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John J. McNesby, President

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January 25th, 2010

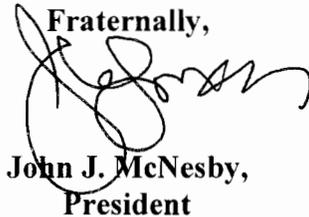
Dear Director:

I have enclosed a copy of a five page letter from Councilman Bill Green to Council President Anna Verna regarding our recent Act 111 Interest Arbitration.

Please read and pass along to the Officers of your Districts and Units, so that we may all be on the same page as to who our friends are.

I guess the saying "The apple doesn't fall far from the tree" fits with this guy.

Fraternally,



John J. McNesby,
President

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January 20, 2010

The Honorable Anna C. Verna
President of City Council
City Hall Room 490
Philadelphia, PA 19107

Dear Council President Verna:

I write today regarding the momentous decision by the Nutter administration not to appeal the recent police arbitration award. First, let me say that we will never pay police officers what they are worth to this City – that amount can't be found in the best of times. Nevertheless, the failure to appeal the award was irresponsible.

However much the terms "reform," "unprecedented," and "historic" are thrown about in relation to the award, the reality is unchanged: the award did not fundamentally change benefits and, thus, does not constitute the long-overdue and necessary structural change to the legacy benefits costs that are undermining the city's fiscal future and will consume almost 25% of our budget in a few short years.

Furthermore, and more importantly for present purposes, the award creates a short-term fiscal disaster for the City, which was already facing yet another deficit for Fiscal Year 2011.¹ The City simply cannot afford the wage increases included in the award, a fact noted by the City's representative on the panel in his dissent to the award. Under the Pennsylvania Intergovernmental Cooperation Authority ("PICA") Act, which sets unique requirements for Philadelphia arbitrations – requirements the panel failed to meet and are discussed below – the City had strong grounds to appeal the award to court.

But rather than being straight with citizens – in other words, explaining that the panel failed to follow the law and we got killed in the arbitration – the Administration immediately launched into positive spin mode. Having committed prematurely to the "we won!" narrative, I suppose it would have been too heavy a lift to reverse course and appeal, despite the clear basis and fiscal imperative for doing so.

¹ The analysis below assumes that the Administration has been candid with City Council about the state of the City's finances. I have already raised with Administration officials some concerns about inconsistencies or inaccuracies in the most recent Quarterly City Manager's Report. If the Administration has cash reserves, or other heretofore unidentified surpluses, I expect that it would bring this updated information to the attention of Council and PICA immediately.

In a one party town, City Council often is all that stands between administration spin and the actual facts. As we prepare to begin hearings on the FY11 operating budget and FY11-15 Five-Year Plan, it is important for us to be clear about where the Administration's lack of leadership on the award has left us. The details of the award, and the consequences for the City's finances of the Mayor's decision not to appeal, are sobering:

Size and Impact of Wage Increases

The \$114 million price tag placed by the Administration on the 7% effective wage increases included in the award is optimistic indeed. The award provided for a "wage reopener" in years four and five of the contract. The true cost of the wage increases and current projected budget deficit over the next Five-Year Plan likely will exceed \$175 million, especially in light of inflationary trends that may drive cost of living increases alone past 3% (about \$16 million per year not including overtime) in years four and five.

In crowing about the contract having "the longest term in memory and probably ever," the Mayor did not mention the fact that we simply do not know what the dollar cost of the wage increases will be over the life of the contract. Without knowing our long-term costs, we don't get the benefit of long-term planning. How this "provides city taxpayers long-term stability," as the Mayor claimed, is a mystery to me, as we only have wage certainty for three of the five years of the contract.

In any event, the City's failure to appeal means the firefighters are likely to receive a similar award, putting us another \$35 to \$40 million in the red over the next five years. If D.C. 33 and 47 reach similar deals with the Administration, we may be facing a \$350 million hole in the FY11-15 Five-Year Plan.

To put this cost in context, we should remember the infamous "Plan C." To close a potential \$700 million deficit, the Mayor proposed defunding the courts for four years, zero-funding the District Attorney's Office and Defender's Association for one year, eliminating 1,000 police and 200 fire positions, closing two City health centers, reducing trash collection to twice a month, and eliminating entire City departments, including Parks & Recreation, Planning, Commerce, and the Free Library.

To close the \$175 million deficit created by the wage increases in the police arbitration award and current deficits, the City would need to implement 25% of the cuts in "Plan C." If the police arbitration award is extrapolated to the other unions, we will be looking at fully 50% of those cuts.

No Structural Reform to Healthcare

The award made no significant, structural changes to union members' current healthcare plan. Although officers will now have minor co-pays (\$5 for generic drugs and \$15 for doctor's visits), they will continue to participate in the same Preferred Provider Organization ("PPO"), continue to have \$0 payroll deductions for healthcare benefits, and continue to have no co-pays for emergency room visits.

Although the much touted shift to a self-insurance plan may generate modest savings of \$5-10 million per year in the first few years, it likely will flip over to a loss thereafter, as is typically the case with self-insurance plans. The Administration's estimate of \$32.9 million in savings over the next five years due to the healthcare provisions in the award assumes 0%

healthcare cost inflation over that period. This, too, is an unrealistically rosy projection – healthcare costs rose 144% from 2000 to 2008.

More importantly, the award did not address the perverse incentive existing when the cost of healthcare utilization decisions is not made explicit and shared by employer and employee. The self-insurance plan will neither create an incentive for employees to think differently about utilization, nor provide a check to make sure that the police-run health benefits plan denies frivolous claims (except via after-the-fact auditing). Without this fundamental change, costs will just go up year after year off of the new base.

