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**AN HONEST BUDGET NOW:
THE NUTTER PLAN
TO BRING FISCAL INTEGRITY
TO CITY GOVERNMENT**

INTRODUCTION

The next Mayor faces enormous budget challenges. As part of the government that produced the Rendell reforms of 1992, I've done it before and I can do it again.

--Michael Nutter

A budget is always an opportunity to lead. A difficult budget, in particular, is an opportunity for leaders to address longstanding problems and ask residents to rise to the challenge of change.

Philadelphia's budget demands three things from any responsible candidate for Mayor.

First, demonstrate an understanding of the issues and a willingness to discuss them candidly.

Second, present an agenda to reform the budget process itself in order to build and sustain public commitment to fundamental change.

Three, take responsibility for the costs and funding sources for new proposals made in this campaign.

The Pennsylvania Intergovernmental Cooperation Authority (PICA) issued a report in September 2006 addressed to anyone running to be the next mayor of Philadelphia—it was appropriately titled, “Look Before You Leap.” I have been looking at Philadelphia's budgets for twenty years. And for fifteen years, I helped write those budgets and vote them into reality. During my time on City Council, I squared off against the biggest budget issues of the day.

In **1992**, I voted for the legislation that former Mayor Ed Rendell needed to bring the City back from the brink of bankruptcy. Many of those votes were difficult and passed by one-vote margins. In **1999**, I sponsored and got passed the legislation that rescued the municipal pension fund from its last crisis. That was an outcome that was built on shared burdens for the benefit of all concerned. In **2002**, I sponsored and got passed legislation that protected the Rendell schedule of Wage Tax cuts when Mayor Street wanted to stop them. And in **2004**, I began the long and unfinished business of implementing the comprehensive agenda of the Tax Reform Commission, including reductions in the Business Privilege Tax.

As Mayor, I will:

- **Convene** the stakeholders in an honest and cooperative effort to redesign the pension and health benefits for City employees in order to make them sustainable for all concerned.
- **Design** a policy for issuing new municipal debt and stick to it.
- **Reform** the process by which the City budget is devised and debated in order to achieve greater levels of public participation and government performance.
- **Present** realistic estimates of the costs and funding sources of new proposals, starting with those I am making in this campaign.

THE PHILADELPHIA BUDGET: A CHALLENGE TO LEAD

It's time to put away the smoke and mirrors and bring out the sharp pencils.

--Michael Nutter

The City's General Fund Budget for Fiscal Year 2007 is about \$3.6 Billion. Three-fourths of City spending goes for three things:

Public Safety	\$1,103 Million
Pensions & Health Benefits	\$ 864 Million
Social Services	\$ 753 Million

Two-thirds of that spending is paid for with local taxes, the largest being:

Wage, Earnings, and Net Profits Taxes	\$1,155 Million ¹
Real Property Tax	\$ 408 Million
Business Privilege Tax	\$ 399 Million
Real Property Transfer Tax	\$ 195 Million
Sales Tax	\$ 131 Million

Over the years, the annual difference between revenue and spending creates a fund balance—a surplus when the City takes in more than it spends and a deficit when it spends more than it receives. As long as the fund balance stays positive (bigger surpluses than deficits), the City's budget is in good shape in the short run.

But PICA, the Pennsylvania Economy League, and *Philadelphia Forward* have all pointed to troubling signs on the horizon. The next Mayor will assume office in January 2008 and must submit a budget within months for Fiscal Year 2009. PICA notes that by then:

- “The general fund's balance will have dropped \$130 million—65 percent—in three years.”
- “By FY09 the cost of the City's debt will be almost \$50 million higher than it was in FY06.”
- “The City's payment into the pension fund will be more than \$110 million higher than it was during FY2006.”
- “Health medical insurance costs for City employees will be almost \$80 million higher than they were in FY06.”

These are daunting facts, but there are a number of things that a Mayor can do to address each one. In every case, these things require a leader committed to fairness, candor, and a disciplined focus on solutions. Addressing these challenges must be understood as a legacy issue, equal in importance to anything being discussed in this campaign. I understand that the City's long-term fiscal stability is the necessary foundation for everything else we seek to do.

