as Mr. Grossman said, the population that's left behind is what I guess he characterized as a high-cost population.

COUNCILMAN KENNEY: Would not these fiscal constraints being forced upon us in some way make us look at theoretically the delivery of prison services, the delivery of social services, of Health Department services, of other types of services that we agree need to be met in some fashion, by us or by someone else, you can't just tell the people, you know, Get out in the street, we can't help you, or educational services.

I mean, is there -- would it not force us to look at life, our life in the City, in a different way that we would not be likely to look at it as long as we're experiencing or sitting on a 295 or a $150 million surplus, we don't want to make anybody mad, we don't want to ruffle anybody's feathers, we don't want to make political decisions that are going to upset certain segments of our constituencies, workforce, or other things, would not this mechanism almost force us to do something that we really should be doing anyway, but because of the robust national economy and because of our increased revenues that we didn't anticipate and things are kind of good and we all feel good about it, shouldn't we be looking at ways in reducing the size of this government seriously as opposed to expanding its costs? Not expanding its costs, but growing it at a predictable rate.

MR. DUBOW: I understand. I guess I agree with the first part of the theory which is that if we forced a 5 percent reduction, that that would force us to look at doing things differently.

I guess I don't completely agree that we're not already doing that. I mean, one of the reasons for the establishment of the Social Services Division in the Managing Director's Office was exactly to do that. And I know that they are in that process. And one of the reasons that they did the children's budget and the report card is so that they could look at all of the services we provide, see how we allocate our resources, see how much things cost, see what we're getting for our dollars so we can decide whether what we're doing is the best way to do it and how we can change that.

COUNCILMAN KENNEY: Does it make any sense -- and I don't want this question to seem naive, but if we were to say this year -- again, theoretically -- a $2.9 billion, a $3 billion budget, we're not going to go above this level for the next three years, but we're going to maintain a 2.9, $3 billion budget level for the next three years as a pilot project to see if there's some way we can stop the growth of the size of this government now and work within these particular means, these immediate means, and then attack the budget from the other side.

I mean, I think that the budgeting process through the last nine years has been light years ahead of where it was prior to that, which was basically department heads coming in and saying, I need this percentage of an increase and not even be questioned as to what they were going to do with it or what their mission was. So I think the whole budgeting pre-budget submission process has been a tremendous difference and a tremendous benefit to the City long-term.

My concern is that this -- again, just look at the economic principle. There's a steady rise in the cost, however restrained that rise is, and a steady decrease of the population. At some point in time, it leads us to disaster.

MR. DUBOW: I think you're right. We have to either figure out ways to grow our economy or to shrink our government. If the economy goes down and the government goes up, actually that's a recipe for disaster.

COUNCILMAN KENNEY: And the Administration does agree that within the discussion ultimately of the details of a rainy day fund, that that is a tool in general that could be a helpful tool in getting us where we need to be.

MR. DUBOW: Yes.

COUNCILMAN KENNEY: Okay, fine.

Any questions?

(No questions.)

COUNCILMAN KENNEY: Thank you very much. I appreciate you waiting.

MR. DUBOW: Thank you.

COUNCILMAN KENNEY: That will conclude the Legislative Oversight hearing for today. Thank you all for attending, and we really appreciate your input into this process.

Thank you.

(Adjourned at 12:15 p.m.)

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C E R T I F I C A T E

I HEREBY CERTIFY that the foregoing proceedings of the Council of the City of Philadelphia of Wednesday, January 31 2001, were reported fully and accurately by me, and that this is a correct transcript of same.

RE: COUNCIL COMMITTEE ON LEGISLATIVE OVERSIGHT
RESOLUTION NO. 000774

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JOSEPHINE CARDILLO,
Registered Professional Reporter