

Q4 2022 Cash Flow Update

This report discusses the City of Chester's financial performance through December 2022 from a cash flow perspective.

The City needs enough cash to provide vital and necessary services to Chester residents throughout the year. According to Pennsylvania law, vital and necessary services include activities such as police patrol, fire suppression, public works functions, and payroll and pension obligations. The General Fund covers most expenditures, and there are also separate funds to support the Delaware County Community College; for roads and streetlights (i.e. Liquid Fuels Fund); and for future debt payments.

City Finance has provided the numbers presented in this report. The information presented here uses the cash basis of accounting. Other reports, like the year-end audits, use a modified accrual basis of accounting, so they will have different results.

We also closely monitor the amount of cash and assets that can be converted to cash in the City's Police Pension Plan (PPP) because it is severely underfunded and at risk to miss benefit monthly benefit payments to retired officers and their dependents.

General and Debt Service Funds

To sustain operations, City government needs enough cash to make payroll every other week and pay its vendors. The City receives tax, fee, gaming, and other revenues and then spends that money throughout the year.

The City started 2022 with \$4.4 million in the General Fund that could be used for 2022 expenditures¹. The City normally does a cash flow borrowing through a private bank in early January to help cover its operating costs for the first few months of the year until tax revenues arrive. For 2022, instead of a private bank loan, the City received a \$5.0 million zero-interest emergency loan from the Commonwealth of Pennsylvania. The proceeds from that \$5.0 million loan arrived in December 2021, so the City entered 2022 with more cash than usual².

The City also has money in other funds that can only be used for designated purposes. For example, the City entered 2022 with \$1.3 million in separate accounts related to future debt payments. Revenues are diverted to these accounts during the year so there is enough set aside to pay the Series 2017 A and B debt and the Series 2010 debt.

At the beginning of the year, we projected that cash would peak in May 2022; stay close to that level through August; and then drop quickly in the final trimester when the City repaid the \$5 million cash flow loan and made the final contributions to the three pension plans.

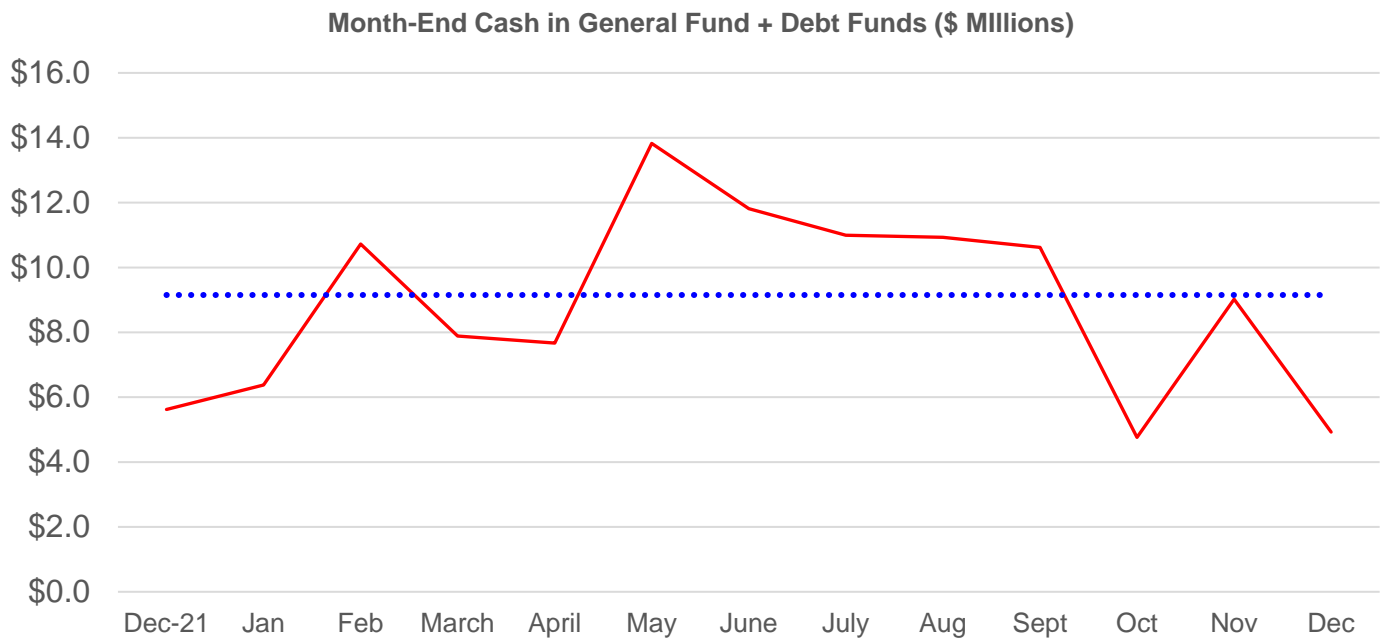
That pattern generally held throughout the year. Between the General Fund and the debt accounts, total cash peaked at \$13.8 million in May. It dropped to \$11.8 million in June after the City made contributions to all three pension plans. The City transferred \$3.0 million to the General Fund under the American Rescue Plan Act's revenue replacement provision in September, and then the rapid decline in cash levels began in October when the City repaid the balance on the \$5 million 2022 emergency loan. Cash levels rose in November, which has

¹ The General Fund had \$5.8 million in it on December 31, 2021, but that included \$1.5 million in outstanding checks that had not been cashed by vendors.

