Revenue
New Issue

Philadelphia, Pennsylvania

Ratings

New Issue

Water and Wastewater Revenue Bonds, Series 2009	A–

Outstanding Debt

Water and Wastewater Revenue Bonds	A–

Rating Outlook

Stable

Analysts

Christopher Hessenthaler
+1 212 908-0773
christopher.hessenthaler@fitchratings.com

Amy R. Laskey
+1 212 908-0568
amy.laskey@fitchratings.com

New Issue Details

Sale Information: $145,000,000 Water and Wastewater Revenue Bonds, Series 2009, on April 27 via negotiation.
Purpose: To fund various capital improvements to the city of Philadelphia's water and sewer utility.
Final Maturity: Dec. 1, 2009–2038.

Related Research

- *2009 Median Ratios for Water and Sewer Revenue Bonds — Retail Systems, Jan. 28, 2009*
- *2009 Water and Sewer Sector Outlook, Jan. 12, 2009*
- *Focus on Housing, Dec. 15, 2008*
- *Water and Sewer Revenue Bond Rating Guidelines, Aug. 6, 2008*

Rating Rationale

- Philadelphia's water and wastewater utility system (the system) benefits from sole rate-setting authority, independent of outside approval.
- The system's rate structure is largely affordable for a service area marked by below-average income levels.
- The system's multiyear capital improvement plan (CIP) is moderately sized relative to the overall size of the system and its large customer base.
- The system's strong credit characteristics are tempered by historically weak collection rates, narrow debt service coverage levels, weak legal provisions, and a high amount of water loss.

Key Rating Drivers

- Maintenance of the system's currently healthy rate stabilization fund (RSF) and overall liquidity will be critical to ensuring an adequate operating cushion, given the weak collection rates and typically slim debt service coverage levels.

Credit Summary

The system serves approximately 472,000 retail accounts throughout the city and in neighboring suburban areas pursuant to long-term wholesale agreements for water and sewer service. Similar to the city's population trend, the system's customer base continues to decline incrementally as retail accounts have dropped by about 1.5% annually since 2000. Average daily water demand is significantly below the system's permitted water supply and treatment capacity at all facilities. Daily wastewater flows are well within treatment plant permit limits. No concentration exists among retail and wholesale customers, and user charges remain affordable despite the city's income levels, which rank well below regional, state, and national figures. Annual rate hikes ranged from 4%–6.5% between fiscal years 2006 and 2009, and yearly increases through fiscal 2012 are forecast to fall between 5.5% and 7.1%. Legal provisions are weak, essentially requiring 1.2 times (x) coverage of senior lien debt service from both net operating revenues and withdrawals from the RSF. The additional bonds test is based on projected compliance with the rate covenant.

Although offset by a high fixed-cost burden, related primarily to debt service, the system generates strong operating margins despite historically weak collection rates of about 85%. Financial operations are adequate as management consistently budgets to meet the rate covenant. As such, the system's financial forecast through fiscal 2015 shows annual debt service coverage remaining at 1.2x. The narrow debt service coverage is balanced by the system's strong cash position, driven primarily by the RSF. Despite a nominal draw of approximately $9.8 million in fiscal 2008, the system ended the year with a healthy balance of $183.1 million in the RSF, leaving almost 250 days of cash available for operations. The system's financial forecast through fiscal 2015 shows a substantial draw-down in the RSF to approximately $17.5 million to support the maintenance of 1.2x coverage of debt service through the projection period. However, Fitch Ratings believes the system is likely to outperform its financial forecast, given its demonstrated history of maintaining strong cash reserves and generating solid operating margins.

Rating History

Rating	Action	Outlook/ Watch	Date
A–	Affirmed	Stable	4/9/09
A–	Affirmed	Stable	2/7/09
A–	Affirmed	Stable	4/11/05
A–	Affirmed	—	11/5/01
A–	Upgraded	—	6/7/00
BBB+	Affirmed	—	5/24/99
BBB+	Assigned	—	12/1/98

The system's proposed CIP for fiscal years 2010–2015 totals slightly more than $1.0 billion, up almost $85 million over the fiscal years 2008–2013 CIP, although still manageable. About one-third of the CIP will address ongoing combined sewer overflow (or CSO) projects, which Fitch believes is moderate given the age of the system. Almost 70% of capital financing for the CIP will be derived from revenue bonds with new money issuance planned in fiscal years 2010 and 2012. The balance of funding is expected to come from state loans and excess operating revenues and reserves.