¹ This source is projected to yield \$1,454 Million in FY 2007, if the Wage Tax revenues that pass through PICA are included.

As Mayor, I will establish a Rainy Day Fund.

A Rainy Day Fund is a place to deposit annual surpluses to create reserves for periods when revenues may fall. Since the rain is starting to fall, it is unlikely that the City could make substantial deposits to such a fund in the next few years (but it would have been nice to have a funded reserve from the past decade to help weather the coming storms). However, now is the time to establish the mechanism so that when surpluses return it provides a responsible alternative to simply increasing spending on pet projects.

As Mayor, I will establish a formal debt issuance policy.

The reason to incur debt is the prospect of increased future returns. For City government, that might mean dealing with problems sooner rather than later because of the costs are lower and/or investing in conditions that will generate higher levels of employment and income than would occur without the investment. As Mayor, I will never obligate future Philadelphians to paying off debt that does not seek these fundamental goals.

As Mayor, I will convene a Commission to devise and implement a fair and responsible solution to Philadelphia's growing pension and benefits costs.

At the *beginning* of the next Mayor's term, PICA estimates that:

“The combined cost of pensions and employee health insurance is projected to be \$840 million in FY09...pension and health benefits will devour 22 percent of the budget.”

One in every five dollars is a huge outlay, especially since it has increased from one in eight dollars at the beginning of Mayor Street's time in office. But again, there are ways to deal with these challenges, with the right mix of trustworthy leadership and honest consideration of all the options affecting all the stakeholders.² Cities such as Denver and Detroit and states such as Oregon, Colorado, and Michigan have successfully put their public pensions on a sound fiscal basis and a number of jurisdictions have successfully reigned in their health care and insurance costs.

There are a number of techniques that have been used to achieve these results. The best are implemented on an incremental and consensus basis that shares the burdens across all concerned. For example, some jurisdictions have offered voluntary defined contribution plans, under which employees gain more control over their retirement investments in return for assuming more risk. In other jurisdictions, employees have agreed to contribute more to the public pension fund in order to preserve the defined benefit plan.

But regardless of the techniques adopted, and all should be subject to consideration and debate, I promise to convene a fair and open process to decide how to save our pension and health benefits. Within my first year in office, I will establish a commission representing current and retired municipal employees, pension and budget experts from the public and private sectors, and citizen and civic organizations. This commission will be charged with identifying a reform of pensions and benefits that will ensure their long-term viability and the provision of ongoing local public services in the rest of the budget, and present that reform for City Council and Mayoral approval.

² I sponsored and got past in City Council the 1999 legislation that stabilized the pension fund in after its last crisis. That legislation provided pensioners with two lump sum bonus payments, created a Pension Adjustment Fund as a mechanism for providing future increases based on earnings, and continued safeguards to protect the integrity of the Pension Fund for future retirees.

OPENING PHILADELPHIA'S BUDGET PROCESS TO MEANINGFUL PUBLIC PARTICIPATION

City budgets are too important to be left to the politicians.

--Michael Nutter

The budget process in Philadelphia is the ultimate game of inside baseball. Today, the budget process has no meaningful public participation. The budget is prepared by the Mayor and then debated in City Council before citizens ever get to comment and by that point the opportunity to set priorities is long past. Philadelphia's budgeting process should include public participation in a formal priority-setting process at the very beginning. Other cities (e.g., Seattle, Portland OR, Toronto, Burlington VT) include meaningful public participation in the budget process—polling, focus groups, deliberative discussions with thousands of residents—as a fundamental starting point for budget discussions. In Philadelphia, public participation is largely absent and I will change this.

As Mayor, I will base my budgets on a realistic estimate of future revenues.

As *Philadelphia Forward* has long pointed out, every year the collected revenues to the General Fund exceed projections by \$50 to \$100 million. This is treated as a windfall that is then used as a discretionary spending fund for the Mayor's Office. The routinely under-estimated revenue projections are used strategically to “hide” predictable funding that appears only months after City Council approves the annual budget. Thus a practice that might otherwise be very prudent (say, if revenues that exceeded conservative projections were placed in a Rainy Day Fund instead of spent on pet projects) has instead become a way of hiding slush funds in plain sight.

