Moody's
INVESTORS SERVICE

New Issue: Moody's assigns MIG 1 rating to City of Philadelphia's (Pa) $127 million TRANs and A2 to $298.7 million City Service Agmt. Ref. Rev. Bds. Series 2012 issued through the Philadelphia Auth. for Ind. Dev. (PA); outlook is stable

Global Credit Research - 03 Dec 2012

NOTE: On December 4, 2012 the press release was revised as follows: Name of bond issue corrected in the headline from City Service Agreement Bonds Refunding Revenue Bonds to City Service Agmt. Ref. Rev. Bds. Series 2012 issued through the Philadelphia Auth. for Ind. Dev. (PA) and in the first paragraph from City Service Agreement Refunding Revenue Bonds (City of Philadelphia Retirement System), Series 2012 (Federally Taxable) to City Service Agreement Refunding Revenue Bonds (City of Philadelphia, Pennsylvania) Series 2012 (Federally Taxable). Revised release follows.

Affirmation of A2 long-term rating affects $3.83 billion in parity GO and unconditional debt obligations

PHILADELPHIA AUTHORITY FOR INDUSTRIAL DEVELOPMENT, PA
Cities (including Towns, Villages and Townships)
PA

Moody's Rating

ISSUE		RATING
City Service Agreement Refunding Revenue Bonds (City of Philadelphia, Pennsylvania) Series 2012 (Federally Taxable)		A2
Sale Amount	$298,700,000	
Expected Sale Date	12/03/12	
Rating Description	General Obligation	
Tax and Revenue Anticipation Notes, Series A of 2012-2013		MIG 1
Sale Amount	$127,000,000	
Expected Sale Date	12/03/12	
Rating Description	Note: Tax and/or Revenue Anticipation	

Moody's Outlook STA

Opinion

NEW YORK, December 03, 2012 --Moody's Investors Service has assigned a MIG 1 rating to the City of Philadelphia's $127 million Tax and Revenue Anticipation Notes, Series A of 2012-2013, which mature on June 28, 2012 and an A2 rating to $298.7 million in City Service Agreement Refunding Revenue Bonds (City of Philadelphia, Pennsylvania) Series 2012 (Federally Taxable) issued through the Philadelphia Authority for Industrial Development (PAID). The notes are secured by a pledge of taxes and revenues to be received by the General Fund during fiscal 2013 (ending June 30), and are being issued to fund temporary cash flow imbalances in the city's General Fund during the fiscal year. The bonds are secured by the city's unconditional obligation to make debt service payments from the General Fund under a Service Agreement with the authority, and are rated the same as the city's general obligation debt. Concurrently, Moody's has affirmed the A2 rating and stable outlook on the city's $3.83 billion of outstanding general obligation bonds and unconditional General Fund obligations.

SUMMARY RATING RATIONALE

The best-quality short-term note rating reflects (i) the city's covenant to make deposits into a dedicated repayment fund held by the note trustee on May 24, 2013 (full principal amount) and June 26, 2013 (full interest requirement); (ii) the city's historically strong financial management practices and state-board oversight and a return to surplus operations in 2010 through 2012 following weak financial operations in fiscal 2008 and 2009; (iii) its long and successful track record as an issuer of short-term notes; (iv) improvement in cash flows in fiscal 2010 through 2012; and (iv) cash flow projections for fiscal 2013 that indicate a narrow, but adequate ending consolidated cash balances given the conservative nature of the city's projections.

The A2 rating on the city's general obligation and unconditional General Fund obligation debt reflects continued improvement in the city's financial operations, which deteriorated in fiscal 2008 and 2009, stabilized in 2010 and returned to surplus operations in fiscal 2011 and 2012 (unaudited), although the city will continue to face challenges in the coming years. In response to the significant financial stresses that began in fiscal 2008, city officials created a fiscal recovery plan that included a temporary sales tax increase and pension deferral in fiscal 2010 and 2011. As required, the plan was approved by the Commonwealth of Pennsylvania (G.O. rated Aa2 with a stable outlook) at the end of September 2009, allowing the sales tax increase to be implemented at the beginning of October and has resulted in the surplus operations for the past three years. Unaudited results for fiscal 2012 indicate that the city will have a positive General Fund balance, on a GAAP basis, for the first time since fiscal 2008.

