Philadelphia Authority for Industrial Development, Pennsylvania

Revenue Bonds
New Issue Report

Ratings

New Issue

City Service Agreement Refunding Revenue Bonds (City of Philadelphia, PA), Series 2012 (Federally Taxable)	A–

Outstanding Debt

General Obligation Bonds	A–

Rating Outlook
Stable

Related Research
Fitch Rates Philadelphia Ind Dev Auth, PA's City Service Agreement Ref Rev Bonds 'A–' (December 2012)

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New Issue Details

Sale Information: $298,715,000 City Service Agreement Refunding Revenue Bonds (City of Philadelphia, PA), Series 2012 (Federally Taxable), expected via negotiated sale during the week of Dec. 10.

Security: By an annual service fee payable by the city under a noncancelable service agreement with the city. The city's obligation to make payments required by the service agreement is absolute and unconditional.

Purpose: To refund certain of Philadelphia Authority for Industrial Development's (PAID) outstanding series 1999B pension funding bonds for interest savings.

Final Maturity: April 15, 2026.

Key Rating Drivers

Limited Financial Flexibility: Financial flexibility is constrained by a high overall tax burden, a minimal general fund balance position, and a high level of fixed costs. Fund balance has shown notable improvement over the past two years but is expected to decline again in fiscal 2013.

Strong Financial Management: Fitch Ratings views positively management's efforts in recent years to contain costs and raise available revenues to address an ongoing budget imbalance, although significant budgetary pressures remain.

Sizable Debt Burden: Debt ratios are exceptionally high and, with limited growth prospects for the city's tax base and population, will remain elevated over the long term.

Large Unfunded Pension Liability: The city's pension fund is poorly funded, although Fitch views favorably the current administration's recent efforts to implement various pension reforms.

Weak Socioeconomic Profile: Wealth levels remain notably low and above-average unemployment persists. Despite this weakness, Philadelphia remains an important center for healthcare and higher education with good prospects for long-term economic stability.

Rating History

Rating	Action	Outlook/ Watch	Date
A–	Affirmed	Stable	12/3/12
A–	Affirmed	Stable	4/4/12
A–	Affirmed	Stable	3/28/11
A–	Revised	Stable	4/30/10
BBB	Downgraded	Stable	12/7/09
BBB+	Affirmed	Negative	7/14/09
BBB+	Affirmed	Stable	6/11/09
BBB+	Affirmed	Stable	12/1/08
BBB+	Affirmed	Stable	3/28/08
BBB+	Affirmed	Stable	12/4/07
BBB+	Affirmed	Stable	11/29/07
BBB+	Affirmed	Stable	7/24/07
BBB+	Affirmed	Stable	11/21/06
BBB+	Affirmed	Stable	7/7/06
BBB+	Affirmed	Negative	9/29/05
BBB+	Affirmed	Negative	2/14/05
BBB+	Downgraded	Negative	10/19/04
A–	Assigned	Negative	11/13/03

Related Criteria

U.S. Local Government Tax-Supported Rating Criteria (August 2012)

Tax-Supported Rating Criteria (August 2012)

Credit Profile

Important Economic Center Tempered By Challenging Demographics

Philadelphia is both a city and county with an estimated population of slightly more than 1.5 million. The city serves as a regional economic center with a stable employment base weighted in the higher education and healthcare sectors. Led by the University of Pennsylvania, Jefferson Health System, and Temple University, the city is home to several large colleges and universities and is anchored by multiple hospitals and health systems.

Above-average unemployment and weak income indicators persist, although current data suggests some recent improvement. Unemployment, measured at 10.8% in September 2012, remains elevated but is down from its recent high. The unemployment rates of the broader metropolitan statistical area (MSA) and state were appreciably lower at 8.4% and 7.5%, respectively. Income levels grew at a slightly better clip over the prior decade in comparison to the state and nation but continue to approximate just 65% of the MSA and 75% of the commonwealth and nation. The city's poverty rate stands at 25%, approximately twice the MSA, state, and nation. The population has grown slightly over the last decade after nearly 50 years of population loss.