As Mayor, I will use a consensus revenue forecast to improve the accuracy of tax-collection projections and end the pattern of manipulation that has gone into the past eight revenue forecasts. Estimates provided by PICA, City Council, and an independent panel of experts will contribute to that consensus. My first priority for reforming the City's budget process is this deployment of a consensus estimate for revenue projections, as a necessary starting point for other priorities.

As Mayor, I will revolutionize the budgeting process by putting the focus on outputs not inputs.

The City budget is focused on inputs (how much we will spend on the Health Department next year) instead of outcomes (how much will obesity and asthma decrease next year). The public cares about results and when obesity increases it is no excuse that we spent more on healthy eating posters. The current budget process does not tie performance to spending, and therefore we have little ability to judge what would happen to services if we increase or decrease spending on a given department or program.

Because the budget is organized by department and by large categories (Fire Department salaries, Streets Department materials), we never know how much we spend to do anything that the public actually cares about (fill a pothole, run a basketball league). Similarly, costs for support functions in the government like legal services and personnel are budgeted in the Law Department and

Personnel Department (in these two examples), and not assigned to the departmental budgets that use those services. Vehicle maintenance, debt service on construction costs, payments resulting from law suits are all budgeted centrally. Because the City does not allocate all costs to the departments whose operations are responsible for those costs, much annual city spending is not traceable to any department or program.

As Mayor, I will lead City government through the process of changing our budget process toward outcomes. Other cities have done and are doing it. The City of Dallas is a useful model, for example.³

As Mayor, I will direct all agencies of City government to pursue non-local funding opportunities to bring additional resources to City priorities.

In 2005, a joint study by the University of Pennsylvania and the Managing Director's Office investigated the number and value of federal, state, and private funding opportunities that the City could apply for but was not pursuing. The study identified nearly 400 funding leads worth over \$500 million in potential awards over several years. Funding possibilities were identified for 39 City departments and agencies. Even using the strictly reasonable criteria for what grants and other funding leads might be worth pursuing, the study identified sources worth over \$100 million in one year alone.

City government is full of employees who want to innovate and, indeed, many of these City employees recognize possible innovations before and better than anyone outside of government. As Mayor, I will unleash this entrepreneurial attitude by changing the rules that constrain the energetic pursuit of new resources by departments that want to try new things.

First, I will allow departments to retain a substantial portion of any new revenues they bring in through non-local funding opportunities, such as foundation grants and state or federal funding programs. Today, these funds simply revert to the General Fund, creating no net resource increase and no incentive to innovate or pursue funding in the first place.

Second, as Mayor, I will allocate a matching fund to support the local match often required of competitive federal grants. These funds would only be expended when used in a winning proposal to bring in new non-local revenues. The Penn study found that \$1 in match yields \$10 in potential non-local grants.

As Mayor, I will support an effort to design public participation in the budget that will work in Philadelphia.

Working with the Pennsylvania Economy League and *Philadelphia Forward*, I will encourage philanthropic funding of a public/private partnership to learn from the efforts in other cities and to design a process for our City that will build a meaningful role for citizen involvement in setting priorities and making choices.

³ I invite all interested citizens to read Dallas' latest budget document: "Budgeting for Outcomes: FY2006-2007 Annual Budget" available at http://dallascityhall.com/council_briefings/briefings0806/20060816_Outcomes.pdf

ESTIMATED COSTS AND PROPOSED FUNDING FOR THE IDEAS OFFERED IN THIS CAMPIAGN

Responsibility starts here and now.

--Michael Nutter

Hundreds of proposals have been made by the mayoral candidates, over 200 by one candidate alone. Whereas the vast majority of proposals have been presented without any estimated cost or funding proposal, I have offered both whenever possible. In the remainder of this policy paper, I provide the complete list of proposals along with what they would cost and how we could pay for them.

