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Fitch Rates Philadelphia Municipal Auth's Lease Revs 'BBB+' & Affirms GOs; Outlook Stable

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Fitch Ratings-New York-11 June 2009: Fitch Ratings assigns a 'BBB+' rating to Philadelphia Municipal Authority's $97 million lease revenue bonds, series 2009. The bonds are scheduled for negotiated sale June 23, 2009 with proceeds being used to design and construct a youth study center. At this time, Fitch also affirms its 'BBB+' rating on the city of Philadelphia's (the city) $1.1 billion of outstanding general obligation (GO) bonds. The Rating Outlook for all bonds is Stable.

The 'BBB+' rating on the Philadelphia Municipal Authority's (PMA) series 2009 bonds relies on the general creditworthiness of the City of Philadelphia (the city). The bonds are limited obligations of PMA payable solely from payments pledged by the indenture, which includes payments under a prime lease. The rental payments made by the city under the prime lease are payable only out of current revenue of the city. The obligation under the prime lease is absolute and unconditional; as such, the bonds are rated the same as Philadelphia's GO bonds.

The 'BBB+' rating on the city's GO debt reflects the city's strong financial management and stable employment base anchored by its role as a regional economic center which serves as home to several major health care and higher education institutions. The city's economy and numerous employment anchors is tempered by exceptionally high debt levels, very little financial flexibility, a significantly under-funded pension position, a rapidly growing fixed-cost burden related to employee benefits, and below-average economic indicators.

The current economic downturn continues to exert significant pressure on the city's operating budget and overall financial flexibility. Although Fitch believes the city's management team has been proactive to date in making significant budgetary adjustments, a high fixed cost burden, a comparatively high tax burden for residents, and the depletion of general fund balances severely limits the city's ability to absorb further revenue declines. Fitch remains concerned about the numerous short- and long-term challenges that the city faces, including the expiration at the end of June 2009 of all four of its major union contracts; the need for state legislative approval for a proposed temporary sales tax increase; and the proposed partial deferral of pension payments over the next two fiscal years. Both measures are needed to balance the city's fiscal 2010 budget and five-year financial plan. Fitch will continue to monitor the city's continued ability to manage through the economic downturn and evaluate how its response will impact the city's overall credit profile.

Philadelphia, with an estimated population of 1.5 million residents, benefits from its role as a regional economic center and a stable employment base weighted in the education and health care sectors led by the University of Pennsylvania and Jefferson Health System as the largest private employers. Despite a slowing economy, commercial and retail development projects have continued, including the transitioning of the city's naval yard into a large private sector business park consisting of approximately 80 companies. In addition, Children's Hospital of Philadelphia, the Fox Chase Cancer Center, and the University of Pennsylvania are each making a significant capital investment to expand their respective research facilities. However, despite the size and stability of its employment anchors, the city's unemployment rate, like national trends, has experienced a notable increase over the past year, growing to an above-average 9.7% in March 2009 from a more moderate 6.6% one year prior. Income levels are also weak; approximately one-fourth of the city's residents live at or below the poverty rate according to the U.S. Census Bureau.

Following a period of stronger than budgeted growth in several tax sources in fiscal years 2005-2007, the city began fiscal 2008 with a moderately healthy unreserved general fund balance. However, a slowing in the local housing market and overall economy resulted in the economically sensitive business privilege and real estate transfer taxes to come in significantly below budget for fiscal 2008, resulting in a sizeable operating deficit and reducing the total fund balance by more than one-half. A continued decline in general fund revenues throughout fiscal 2009 is expected to result in another sizeable operating deficit, despite a notable amount of mid-year expenditure cuts, including significant employee reductions, mostly through attrition and vacancy elimination, a reduction in a portion of several active fire companies, and a decrease in certain city services, among other cost-cutting initiatives. Forecasted results for fiscal 2009 show a $204 million operating deficit on a budgetary basis, which will increase the city's unreserved general fund balance to well over a negative $60 million on a budgetary basis.

To regain structural balance for fiscal 2010 and address a notable $1 billion budget gap projected over the 2010-2015 multi-year plan (MYP), the city is now seeking legislative approval from the Commonwealth of Pennsylvania for a partial deferral of pension payments over the next two years and a four-year, one-cent sales tax increase beginning in 2013. According to the MYP, a portion of the expected revenue from the sales tax increase will be reserved to pay-back the city's pension fund beginning in fiscal 2014, with interest based on an assumed rate of return on investments of 8.25%. Other measures already enacted include delaying until fiscal 2015 long-standing annual wage and business privelage tax cuts. While Fitch recognizes management's proactive response to the economic downturn and its mid-year measures, to address revenue declines, Fitch remains concerned about the city's diminishing flexibility in terms of addressing potential revenue declines going forward, as well as a pension funding position that has weakened considerably and the pending contract negotiations with the city's four major unions.

The city's overall debt burden remains very high at $5,000 per capita and 17% of market value. Even excluding $1.4 billion in outstanding pension obligation bonds, debt ratios remain well above average. The 2010-2015 capital improvement plan is estimated at $7.9 billion with

slightly more than half supported by operating revenues of, and revenue bond issuance by the city's airport and water department. The balance of capital funding will come from state and federal sources as well as from city-supported debt issuance, which Fitch believes will keep debt ratios at a high level for the foreseeable future.

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