² The City repaid the \$5 million in October 2022 and received another \$5 million for 2023 in early January 2023.

the last large quarterly installments of earned income tax and casino revenues, and then dropped in December when the City made its final contributions to the three pension plans.

The blue line in the graph below shows the amount of cash the City would need to cover two months' worth of expenditures, which is a reasonable starting point for setting a cash balance target. The City finished the year far short of that \$9.1 million target.



The prior graph shows the City finishing 2022 with \$4.9 million between the General Fund and the debt funds, but that significantly overstates the City's cash position. The debt-related lockboxes held most of the cash, so it was not available to the City to fund operations entering 2023³. The General Fund itself had \$2.6 million in cash on December 31, 2022 but that included:

- \$734,000 in unpaid payroll taxes for November and December 2022. The City cannot use that money for operations and will pay those taxes to the appropriate levels of government in Q1 2023
- \$658,000 in outstanding checks that were issued but not cashed before December 31, 2022
- \$256,000 in distressed pension EIT that the City received in its General Fund in December 2022 and deposited in the Police Pension Plan in January 2023. By law, this money cannot be spent on operations.

Once these three items are removed, the City's actual amount of cash available to spend on operations entering January 2023 was just \$966,000, or six days of operating expenses. The City received another \$5 million emergency loan from the Commonwealth in early January 2023 to fund operations until tax revenues arrive in the Spring. The City will repay that loan during the second half of 2023, just as it did in 2022.

Revenue performance through Q4 2022

The City receives about two thirds of its General Fund revenue from three sources: earned income taxes (EIT); gaming revenues; and the real estate tax.

³ In February 2023, federal bankruptcy court issued a consent order that released a portion of this accumulated cash to the City's General Fund. The Consent Order's impact on the City's cash position will be covered in the Q1 2023 report.

- **EIT revenues** were very strong during 2022. The City received \$21.0 million in EIT revenue split between residents (\$12.4 million) and commuters (\$7.9 million)⁴. The year-end total was \$4.1 million (or 24.5 percent) more than projected at the start of the year.

The \$21.0 million total included \$8.2 million in distressed pension EIT revenue that must be routed to one of the three pension plans⁵. Since the distressed pension tax generated \$1.3 million more than projected at the start of the year, the City deposited that additional amount in the Police Pension Plan.

- **Gaming revenues** from activity at Harrah's Casino finished the year lower than projected after a weak fourth quarter. Revenues from slots activity ended the year \$211,000 (or 7.2 percent) lower than projected and revenues from table games were \$175,000 (or 18.3 percent) lower than projected. Between these revenues and the quarterly host fees, the City received \$11.2 million in gaming revenues in 2022. The City used a portion of that to support the Delaware County Community College.
- The City collected \$8.0 million in **current year real estate tax revenues**, which was \$192,000 (or 2.3 percent) less than projected. Prior year (or delinquent) real estate tax revenues finished \$329,000 (or 17.7 percent) lower than projected.

Expenditure performance through Q4 2022

- The City spent \$18.5 million on employee **salaries, wages, and other forms of cash compensation**, which was \$178,000 (or 1.0 percent) less than projected. Compared to 2021, the City spent \$0.9 million (or 4.9 percent) more in 2022. The biggest difference was overtime where the City spent \$428,000 (or 32.8 percent) more than in 2021.
- The City spent \$10.7 million on current and retired **employee medical and prescription drug insurance** in 2022. That was \$1.7 million (or 18.9 percent) more than reported in 2021 but only \$305,000 (or 2.9 percent) higher than projected at the beginning of 2022. The City is self-insured so its monthly expenditures vary depending on the volume and cost of medical care received. During 2022, the City spent \$894,000 per month on these items, with monthly expenditures ranging from \$516,000 to \$1.3 million.
- The City budgeted \$4.2 million for **contracted services** with the largest items being refuse collection (\$1.4 million); landfill costs (\$1.2 million) and legal fees (\$648,000). Last year, the City reported \$5.0 million in spending on contracted services. The largest differences were refuse collection (+\$561,000)⁶ and finance department support (+\$491,000) where the City contracted with an outside firm after the 2022 budget was established. These variances were offset by lower-than-projected spending on landfill costs (-\$351,000) and auditing (-\$198,000).

Pension contributions

The City has three employee pension plans – one for police, one for firefighters and one for all other employees (officers and employees or “O&E” plan). Each year, the City must make a Minimum Municipal Obligation (MMO) payment to each plan. The total combined MMO for 2022 was \$10.6 million with \$7.7 million going to the police plan, \$1.7 million to the fire plan, and \$1.2 million to the O&E plan⁷. The 2022 contributions were not applied

⁴ In addition to the current year resident and commuter EIT, there was prior year revenue for which the tax collector does not differentiate between residents and commuters.

⁵ Currently all distressed pension EIT revenues are deposited in the Police Pension Plan.