It is important to note that the current Five-Year Plan assumes no increase in the salaries of municipal employees for the four years beginning in 2009. This so-called 0-0-0-0 contract presents an enormous challenge to any mayoral candidate who proposes new spending. Candidates in this race are proposing plans that would cost a Billion dollars or more. Unless they identify where the money is coming from for their proposals, these candidates are promising to spend a Billion dollars before they spend a single dollar on our municipal employees. This policy paper presents my guarantee that I will not dig that hole. Every proposal is paid for; I will not hobble contract negotiations with campaign promises that have not been paid for.

Taxes

A budget consists of a revenue side as well as a spending side of the ledger. In a better world, Philadelphians would decide what they wanted to spend their money on and then raise the revenues needed to pay for that spending. The proposals I make to improve our budget process would get us closer to that better world. But until that happens, it is clearer to begin this section with a statement of my tax and other revenue proposals.

We cannot grow or even preserve our revenue base unless we cut and reform the taxes that have accelerated half a century of decline in Philadelphia. The status quo will lead to less revenue (and therefore fewer services) not the same. We have been steadily cutting taxes for a decade and in each year the revenues generated by lower rates has exceeded the preceding tax year. So local tax cuts and local tax revenues (and the services they fund) are compliments not substitutes.

When businesses consider the taxes in several competing locations, it doesn't matter to them if the place with the highest taxes used to have even higher ones. If you come in last in a foot race, no one cares how last you were. So, too, with taxes. We must get them low enough that we can be a contender in the race. That requires that we maintain our commitment to the schedule of rate reductions Mayor Rendell proposed and I sheperded through City Council, and were expanded on the recommendation of the Tax Reform Commission.

The key provisions of my proposals for tax reform can be summarized as follows:

As Mayor, I will continue my leadership in reforming the self-defeating tax structure in Philadelphia with responsible and reliable changes.

I will sustain the scheduled reductions in the Wage Tax to a rate of 3.25% for both residents and non-residents by 2015.

I will establish a certain schedule for the gradual elimination of the Gross Receipts portion of the Business Privilege Tax over a five-to-seven year period and the gradual reduction of the Net Income portion of the BPT to the current rate of the Wage Tax.

I will support a revenue-neutral move toward Full Value Assessment by the BRT for the purposes of the Real Property Tax matched by a proportional reduction in the millage rate by City Council.

I will support a fair and accurate reassessment of property in the City to current market value with the provision that safeguards be in place (as proposed in my Better Housing Now Plan) that ensure no Philadelphian is forced to sell their home because of an increase in property taxes.

I will modify the 10-year Tax Abatement to encourage development beyond Center City and help provide relief for the City's critical need for affordable housing. In neighborhoods where the market is strong enough to operate with less incentive, the period of the abatement will be reduced to five years; everywhere else in the City, the period will be increased to fifteen years. Furthermore, the value of the abatement will be reduced to 90 percent of the Property Tax owed during the period and the remaining 10 percent will be deposited by developers into a trust fund dedicated to the provision of affordable housing throughout the City.

The experience of the past five years, the expert opinion of every economist who has studied the issue, and the recommendations of the Charter-mandated Tax Reform Commission all agree that these proposals will make taxation in Philadelphia fairer and more efficient, will not lower City revenues for the provision of public services, and will stimulate growth and investment in Philadelphia.

Except for the proposals I have made in this campaign, I will not assume that we will have any increase in revenues from this tax reform plan. Instead I identify sources of revenue to pay for my new proposals. Some of these will be general sources that can be applied to any spending proposal and others are specific to proposals themselves (such as Homeland Security grants for my Emergency Preparedness proposals). But all are real.

Other candidates have proposed phantom revenue sources for their proposals. The most common example is the use of expiring 10-Year Tax Abatements to fund affordable housing or other initiatives. But this is not new revenue. *Those funds are already assumed in the current Five-Year Plan.* Anyone who says they plan to spend those funds is also saying they plan to cut something else already in the budget, such as libraries or recreation centers.