Budget Balancing Plan Implemented and Falling Revenues

Recessionary pressure in recent years coupled with a depressed housing market prompted significant decline in tax revenues between fiscal years 2008 and 2010 leading to multiple years of large operating deficits. Management responded favorably with a number of expenditure cuts. The city also suspended through fiscal 2014 long-running annual rate cuts in its wage and business privilege taxes as part of a comprehensive budget-balancing plan.

In fiscal 2010 the city implemented a temporary five-year sales tax increase and the partial deferral of annual pension costs over the ensuing two fiscal years. In total, the administration's efforts would have produced an operating surplus if not for a late state-aid payment that was received early in fiscal 2011. Instead, fiscal 2010 ended with a $54.7 million general fund deficit on a GAAP basis, although the unreserved fund balance improved slightly from negative $274.5 million to negative $251.8 million, still equal to an insufficient negative 6.8% of spending.

Results for fiscal 2011 were positive, driven primarily by a nearly 10% property tax increase, a full year of the sales tax increase, nominal growth in general fund expenditures, and receipt of a large state aid payment intended for the prior fiscal year. Fiscal 2011 ended with a sizeable $106.4 million general fund surplus on a GAAP basis as a result, which improved the unrestricted general fund balance (the sum of the unassigned, assigned and committed fund balance under GASB 54) to a still weak negative $46 million. On a budgetary basis, the city reported a minimal year-end general fund balance of $92,000.

Fiscal 2012 looks to continue the improvement shown in fiscal 2011. Unaudited results indicate a $113 million surplus on a GAAP basis, bringing the unrestricted general fund balance to $71 million, or 2% of expenditures. On a budgetary basis, the surplus is $147 million, notably better than the budgeted $60 million surplus. The surplus and outperformance of budget result from tax revenues growing 4.4% over fiscal 2011 and $34 million of one-time pension aid from the commonwealth.

General Fund Financial Summary

($000, Audited Fiscal Years Ended June 30)

	2008	2009	2010	2011
Total Tax Revenue	2,395,229	2,259,321	2,316,271	2,447,035
Intergovernmental Revenue	782,441	715,693	785,904	784,332
Other Revenue	265,657	276,042	245,945	295,937
General Fund Revenue	**3,443,327**	**3,251,056**	**3,348,120**	**3,527,304**
Public Safety Expenditures	1,518,877	1,515,956	1,420,405	1,515,643
Health and Social Services Expenditures	917,220	889,881	840,400	859,841
Culture and Recreation Expenditures	159,177	147,895	129,507	133,720
Educational Expenditures	65,468	67,176	65,008	64,009
Other Expenditures	1,209,768	1,190,647	1,126,511	1,038,390
General Fund Expenditures	**3,870,510**	**3,811,555**	**3,581,831**	**3,611,603**
General Fund Surplus	**(427,183)**	**(560,499)**	**(233,711)**	**(84,299)**
Transfers In	271,649	373,245	316,359	335,084
Other Sources	394,824	0	0	0
Transfers Out	103,353	122,747	137,340	144,435
Other Uses	389,329	0	0	0
Net Transfers and Other	173,791	250,498	179,019	190,649
Net Surplus/(Deficit)	**(253,392)**	**(310,001)**	**(54,692)**	**106,350**
Total Fund Balance	234,443	(75,558)	(130,250)	(23,900)
As % of Expenditures, Transfers Out, and Other Uses	5.4	(1.9)	(3.5)	(0.6)
Unreserved Fund Balance[a]	(24,346)	(274,554)	(251,847)	—
As % of Expenditures, Transfers Out, and Other Uses	(0.6)	(7.0)	(6.8)	—
Unrestricted Fund Balance[b]	—	—	—	(45,685)
As % of Expenditures, Transfers Out, and Other Uses	—	—	—	(1.2)

[a]Pre GASB54. [b]Reflects GASB 54 Classifications: Sum of Committed, Assigned, and Unassigned.