⁶ The City spent more than projected on refuse collection but less than projected on landfill costs because it contracted with an outside company for residential bulk trash collection. The company receives a higher payment to collect bulk trash but covers some of the landfill costs there were previously charged to the City when its staff collected bulk trash.

⁷ The \$10.6 million MMO is based on an actuarial quirk that treats the City's delinquent contributions as an asset, even though that money is not actually in the pension plans. If those items are removed to reflect the actual funding level, the MMO would have been \$2 million higher.

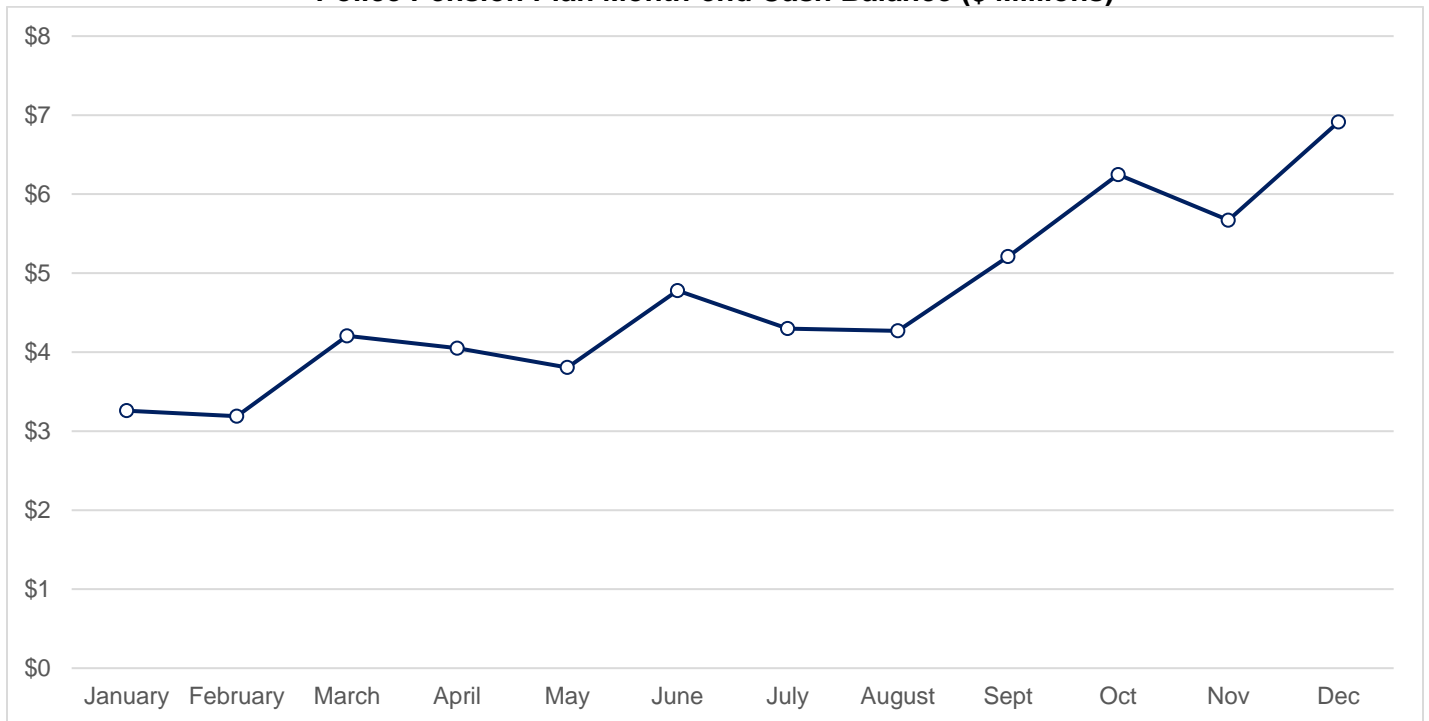
to the 2022 MMOs, but instead went toward amounts due in prior years, including accumulated interest penalties.

It is very rare for a municipal pension plan to have such a low level of cash that there is risk the plan could fail to make monthly payments. Most pension plans have assets invested in interest-earning securities that can be converted to cash when needed to cover plan expenses and then the plans gain interest earnings throughout the year.

Chester's Police Pension Plan (PPP) has such a small amount of cash left that interest earnings are close to zero. The PPP is effectively in "pay-as-you-go" status, meaning the City must continually put money into it to cover monthly benefit payments throughout the year.

Excluding money set aside in Deferred Retirement Option Plan (or DROP) accounts, the PPP began the year with \$3.5 million, or only enough to make seven months of pension payments. During Q4 2022, the City contributed \$3.3 million to the Police Pension Plan from Commonwealth pension aid (\$1.3 million) and distressed pension EIT (\$2.0 million). The PPP finished December 2022 with \$6.9 million, or 13 months of benefits. The following graph shows the month-end balances in the PPP during 2022.

Police Pension Plan Month-end Cash Balance (\$ Millions)



The City also contributed \$1.2 million to the O&E pension plan and \$1.7 million to the firefighters pension plan during 2022.