In the following sections, I list revenues available in my first year in office, annual revenues expected after my first year, and the estimated costs of proposals I have made in this campaign. These revenue sources represent the combined wisdom of years of analysis and testimony by PICA, the Controller's Office, *Philadelphia Forward*, City Council, the Tax Reform Commission, and the Pennsylvania Economy League.

As Mayor, I will identify and dedicate existing revenues during my first year in office.

- **Fund Balance Increase from Under-Estimated Revenues: \$50 Million**
Because of the continued manipulation of the City's estimated annual revenues, the fund balance increased in FY 2006 from an estimated \$201.5 Million to an actual \$254.5 Million. This amount is already reflected in the Five-Year Plan. It is likely that similar surprise revenues will appear in FY2007 as well. While the "surprise" may be even larger, I assume only that revenues will exceed the budgeted projection by \$50 million, as it has in every budget for years.
- **Productivity Bank: \$30 Million**
These are Rendell-era funds that have been under-used by the current Administration and sit idle.
- **PICA Bond Proceeds: \$30 Million**
These are proceeds from bonds issued on the City's behalf in the 1990s that have not been spent. They can only be spent on qualified capital spending.
- **Economic Stimulus Funds: \$4 Million**
These are funds used to give grants and loans to favored firms.
- **Act 71 Funds: \$15 Million**
These are funds that reimbursed the City for past spending that sit idle.

As Mayor, I will identify and pursue the following revenues through reforms that will be completed by the end of my first year in office.

- **Collected Back Taxes: \$30 Million**
The City is owed \$300 Million in back taxes. I assume that only one out of ten outstanding debts will be collected. This funding source could actually yield two or three times that amount.
- **Economic Stimulus Funds: \$4 Million annually**
These are funds used to give grants and loans to favored firms.
- **Efficiency Savings: \$72 Million annually**
One candidate for Mayor claims that the City budget contains \$400 Million dollars per year in "waste" and another that five percent (\$170 Million per year) is "waste." But guesses about some vague notion of "waste" does not pay the City's bills. I will request a complete review of all City spending and programs, and aggressively seek savings and efficiencies. For the purposes of this budget, I assume that these savings will produce revenues equal to less than two percent of the overall budget—a far smaller estimate than any other candidate. The amount is assumed to be \$47 million per year. The proposals I have made in this campaign are too important to rely solely on finding "waste." I will also assume revenue from two specific sources of savings: \$15 million from expanded citywide recycling and \$10 million from reduced energy costs. These are discussed in detail in my Sustainability Now and Tomorrow Plan.

- Acquisition of Non-Local Revenues: \$25 Million annually
This estimate assumes that only the most restricted and likely state and federal grant opportunities are pursued and that the City wins only one out of every four dollars it applies for. This is revenue could easily yield \$50 or \$100 million, but I am using a very conservative estimate.
- Set-Aside from New Property Tax Abatements: \$6 Million annually
This estimate assumes that the total value of new abatements each year will be equal to the average of the last three years. This revenue estimate, which will be dedicated to affordable housing, represents 10 percent of that new abatement.
- Sales of new Philly Gear Licensed Clothing and Products: \$1 Million annually
Modeled on Mayor Bloomberg's New York CityStore, I believe that branded hats, shirts, and other items from America's Next Great City could yield significant revenues.

As Mayor, I will present the estimated costs over five years of all new proposals, starting with the ones made in this campaign.

- 500 more police officers: \$130 Million over five years
This proposal phases the hiring of 165 police officers per year for three years and projects the total cost over of these officers over five years.
- Expand Youth Violence Reduction Project: \$25 Million over five years
This proposal doubles the current YVRP budget and would allow sufficient resources to deal with the problem of youth violence within and beyond the four police districts in which YVRP currently operates.
- Increased number of Surveillance Cameras: \$20 Million over five years
This would allow for the purchase of 1000 cameras over five years. The City of Chicago was able to recover the cost of its camera investment with a later grant from the U.S. Department of Homeland Security.
- Support for After-School Activities: \$20 Million over five years
This proposal would support programming to help reduce violence during the 3-7pm period when juvenile crime is most prevalent.
- [Emergency and Disaster Preparedness: \$100 Million over five years
These resources would support the creation of a new emergency operations command center, the completion of radio interoperability including the SEPTA tunnels, and the security of the City's ports and railyards.] This will be pay-as-we-go with federal funds.
- Increase local revenues going to School District: \$100 Million over five years
This would allow for the proposed increase of the District's share of revenues from 58 percent to 60 percent of the Real Property Tax.
- PREP Re-Entry Program: \$50 Million over five years
This level would allow the PREP program to support 1000 ex-offenders at a time over the five-year period.
- Full City Funding for Community College of Philadelphia: \$100 Million over five years
This amount would bring the City in line with the one-third share of CCP funding expected of local government.
- Increased Contribution to Arts & Culture Fund: \$15 Million over five years
This amount supports a increase in annual City contributions from about \$2 Million today to

