# Narrative Accompaniment to Archdiocesan Office for Financial Services Audited Financial Statements for Fiscal Year Ended June 30, 2014

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 reader 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 or the Heritage of Faith-Vision of Hope Capital Campaign. Audited financial statements for those entities will be posted in the coming weeks.*

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

***Comparison of FY 2014 to FY 2013***

The analysis presented below compares the "Change in Net Assets Before Other Items" for fiscal years 2014 and 2013. The "as reported" deficit of $ .7 million in FY 2014 compares to an "as reported" surplus of $3.9 million in FY 2013. These amounts can be found in the Statements 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 each fiscal year after adjusting for the impact of items that are non-recurring in nature.

| **(in millions)** | FY 2014 | FY 2013 |
|---|---|---|
| Change in Net Assets Before Other Items | ($ .7) | $ 3.9 |
| Non-Recurring Credits | | |
| A Net gain on sale of real estate assets | (1.2) | (10.3) |
| B Net assets released from restrictions | (2.3) | (2.7) |
| C Contribution from Cemeteries Office | – | (2.0) |
| Favorable Welfare Benefits Trust experience | (1.2) | – |
| Fidelity Insurance recovery | – | (.7) |
| Investment Gains | (.5) | (.5) |
| Non-Recurring Charges | | |
| D One Time Pledges/Subsidies | – | 2.9 |
| E Legal and Professional Fees | 1.2 | 1.1 |
| Recurring deficit including depreciation expense | (4.7) | $ (6.4) |
| Depreciation expense | 1.6 | 1.5 |
| Recurring Deficit excluding Depreciation Expense | ($ 3.1) | $ (4.9) |

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

The "Recurring Deficit excluding Depreciation Expense" caption above represents what we have previously referred to as our "core" (excludes items of a non-recurring nature and depreciation) run rate deficit. We took significant steps beginning in June 2012 aimed at reducing the core deficit. The actions implemented did have the effect of reducing the deficit to a level in line with our previously disclosed expectations. We continue to experience a core operating deficit and have budgeted an expected deficit for FY 2015 of less than $5 million.

***Discussion of Other Significant Matters***

In connection with our recent financial disclosures we have provided specific commentary regarding several significant underfunded balance sheet obligations.

Those obligations included the following:

- Trust and Loan Fund
- Insurance Fund
- Lay Employees' Retirement Plan
- Priests' Pension Plan

Please find a more current update for each of these matters below.

**Trust and Loan Fund**

Included in the financial statements for the Office for Financial Services are all assets and liabilities of the Archdiocesan Trust and Loan Fund. The Trust and Loan Fund is a cooperative deposit and loan program established for the benefit of parishes and to assure continuation of the ecclesial goals of the Archdiocese and the parishes. If a parish deposits funds in the Trust and Loan Fund, it receives a competitive interest rate. In turn, these funds are loaned by the Fund to other parishes for construction and other projects. During FY 2012, the Archdiocese executed a promissory note to the Trust and Loan Fund 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 Trust and Loan collateral transactions will be deposited into the Trust and Loan Fund, 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. The Archdiocese closed the cemeteries transaction with StoneMor in May 2014 and $30 million of the net proceeds from that transaction was used to make a payment on the promissory note.

As of June 30, 2014 the unfunded obligation in the Trust and Loan Fund was as follows:

| | **(in millions)** |
|---|---|
| Deposits | $ 131.3 * |
| T&L Fund Assets (*excl. promissory note and related party receivable*) | 80.0 |
| Excess of Deposits Over Assets | $ 50.3 |

* includes approximately $800K in Trust and Loan Fund Liabilities.

**Insurance Fund/Risk Insurance Trust**

Effective July 1, 2014, the Archdiocese of Philadelphia Risk Insurance Trust ("Risk Insurance Trust") replaced the Insurance Fund. On that date the assets and liabilities of the Insurance Fund were assigned to and assumed by the 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, 2014 insurance related liabilities exceeded dedicated insurance assets, as follows:

| | (**in millions**) |
|---|---|
| Insurance Related Liabilities | $ 51.9 |
| Insurance Related Assets (*excl. prepaid expenses*) | 32.3 |
| Excess of liabilities over assets | $ 19.6 |

**Lay Employees' Retirement Plan**

The Lay Employees' Retirement Plan is considered a multiemployer plan for financial reporting purposes. As such, the assets and actuarially determined liabilities for these plans 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, 2014 was not available as of the issue date of the OFS financial statements. A preliminary estimate of that liability is $700 million.

When the estimated liability is compared to plan assets available for benefits as of June 30, 2014 (approximately $593 million), the plan's shortfall is approximately $107 million.

**Priests' Pension Plan**

The Priests' Pension Plan is also 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.

While not a direct liability of OFS, the amount by which the plan liability exceeds plan assets is a liability of the Archdiocese. As of June 30, 2014 it is estimated that the Priests' Plan liabilities (estimated at $94 million) exceeded plan assets (approximately $14 million) by approximately $80 million.

***Looking Forward***

The core operating deficit for FY 2014 of $3.1 million was slightly better than the deficit incurred in FY 2013 and was significantly less than 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.

The previously announced sale of the six nursing homes and one independent living facility operated by Catholic Health Care Services ("CHCS") closed on November 3, 2014. Those facilities are now owned by Center Management Group. We anticipate that, once they are available, net proceeds – after accounting for amounts to be retained by CHCS, amounts allocated to other ministries, and transaction and other costs – will be allocated primarily to priests' pension obligations and the Risk Insurance Trust.

We are hopeful that net proceeds from previously announced real estate transactions, that have not yet closed, will be sufficient to satisfy the remaining balance on the promissory note due to the Trust and Loan Fund for the remaining $50.3 million shortfall in that fund. As disclosed previously, we will continue to fund the shortfall in the Lay Employees' Retirement Plan and project that the plan will be fully funded in 20-30 years.

Explanations for items noted in analysis

**A** In FY 2014 the amount represents the net gain resulting from the sales of several Archdiocesan properties. In FY 2013 the amount represents the gain on the sale of the Archbishop's residence.

**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 the Mission Schools commitment noted below.

**C** The $2.0 million annual contribution from the Cemeteries Office was discontinued after FY 2013.

**D** The $2.9 million includes: $1.5 million of transitional support - $750K in FY 2014 and $750K in FY 2015 – committed to the Independence Mission Schools, a non-profit organization managing 14 Catholic elementary schools; $1.0 million pledged to the World Meeting of Families event to be held in September 2015; and $370K representing the outstanding commitment to the St. Martin de Porres Catholic elementary school.

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

| (in millions) | FY 2014 | FY 2013 |
|---|---|---|
| Financial and legal costs incurred in connection with potential transactions | $ .9 | $ .5 |
| Fees incurred for supplemental finance office staffing | .3 | .3 |
| FY 2012 financial audit over-run costs | – | .3 |
| | $ 1.2 | $ 1.1 |