Decreasing healthcare costs from highway robbery to the actual cost of claims without making changes in benefits – as the arbitration award has done – is not structural reform, no matter how much you dress it up.

No Structural Reform to Pensions

As with healthcare, the award did not create fundamental, structural reform to the pension plan, such as by slowing vesting percentages, delaying retirement ages, or requiring all employees to contribute more to their pensions.

Instead, new and existing employees have the same exact pension benefits and new hires will be required to contribute just 1% more of their wages (i.e., one-third of their raises, which still leaves them 2% ahead of this year's rookies) to get the same deal. Although the award allowed the City to create a new defined-benefit/defined-contribution hybrid plan, employees are not required to join it and the head of the police union is on record saying he will discourage all new members from doing so. Requiring employees to join the new hybrid plan, plus different benefits, would have been actual reform.

At best, the increased employee contribution level will save the city \$6 million over the Five-Year Plan, compared to the wage increases of at least \$135 million for police. Present-value calculations establish that any long-term pension-related savings from the police award are entirely outweighed by the wage increases.² If the three other unions get the same or similar terms, the total pension-related savings are potentially \$30 million over the Five-Year Plan, compared to \$350 million in wage increase costs over that same time frame. If this is reform, I don't want it.

Basis for Appeal under PICA Act

The City had a clear basis for appealing the award under the PICA Act. The Act required the arbitration panel to “take into consideration and accord substantial weight to” the City's approved Five-Year Plan (which had \$0 in wage increases and \$25 million per year in benefits-related savings) and its ability to pay any ordered “increase in wages . . . without adversely affecting levels of service.” Furthermore, the Act required the panel to “state with specificity in writing all factors [it] took into account in considering and giving substantial weight to . . . [the

² At 6% interest, the present value of \$190 million in thirty years (i.e., the Administration's estimate of savings from pension plan changes in the police contract over the next 30 years) is \$33 million, whereas the present value of \$810 million in thirty years (i.e., the carry-forward cost of the \$135M wage increase for the next six Five-Year Plans) is \$141 million. This calculation does not attempt to add up inflation-adjusted dollars thirty years from now and bring those back to present value – a comparison that would be far worse for the City's finances.

City's] financial ability to pay the cost of such increase." Finally, the Act provided that an award "shall be vacated" if the panel failed to satisfy this requirement.

The Administration witnesses at the arbitration hearings gave compelling and thorough testimony about the devastating impact wage increases would have on the provision of services and I credit the City's team for the information they put together for the arbitrators. I note, however, that the City should have asked a representative from PICA to testify as well – because PICA was not a party to the arbitration, it likely would have proved more credible to the neutral arbitrator than Administration representatives whose mandate was to keep the award low.

Regardless, despite the testimony from Administration witnesses, the seventy-seven paragraphs of factual findings in the award did not contain a single mention of the City's ability to pay the ordered wage increases without adversely affecting levels of service. Accordingly, the award did not comply with the PICA Act. The panel violated the PICA Act, and did the City a grave disservice, by ordering an award the City simply could not afford.

The Mayor, however, compounded that harm by not exercising his right to appeal. In a letter to PICA yesterday, the Mayor contended that by appealing the City might receive a revised decision with "changes . . . that could be damaging in the long run, both fiscally and operationally."

This seems, to me, to miss the point. The City already has received a decision that is damaging in the short- and long-term. If the award had forced fundamental reform of the City's broken benefits system, perhaps citizens would have an easier time stomaching the \$175 million hole (before other awards) it has driven in the City's Five-Year Plan. As it stands, however, they are stuck with a hefty bill for precious little in return.

A bright spot in the police award is the City's new ability to furlough employees for up to thirty (30) days per year. As has been acknowledged, however, it is unlikely that police officers will be furloughed, given public safety concerns. The cost of achieving this term in the police award – perhaps in the hope that D.C. 33 and 47 would agree to it in their contracts, where it actually could yield significant budgetary savings – likely was steep. Looking at what we may have given up in order to get it – holding the line on raises, or maintaining the residency requirement, perhaps – I suspect the price was way too high.

Repeatedly – in his inaugural address, in his two budget addresses, in the *Inquirer* several weeks ago – Mayor Nutter has claimed he can make the tough decisions. Declaring victory instead of appealing an award the City clearly cannot afford and would be vacated in court is a decision. Unfortunately, it is neither the tough decision nor the right one.

After the required reversal of the initial award, the details of a revised award are not certain. But it is certain that by not appealing the Mayor did not do his best to avoid the pain that will result. It is up to us now to help craft a budget with fewer resources than we otherwise would have and that will cause the least pain to the least among us.

Now that an appeal is off the table, in my view the only responsible course of action is for the Mayor to begin cutting costs immediately. If he fails to do so – just as happened last year, when we witnessed nine months of Administration handwringing after the fiscal crisis became clear – the required cuts will be broader and deeper than otherwise necessary. This time around, we can't put our heads in the sand. We can generate five full months of savings before the end of FY10 and build up cash to soften the budget blow next year. PICA has already stated that it

will not allow the City to assume 0% wage increase in years four and five of the police contract and, I expect, will require a Five-Year Plan that assumes 3% increases in each of those years.

It is my hope the Administration will begin discussion of its short- and long-term plans with us immediately. Although I disagree with the decision not to appeal, it is now our responsibility to do what we can to help the city and the Mayor succeed. It will not be easy.

Sincerely yours,



Bill Green
Councilman-At-Large

Cc: All members of City Council
PICA board members
Mayor Michael A. Nutter
Uri Monson, PICA Executive Director
Clarence D. Armbrister, Chief of Staff
Rob Dubow, Finance Director
Stephen Agostini, Budget Director