Note: Numbers may not add due to rounding.

The city relies on annual cash flow notes for liquidity. The $173 million note issuance for fiscal 2012 was well below historical borrowings and the fiscal 2013 borrowing is scheduled to be approximately $127 million, reflecting further improvement in the city's liquidity.

Budgetary Pressure Remains

The fiscal 2013 general fund budget raises spending by almost 3%, mostly due to the repayment of previously deferred pension costs. Through one quarter, total revenue is projected to be flat to unaudited fiscal 2012 revenue, with tax revenues expected to be $12 million ahead of budget. Expenditures are projected to be $35 million over budget as prison costs are $9 million over budget due to an increase in inmates. Expenditures were also increased from council actions restoring several items removed from initial drafts of the budget. The original budget included a $17 million deficit that has now grown to $29 million on a budgetary basis.

The city also faces several budgetary challenges in future years. The five-year increase in the sales tax ends after fiscal 2014, resulting in an expected decline of approximately $130 million of revenue. The city is also finalizing the implementation of a major revaluation of the city's entire property tax base, which has not been done in many years. The revaluation is planned to be revenue neutral and will be effective for fiscal 2014. However, the city faces significant risk regarding implementation of the revaluation and the expectation of a large number of appeals.

Elevated Long-Term Liabilities

The city's aggregate debt burden, which includes debt associated with the Philadelphia School District, remains notably high at $4,688 per capita and 16% of full market value, although Fitch notes that the market value ratio is somewhat overstated due to antiquated property assessment practices. As indicated above, the city expects to implement a more accurate assessment process based on full value in fiscal 2014.

Debt Statistics

($000)

This Issue	346,340
Outstanding Direct Debt – Net of Refunding	3,990,576
Total Net Direct Debt	**4,336,916**
Overlapping Debt	2,866,300
Total Overall Debt	**7,203,216**
Debt Ratios	
Net Direct Debt Per Capita ($)[a]	2,823
As % of Full Market Value[b]	9.4
Overall Debt Per Capita ($)[a]	4,688
As % of Full Market Value[b]	15.6

[a]Population: 1,536,471 (2011). [b]Full market value: $46,192,000,000 (fiscal 2011). Note: Numbers may not add due to rounding.

The city's fiscal years 2013–2018 governmentwide capital improvement plan (CIP) totals $10 billion, of which about $6.7 billion is for the city's self-supporting airport and water and sewer utility system. Of the remaining $3.3 billion in capital projects, the city expects the state and federal government to fund about $2.4 billion while the balance, estimated at $923 million, will be derived almost entirely from city-supported annual debt issuance.

Pension funding continues to be a key credit concern for Fitch, despite the recent implementation of cost-saving changes to pension benefits for uniformed employees. The city funds on an annual basis the amount determined by the actuary to be required by state law, which is less than the amount the actuary determines is required by the pension board's funding policy. Full funding of the annual obligation resumed in fiscal 2012 following a partial deferral for budgetary relief in the previous two years. The five-year plan shows annual pension payments rising by 13% and 5% in fiscal years 2013 and 2014, respectively, to meet the repayment obligation. Pension costs are forecast to consume an above-average 17% of annual general fund spending in fiscal 2013. Savings from the current refunding will be contributed to the pension fund in addition to the required annual payment.

The most recent actuarial report shows a funded ratio of about 50% and an unfunded liability of about $4.7 billion. Using Fitch's more conservative 7% discount rate assumption, the city's pension plan would be 44% funded. The city's other post-employment benefit liability is also sizable at $1.2 billion based on the latest valuation available, although benefits are only provided for the first five years following retirement and the city's five-year financial plan consistently includes the annual pay-as-you-go amount.

The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.