



Fitch Rates Philadelphia, PA's \$200MM 2011A-D Water & Sewer Revs 'A+'; Outlook

Stable Ratings

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Fitch Ratings-New York-20 October 2011: Fitch Ratings has assigned the following ratings to Philadelphia, PA (the city) water and wastewater system revenue bonds:

- Approximately \$135 million series 2011A 'A+';
- \$33.6 million series 2011B 'A+';
- \$12.4 million series 2011C 'A+';
- \$18.9 million series 2011D 'A+'.

The city expects to sell the bonds in a negotiated sale the week of Nov. 7. Proceeds of the 2011A bonds will be used to fund general capital needs of the city's water and sewer system. Proceeds of the 2011B-D bonds will be used to refund and restructure outstanding parity bonds for cost savings.

In addition, Fitch affirms the following ratings:

- \$1.6 billion in outstanding water and wastewater revenue bonds at 'A+'.

The Rating Outlook is Stable.

SECURITY:

The series 2011 bonds and outstanding parity bonds are secured by a senior lien on combined net revenues of the city's water and sewer system. The series 2011A-D bonds will have a debt service reserve fund funded at the maximum annual debt service amount.

KEY RATING DRIVERS

Essential Service: The city's combined water and wastewater system (the system) provides an essential service to a large and diverse service area.

Ample Capacity: Water supply and overall system treatment capacity are sufficient for the foreseeable future.

Sound Management and Stable Operations: Consistent operating results, sound liquidity, and the ability of management to establish rates independent of city council approval offsets narrow debt service coverage levels.

Below-Average Economic Characteristics: The service area exhibits weak income levels and above-average unemployment, which contributes to chronically poor collection rates.

Elevated Debt Levels: The system has above-average debt levels with sizeable additional borrowing plans expected over the medium term.

Large Capital Plan: The capital program remains sizeable, although required projects stemming from a consent order do not appear onerous.

CREDIT SUMMARY:

The water system serves all of the 1.5 million residents of the city as well as an additional 150,000 people in neighboring Bucks, Montgomery and Delaware Counties. Of the nearly 480,000 water customer accounts, the vast majority are residential (83%) and the ten largest users account for just 13% of total billings. The wastewater system serves a more expansive area that includes an estimated population of nearly 2.2 million people. The city maintains 11 wholesale agreements for wastewater service and two wholesale contracts for water service to customers outside of the city. In total, wholesale revenues accounted for a moderate 7% of total system revenues in fiscal 2011. All wholesale agreements are

current and management does not anticipate future departures.

Average daily water demand is comfortably below permitted water supply and treatment capacity at all facilities, and daily wastewater flows are well within treatment plant permit limits. Available water supply is sufficient for the foreseeable future, although significant water loss persists.

Unauthorized consumption was reduced by a notable 40% during the 1990s, but progress has since stalled as non-revenue water has averaged about 30% annually over the last ten years.

Below-average collection rates continue to be a key credit concern. On a current basis annual collections typically average 85%. Delinquent collections are recovered through an enforcement process and property tax lien sales, but both are only somewhat effective, as total collections approximate 90%. Management conservatively budgets for an 85% collection rate of current year revenues and a nominal percentage of delinquent charges.

The utility system's management team is tenured and, in Fitch's view, very capable. Management continues to budget to meet its bond required rate covenant of 1.2 times (x) senior annual debt service (ADS), although actual results typically outperform budgeted expectations. Net revenues covered all-in ADS by 1.4x in fiscal 2010, and available liquidity, which includes a rate stabilization fund (RSF), has remained at a healthy level over the last several years, equal to around 275 days. Depending on yearly consumption, collections and containment of operating expenditures, the RSF is utilized to augment operating revenues. However, rate revenues alone have historically covered ADS by an adequate margin and officials expect to add about \$14 million to the RSF at the close of fiscal 2011.

Affordable user charges provide the system with ample flexibility. Yearly rate increases have averaged a moderate 5.5% since 2002, leaving the average combined water and sewer bill currently equal to a moderate 1.6% of median household income (MHI). Including the city's stormwater fee levied according to the amount of impervious area a rate-payer owns, monthly charges rise to what Fitch considers above average at 2.1% of MHI. Nonetheless, the system's charges remain low in comparison to regional water and sewer systems.

Projected results through fiscal 2018 appear achievable. Based on annual rate hikes of 5.5% through fiscal 2016 and 5.0% each year after through 2018, debt service coverage ramps up slightly, eventually meeting management's revised minimum coverage level of 1.3x senior lien ADS. Financial projections also include no growth in customer accounts, wage increases ranging from 1%-3% annually, and an average increase in operating expenditures of about 3.5%. Similar to prior forecasts, sizeable outflows from the RSF are projected through fiscal 2016, although Fitch believes actual results will continue to outperform budgeted expectations leaving liquidity at a favorable level.

After several years of negotiations, the Pennsylvania Department of Environmental Protection (PA DEP) and the city signed a consent order and agreement (the COA) in June 2011 that will require the city to substantially eliminate combined sewer overflows (CSOs) over the next 25 years. To comply with the COA, the city will employ its Green City, Clean Waters Program (the program), which will utilize largely green technologies to capture rainwater runoff that would otherwise infiltrate and overwhelm the system's sewer system. The system also offers a credit to customers willing to reduce the amount of impervious area on their property in favor of more green space.

Compliance with the COA will require the city to spend approximately \$2.4 billion over the next 25 years. The program also includes wastewater treatment facility enhancements and pipe renewal and replacement. Fitch views the program favorably considering alternative strategies to mitigate CSOs, including the construction of tunnels and storage tanks, would have cost substantially more.

Reflecting the COA now in place, projected capital spending through fiscal 2017 totals \$1.3 billion, about three-quarters of which will be debt funded with the current offering and additional borrowings slated for fiscals 2014, 2015 and 2017. Pay-out of existing debt is above average for a utility system. Descending annual debt service requirements will allow future issuances to be structured in a way that does not prompt a material increase in annual debt carrying costs beyond current levels.

Debt levels are elevated compared to similarly rated systems, although relative to other large urban systems, the debt profile is closer to the moderate range. Exposure to variable-rate debt and derivatives has diminished significantly over the last few years as management has taken a more conservative approach to debt management.

Philadelphia, as both a city and county and with an estimated population of almost 1.5 million residents, benefits from its role as a regional economic center with a stable employment base weighted in the higher education and healthcare sectors. Despite positive, albeit minimal, year-over-year improvement, the city's July 2011 unemployment rate of 11% remains elevated compared to the regional, state and national figures. The city's poverty rate remains high at close to 25%, and income levels on both a per capita and median household level are just 75% of the state and national averages.

Economic indicators for the surrounding suburbs are notably stronger.

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Additional information is available at 'www.fitchratings.com'. The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.

In addition to the sources of information identified in Fitch's Revenue-Supported Rating Criteria, this action was additionally informed by Creditscope and HIS Global Insight.

Applicable Criteria and Related Research:

--'Revenue-Supported Rating Criteria', dated June 20, 2011;
--'Water and Sewer Revenue Bond Rating Guidelines', dated Aug. 10, 2011;
--'2011 Water and Sewer Medians', dated Jan. 18, 2011;
--'2011 Outlook; Water and Wastewater Sector', dated Jan. 18, 2011.

Applicable Criteria and Related Research:

Revenue-Supported Rating Criteria
U.S. Water and Sewer Revenue Bond Rating Criteria
2011 Water and Wastewater Medians
2011 Outlook: Water and Wastewater Sector

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