Narrative Accompaniment to Archdiocesan Office for Financial Services Audited Financial Statements for Fiscal Year Ended June 30, 2015

This narrative is intended to be used in connection with a review of the Archdiocese of Philadelphia – Office for Financial Services ("OFS") financial statements in order to provide a more general understanding of the financial situation of OFS.

OFS provides programs and administrative support to the parishes, schools and other related ecclesiastical entities of the Archdiocese. While OFS provides services to multiple entities, for financial reporting purposes, it is considered a wholly-owned subsidiary of the Archdiocese.

A description of the offices and funds that are included in the OFS financial statements can be found in Note A in the audited financial statements for OFS which are available on CatholicPhilly.com.

Please note that the OFS financial statements do not include financial results for the Office for Catholic Education, Catholic Healthcare Services, Catholic Social Services, Saint Charles Borromeo Seminary, Catholic Charities Appeal, Heritage of Faith-Vision of Hope Capital Campaign, or the World Meeting of Families-Philadelphia 2015. Audited financial statements for those entities will be posted separately.

Also note that none of these reports will include financial statements for parishes. All parishes are independent and autonomous entities.

Comparison of FY 2015 to FY 2014

The analysis presented below compares the "Change in Net Assets Before Other Items" for fiscal years ("FY") 2015 and 2014. The "as reported" surplus of $13.3 million in FY 2015 compares to an "as reported" deficit of $ .7 million in FY 2014. These amounts can be found in the Statement of Activities and Changes in Net Assets under the caption "Change in Net Assets Before Other Items" in the "Unrestricted" column. We believe that the analysis presented below provides a meaningful comparison of results after adjusting for the impact of items that are non-recurring in nature. ***Note to readers: Please note that the FY 2014 analysis presented below is slightly different than what was presented in connection with our FY 2014 financial disclosures. The different presentation allows for better comparability to FY 2015's results. Please see the appendix at page 8 of this narrative for a fuller explanation.***

(in millions)	FY 2015	FY 2014
Change in Net Assets Before Other Items	$ 13.3	$ (.7)
Non-Recurring Items		
A Net gain on sale of real estate assets	(.9)	(1.2)
B Net assets released from restrictions	–	(2.3)
C Risk Insurance and Welfare Benefits Trust experience	(13.5)	(.8)
Investment Losses/(Gains)	.3	(.5)
D Adjustments in Deposit and Loan Reserves	(1.9)	.4
E Legal and Professional Fees	.4	1.2
Recurring Deficit including Depreciation Expense	(2.3)	(3.9)
Depreciation expense	1.6	1.6
Recurring Deficit excluding Depreciation Expense	$ (.7)	$ (2.3)

The explanations for the items noted A through E are included at page 7 of this narrative.

The "Recurring Deficit excluding Depreciation Expense" caption above represents what we refer to as our "core" (excludes items of a non-recurring nature and depreciation) run rate deficit.

Discussion of Other Significant Matters

In connection with our recent financial disclosures we have provided specific commentary regarding certain balance sheet obligations. As of June 30, 2014 all of these balance sheet obligations were underfunded.

These obligations are:

- Deposit and Loan Program Trust
- Risk Insurance Trust
- Lay Employees' Retirement Plan
- Priests' retirement plans

Please find an update as of June 30, 2015 for each of these obligations below.

Deposit and Loan Program

Included in the financial statements for the Office for Financial Services are all assets and liabilities of the Archdiocese of Philadelphia Deposit and Loan Program Trust Fund ("Deposit and Loan Program Trust" or "D&L"). The Deposit and Loan Program Trust is a separate legal entity that provides a deposit and loan program for the benefit of parishes to assure continuation of the ecclesial goals of the Archdiocese and the parishes. If a parish deposits funds in the Deposit and Loan Program Trust, it receives a competitive interest rate. In turn, these funds are loaned to other parishes for construction and other projects.

During FY 2012, the Archdiocese executed a promissory note to the Deposit and Loan Program Trust in the amount of $82 million, which represented the excess of deposits over assets as of June 30, 2012. The promissory note is collateralized by specific pledged real estate assets which are documented in the note. As pledged properties are sold or monetized, net proceeds from these collateral transactions will be deposited into the Deposit and Loan Program Trust, in accordance with the provisions of the promissory note. In the event a transaction generates in excess of $20 million in net proceeds, the Archdiocese has discretion regarding alternative uses for the excess so long as remaining pledged assets are at least equal to the then outstanding principal amount owed.

