Narrative Accompaniment to the Archdiocesan Office for Financial Services Audited Financial Statements for the Fiscal Year Ended June 30, 2016

This narrative is intended to be used in connection with a review of the Archdiocese of Philadelphia – Office for Financial Services ("OFS") audited 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.

Analysis of FY 2016 Results

The analysis below presents the "Change in Net Assets Before Other Items" for the year ended June 30, 2016. This amount (i.e. the $12.3 million surplus shaded below) 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 disclosure of results after adjusting for the impact of items that are non-recurring in nature.

	(in millions)	FY 2016
	Change in Net Assets Before Other Items	$ 12.3
	Non-Recurring Items	
A	Net gain on sale of real estate assets	(10.8)
B	Risk Insurance and Welfare Benefits Trust experience	(1.2)
	Investment Gains (includes interest)	(.4)
B	Deposit and Loan Program Experience	(1.9)
	Recurring Deficit including Depreciation Expense	(2.0)
	Depreciation expense	1.7
	Recurring Deficit excluding Depreciation Expense	$ (.3)

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

B The experience of the Risk Insurance and Welfare Benefits Trusts and the Deposit and Loan Program Trust should be considered separately and treated as non-recurring. The assets in these trusts are not available for general operating needs.

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.

While the FY 2016 result compares favorably to our recent trend (see graph later in this document) we believe our sustainable run rate deficit is still higher and we will need to take additional actions in the near term in order to achieve a sustainable break-even or better result. It should also be pointed out that while depreciation expense has been excluded in the final total noted above, cash is still needed for some level of capital expenditures for this entity. In 3 of the last 4 fiscal years capital expenditures for OFS have exceeded $500,000.

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, 2016 the following balance sheet obligations remain underfunded:

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

Please find an update as of June 30, 2016 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 the year ended June 30, 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, 2016 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	$ 144.3
D&L Assets (*excludes promissory note*)	105.0
Excess of Deposits Over Assets	$ 39.3

As of June 30, 2016 the balance outstanding on the promissory note was $43,532,482, which is greater than the underfunded obligation noted above. Subsequent to June 30, 2016 we completed the sale of a pledged property resulting in proceeds of approximately $1.5 million which were applied to the promissory note and also reduce the shortfall noted above.

The following properties are pledged as part of the promissory note:

- Sproul Road property in Marple Township (Delaware County)
- Manor Road property (Chester County)

We estimate that the value associated with the properties noted above and other pledged properties will be sufficient to resolve the remaining underfunded obligation in the Deposit and Loan Program Trust.

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 preliminary estimate of the actuarially determined liability for this plan as of June 30, 2016 was $629 million.

When the estimated liability is compared to plan assets available for benefits as of June 30, 2016 (approximately $445 million), the plan's shortfall is approximately $185 million.

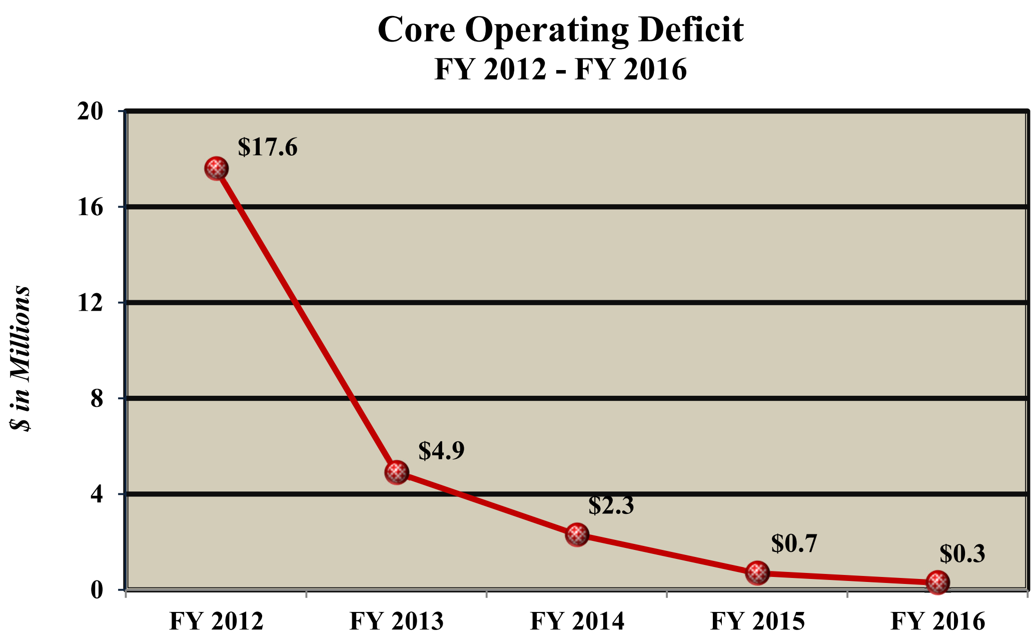
Priests' Retirement Plans

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, 2016 it is estimated that the Priests' retirement plans' liabilities (estimated at $98 million) exceeded assets ($85.7 million) by $12.3 million.

Looking Forward

The core operating deficit has improved each year since FY 2012's deficit of $17.6 million. While we have moved much closer to break-even, we continue to acknowledge that the core deficit needs to be eliminated completely in the very near future. As noted earlier we also do not believe we can improve upon, or even sustain, the FY 2016 result without taking further action. We expect to achieve a break-even result in our fiscal year ended June 30, 2018.



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

	Underfunded Balance at	
	June 30, 2012	June 30, 2016
Deposit and Loan Program	$ 82.0	$ 39.3
Risk Insurance	30.4	–
Lay Employees' Retirement Plan	152.0	185.0
Priests' retirement plans	90.0	12.3
	$ 354.4	$ 236.6

As noted earlier, we estimate that the value associated with properties pledged for the Deposit and Loan Program promissory note is sufficient to resolve the remaining underfunded obligations once those properties are sold.

Going forward our remaining issues will be the underfunded pension obligations. We are reviewing opportunities to fully fund the priests' retirement plans in the very near term. We have also taken the following steps to address the Lay Employees' Retirement Plan:

- froze the plan effective June 30, 2014;
- completed more than $100 million of lump sum distributions in calendar year 2015 to eligible participants at a rate equivalent to 85.1% of the present value of their normal retirement benefit;
- made an unplanned contribution of $7.5 million during the year ended June 30, 2016;
- increased the funding rate to 5.9%, from 4%, of "pension eligible payroll" effective July 1, 2016.

We will continue to explore ways to reduce the funding shortfall and also hope to make a significant unplanned contribution in the very near term.