Legal Provisions

The security for the bonds is a net pledge of system project revenues. Project revenues are defined as all income of the system, as well as all available funds of the system, including cash and certain reserves, primarily from the RSF. Net revenues are project revenues reduced for operations and maintenance expenses.

Rate Covenant: The rate covenant requires that rates, charges, and fees be set for net revenues (including the RSF) to cover the annual debt service payment on senior bonds 1.2x and all debt service and reserve requirements by 1.0x. The general ordinance governing the issuance of system revenue bonds also requires rates and charges to be set to cover senior debt service requirements by 90%, thereby allowing a maximum draw from the RSF of 30% of senior debt service to meet the 120% coverage test.

Additional Bonds Test: Additional parity debt can be issued if a consulting engineer certifies that with the issuance of the additional bonds, the rate covenant will be satisfied in the fiscal year the debt is issued, in addition to the following two fiscal years. If capitalized interest is part of the debt structure, the two-year lookout provision begins the year after the capitalized interest period ends. Stronger legal covenants provide for at least a sum-sufficient coverage requirement from operating revenues and/or include a more expansive coverage requirement with a minimum coverage provision for either maximum annual debt service (MADS) or average annual debt service. As a result, the system's legal provisions are quite liberal, and given that the system manages operations tightly to this low coverage level, it is one of the system's primary credit risks.

Financial Summary

($000, Audited Fiscal Years Ending June 30)

								Projected			
	2005	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**
Operating Statement											
Operating Revenues	452,035	470,844	493,569	506,293	507,239	547,175	574,994	599,017	655,417	698,735	742,973
Non-Operating Revenues	11,427	23,141	31,804	27,849	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Gross Revenues	**463,462**	**493,985**	**525,373**	**534,142**	**507,239**	**547,175**	**574,994**	**599,017**	**655,417**	**698,735**	**742,973**
Operating Expenses (Excluding Depreciation)	(277,705)	(261,378)	(284,327)	(313,140)	(335,323)	(357,573)	(375,683)	(392,657)	(410,250)	(428,760)	(448,237)
Net Income	**185,757**	**232,607**	**241,046**	**221,002**	**171,916**	**189,602**	**199,311**	**206,360**	**245,167**	**269,975**	**294,736**
Transfers from RSF In/(Out)	628	(21,553)	(25,959)	9,763	48,500	37,445	42,225	36,685	(80)	(880)	(27,135)
Net Income Adjusted for RSF Transfer	**186,385**	**211,054**	**215,087**	**230,765**	**220,416**	**227,047**	**241,536**	**243,045**	**245,087**	**269,095**	**267,601**
Debt Service Requirements – Senior Lien	156,460	166,416	172,893	174,827	183,211	189,109	201,184	202,428	204,146	224,156	222,904
Debt Service Requirements – Junior Lien	99	87	64	1,227	1,690	1,318	1,318	1,129	91	91	91
Total Debt Service Requirements	**156,559**	**166,503**	**172,957**	**176,054**	**184,901**	**190,427**	**202,502**	**203,557**	**204,237**	**224,247**	**222,995**
Financial Statistics (x)											
Debt Service Coverage from Operations[a]	1.2	1.4	1.4	1.3	0.9	1.0	1.0	1.0	1.2	1.2	1.3
Debt Service Coverage Including RSF Transfers[a]	1.2	1.3	1.2	1.3	1.2	1.2	1.2	1.2	1.2	1.2	1.2

[a]Including junior lien debt. N.A. – Not available. RSF – Rate stabilization fund. Note: Numbers may not add due to rounding.

Reserve Requirement: The debt service reserve requirement is equal to the MADS payment and is held in restricted cash in the sinking fund. The sinking fund may be funded by bond proceeds or met by revenues over no more than three fiscal years following the issuance of the bonds.

Flow of Funds: All revenues of the system flow to the revenue fund whereby moneys are applied in the following standard order: operating expenses; principal and interest on senior bonds; swap payments; repayment of credit facility advances; the debt service reserve fund (DSRF) for senior bonds; the DSRF for subordinate bonds; transfer to the city for payment of system-related general obligation bond debt service; the rate stabilization fund; the capital account fund; and, finally, the residual account.

The flow of funds provides for a limited closed-loop structure whereby the city covenants not to direct the transfer of funds from the residual account other than for water and wastewater purposes. However, the structure also provides for an annual transfer from the residual fund to the city's general fund not to exceed the lesser of $4.994 million or net reserve earnings defined in the documents. While a transfer to the general fund theoretically dilutes revenues available to pay for system needs, the maximum exposure in this case is minimal, typically representing about 1.0% of system revenues.