As of June 30, 2015 the underfunded obligation (i.e. the excess of deposits over assets) in the Deposit and Loan Program Trust was as follows:

	(in millions)
D&L Deposits	$ 151.0 *
D&L Assets (*excludes promissory note*)	108.4
Excess of Deposits Over Assets	$ 42.6

* includes approximately $158K in Deposit and Loan Program Trust Liabilities.

As of June 30, 2015 the balance outstanding on the promissory note was $44,950,000, which is greater than the underfunded obligation noted above. The following pledged properties are all under agreement of sale and, presently, we expect that each of these transactions should close in the timeframes noted below:

- Sproul Road property in Marple Township (Delaware County) –
  anticipated close before June 30, 2016
- Mary Immaculate Center property (Northampton County) –
  closed October 30, 2015
- Hilltown property (Montgomery County) –
  anticipated close before June 30, 2016
- Manor Road property (Chester County) –
  anticipated close before December 31, 2017

We expect to receive aggregate net proceeds in the $35-40 million range (in the timeframe noted) for the transactions listed above — thus resolving most of the remaining underfunded obligation in the Deposit and Loan Program Trust.

Risk Insurance Trust

The Risk Insurance Trust administers the risk management program of the Archdiocese. As part of the risk management program, levels of self-insurance risk are retained. As of June 30, 2015 insurance related assets exceeded insurance related liabilities, as follows:

	(in millions)
Insurance Related Assets	$ 52.9
Insurance Related Liabilities	42.0
Excess of assets over liabilities	$ 10.9

The Risk Insurance Trust is no longer an underfunded obligation.

Lay Employees' Retirement Plan

The Lay Employees' Retirement Plan (LERP) is considered a multiemployer plan for financial reporting purposes. As such, the assets and actuarially determined liabilities for this plan are not included in the OFS financial statements. The Archdiocese froze this defined benefit pension plan effective June 30, 2014.

While not a direct liability of OFS the amount by which the plan liability exceeds plan assets is a liability of the Archdiocese. The actuarially determined liability for this plan as of June 30, 2015 was not available as of the issue date of the OFS financial statements. A preliminary estimate of that liability is $639 million. It should be noted that our actuary will be using the updated mortality tables recently published by the Society of Actuaries to determine the liability. These tables reflect the most up-to-date estimates of life expectancy developed for the purpose of determining pension plan liabilities. The preliminary estimate also assumes the use of these new mortality tables.

When the estimated liability is compared to plan assets available for benefits as of June 30, 2015 (approximately $477 million), the plan's shortfall is approximately $162 million.

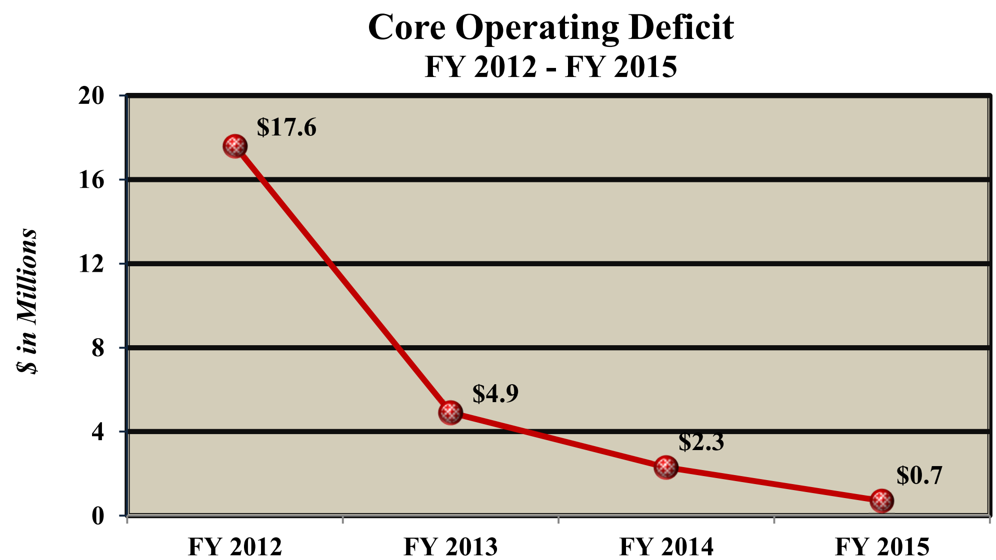
Priests' Retirement Plans

The Priests' retirement plans are also considered multiemployer plans for financial reporting purposes. As such, the assets and actuarially determined liabilities for these plans are not included in the OFS financial statements.