\$7 Million by the fifth year.

- Increased Contribution to Housing Trust Fund: \$25 Million over five years
This level of support will bring the HTC to the \$15 million annual amount originally envisioned.
- Increased Funding for Office of Supportive Housing: \$20 Million over five years
Federal resources for homelessness fell from \$23 to \$16 Million this year and these funds will help offset this cut in programs for the most vulnerable.
- Establish Office of Development Coordinator: \$1 Million over five years
These funds will support the work of the coordinator designated to shepherd major development projects through the planning, design, approval, and construction phases in the best interests of the City and the project.
- Establish Zoning Code Reform Commission: \$1 Million over five years
These funds will support the work over the first year of my Administration to convene a commission to modernize the Philadelphia Zoning Code and Map.
- Establish New Office of CDC Assistance: \$2.5 Million over five years
These funds will support the provision of technical assistance and guidance to the City's CDCs as they develop affordable housing and sustainable neighborhoods.
- Establish Office of Business Services: \$15 Million over five years
This will allow the new office to provide technical assistance for new and expanding small business and to remove obstacles they face in City government.
- Establish Office of College and University Relations: \$2.5 Million over five years
This will support the retention and attraction of students graduating from local colleges and universities, and market the City as a destination for young entrepreneurs.
- Establish Budget Process Reform Commission: \$1 Million over five years
This will support the work during the year of my Administration of a new commission charged with designing a budget process with greater public participation and thereafter support that participation.
- Establish Department of Transportation: \$5 Million over five years
This level of funding will support the Department's efforts to coordinate policy across City agencies, seek significant increases in state and federal funding for City transportation needs, and identify recommendations to reform parking, signage, and pedestrian/bicycle usage throughout the City.
- Establish Office of Sustainability Coordinator: \$5 Million over five years
This funding will support the staffing of the Sustainability Cabinet, the energy audit and LEED certification of existing City buildings, and the development of a sustainable Philadelphia Building Code.
- Increase City Funding for Fairmount Park: \$30 Million over five years
This level will gradually increase the level of City funding for the Park system from \$13 Million to \$23 Million. Additional park user fees and contributions from private and other sources will increase the annual funding to the estimated need of \$30 Million.
- Plant 23,000 Trees: \$8 Million over five years
This level will replace the number of shade trees lost since 2001.
- Clean and Green Vacant Lots: \$15 Million over five years
This level of funding will continue the City's contribution to Philadelphia Green beyond the

life of NTI funding.

As Mayor, I will involve the public in a meaningful budget process that allows for discussion of the costs and benefits of City government, beginning with my campaign proposals.

This analysis has identified \$129 Million in revenues available during my first year in office and a total of \$591 Million in new revenues available over five years. The combined cost of the proposals that I have made in this campaign is \$591 Million over five years. (This does not include the costs of needed investments in emergency preparedness, which require additional state and federal resources and will be implanted as the needed funds are secured from those sources.)

These are conservative estimates (that is, low on new funding sources and high on estimated costs) and as part of my commitment to a transparent and responsible budget process, any savings that derive from higher revenues or lower costs will be deposited in the City's Rainy Day Fund.

This policy paper illustrates my promise to lead Philadelphia with a new spirit of progressive reform and open-decision-making. I invite all Philadelphians to join me in the demanding but rewarding process of self-government.