While not a direct liability of OFS, the amount by which the plans' liabilities exceeds assets is a liability of the Archdiocese. As of June 30, 2015 it is estimated that the Priests' retirement plans' liabilities (estimated at $107 million) exceeded assets (approximately $82 million) by approximately $25 million. It should be noted that our actuary will also be using the updated mortality tables to determine this liability and the preliminary estimate was prepared using those tables as well.

Looking Forward

The core operating deficit has improved each year since FY 2012's deficit of $17.6 million. We continue to acknowledge that the core deficit needs to be eliminated completely in the very near future and we will continue to take steps to achieve at least a break-even result.



We have also made significant progress against our underfunded balance sheet obligations.

	Underfunded Balance at	
	June 30, 2012	June 30, 2015
Deposit and Loan Program	$ 82.0	$ 42.6
Risk Insurance	30.4	–
Lay Employees' Retirement Plan	152.0	162.0
Priests' retirement plans	90.0	25.0
	$ 354.4	$ 229.6

As noted earlier, we expect that most of the remaining underfunded obligation for the Deposit and Loan Program will be resolved by December 31, 2017 once the transactions for properties under agreement of sale are closed and the expected proceeds of $35-40 million are applied.

Going forward our remaining issues will be the underfunded pension obligations. The new mortality tables have impacted our pension liabilities but so too have investment returns and other factors. We expect that we will need to increase our funding rates, particularly for the LERP. We will also need to consider allocating proceeds from future real estate transactions to these obligations.

Explanations for items noted in analysis on page 2

A The amounts represent the net gains resulting from the sales of several Archdiocesan properties.

B The gain on the sale of the property known as "Villa St. Joseph by the Sea" in Ventnor, New Jersey was approximately $4.2 million. This amount was accounted for as a "Temporarily Restricted" gain and was reflected as such on the Statement of Activities and Changes in Net Assets for the year ended June 30, 2013. The proceeds from the sale were used for the benefit of Villa St. Joseph in Darby, Pennsylvania, a residence for retired Archdiocesan priests. Approximately $2.7 million of the gain was used for that purpose in FY 2013 and the balance was used in FY 2014. FY 2014 was also benefitted by approximately $ .7 million used to fund a commitment to the Independence Mission Schools.

C The experience of the Risk Insurance and Welfare Benefits Trusts should be considered separately and treated as non-recurring.

D We provide an "allowance for doubtful accounts" for outstanding loans that we do not expect to fully collect from parishes. This allowance, or "reserve," is analyzed each year. In FY 2015 we determined that, because of positive collection experience, we could reduce this reserve by approximately $1.9 million. While this adjustment positively impacted our reported FY 2015 results, it is not an item – particularly when so significant – that we consider to be recurring.

E Non-recurring legal and professional fees is comprised of the following:

(in millions)	FY 2015	FY 2014
Financial and legal costs incurred in connection with transactions	$ .4	$ .9
Fees incurred for supplemental finance office staffing	–	.3
	$ .4	$ 1.2

Appendix

(in millions) *changes are highlighted in yellow*	FY 2014 as originally disclosed	FY 2014 as currently disclosed
Change in Net Assets Before Other Items	$ (.7)	$ (.7)
Non-Recurring Items		
Net gain on sale of real estate assets	(1.2)	(1.2)
Net assets released from restrictions	(2.3)	(2.3)
A **Risk Insurance and** Welfare Benefits Trust experience	(1.2)	**(.8)**
Investment Losses/(Gains)	(.5)	(.5)
B **Adjustments in Deposit and Loan Reserves**	–	**.4**
Legal and Professional Fees	1.2	1.2
Recurring Deficit including Depreciation Expense	(4.7)	(3.9)
Depreciation expense	1.6	1.6
Recurring Deficit excluding Depreciation Expense	$ (3.1)	$ (2.3)

A In the original presentation for FY 2014 only the experience in the Welfare Benefits Trust was treated as a non-recurring item. In FY 2015 the impact of the experience in both the Risk Insurance and Welfare Benefits Trust was much more significant. We believe it is more appropriate to consider the experience of both trusts as non-recurring.

B In FY 2014, the reserve for loans adjustment in the Deposit and Loan Program was a "charge" (i.e. an increase to the reserve) of $.4 million. Given the significance of FY 2015's adjustment (i.e. a reduction of the reserve of $1.9 million) we consider it to be non-recurring. We believe that adjusting the original FY 2014 presentation to include the loan reserve adjustment results in better comparability and a better analysis of our results.