The city benefits from a state-appointed oversight board with quarterly monitoring procedures and well-established five-year planning. Financial flexibility is relatively constrained over the course of its five-year plan (currently ending in fiscal 2017), in part due to the significant costs required to repay the deferred pension contributions in 2013 and 2014 and other significant fixed costs. We believe growth in the local economy is likely to remain tepid, moderating growth in wage tax collections and other economically sensitive revenues. The city continues to face ongoing economic challenges, weak demographics and high unemployment, modest property value growth, and a heavy burden of tax-supported debt and unfunded pension liability.

STRENGTHS

-Large, diverse tax base; economic center for a multistate region

- Improved financial operations

- Strong state oversight and comprehensive five-year financial planning

CHALLENGES

-Constrained financial flexibility given narrow reserve levels

-Limited tax base growth, weak demographics and high unemployment

-Very high debt burden and fixed expenditure pressure

DETAILED CREDIT DISCUSSION

PROJECTED CASH DEFICIT IN GRANTS REVENUE FUND REDUCES CONSOLIDATED CASH TO NARROW, BUT ADEQUATE LEVELS AT TIME OF NOTE PRINCIPAL SET ASIDE

The city is a regular issuer of temporary cash flow notes, reflecting its essentially level monthly expenditure patterns and uneven revenue collections. The majority of Philadelphia's projected fiscal 2013 receipts from the property tax (14.4% of General Fund receipts) and business privilege tax (11.1% of General Fund receipts) are collected in the second half of the fiscal year. In the several years prior to fiscal 2012, the city issued cash flow notes of between $275 million and $350 million, but reduced that borrowing considerably in fiscal 2012 to $173 million and reduced it further for the current borrowing. The city ended fiscal 2012 with a General Fund cash balance of $281 million, or an adequate 7.6% of General Fund receipts, well above the original projection at the time of the TRAN issuance, which was $197 million, or 5.5% of General Fund receipts. Consolidated cash, which includes additional funds, ended the year at $372 million, or 10.1% of General Fund receipts. Without the benefit of the Capital Improvement Fund (which is largely made up of bond proceeds), the city had consolidated cash equal to $259 million (7.4% of General Fund receipts) at the end of the year.

At the time of the covenanted set aside of principal in May of 2012, General Fund cash balance was $326.1 million, or 8.9% of General Fund receipts; consolidated cash was $486.4 million (13.2% of General Fund receipts) and $365.9 million (10% of General Fund receipts) without the Capital Improvement Fund. These balances were all higher than originally projected at the time of the TRAN issuance.

The city's fiscal 2013 cash flow projections, developed as part of its budgeting process and required by the Pennsylvania Intergovernmental Cooperation Authority (PICA), the state-appointed oversight board, indicate that the city expects to end fiscal 2013 with a General Fund cash balance of $218 million (6.1% of General Fund receipts), a use of $62 million. The city also projects consolidated cash at the end of the year to be $163 million (4.5% of General Fund receipts) and without the benefit of the Capital Improvement Fund, to be $144 million (4.0% of General Fund receipts). The consolidated cash balance is less than the General Fund cash balance due to a projected negative balance in the Grants Revenue Fund which the city reports to incorporate reimbursements of state aid that come after associated expenditures. At the principal set aside date in May, the city projects to have a General Fund cash balance of $263.8 million (7.4% of General Fund receipts), a consolidated cash balance of $144 million (4.0% of General Fund receipts), and consolidated cash of $118.3 million (3.3% of General Fund receipts). While these projected consolidated cash balances are narrow, we believe the city's projections are conservative given the city's record for the past two years of better-than-projected cash flow results.

FISCAL RECOVERY PLAN RESULTS IN SURPLUS OPERATIONS IN FISCAL 2011 AND UNAUDITED 2012; SMALL USE OF FUND BALANCE IN FISCAL 2013 BUDGET

Moody's believes the city's financial operations have stabilized, although operating reserves are likely to remain narrow in the near term. During fiscal 2009, the city outlined a $1 billion shortfall in its five-year financial forecast and developed a fiscal recovery plan to reduce the budget gap, including the delay until 2014 of scheduled city-funded wage tax reductions as well as various expenditure cuts, such as a reduction in force, employee furloughs, a hiring freeze, and reduced overtime. Despite these efforts, mid-year revenue estimates revealed continued deterioration and ongoing weakening of the pension fund, driving the city to announce an additional shortfall of $1 billion across the five-year plan. The city ended fiscal 2009 with a budget deficit of $277 million, (before adjustments) resulting in a General Fund deficit of $137.2 million (-3.5% of General Fund revenues), on a budgetary basis, inclusive of a late state aid payment of $55 million that was remitted in fiscal 2010. On a GAAP basis, the total General Fund balance deficit was $76 million (-2.1% of General Fund revenues) and unreserved General Fund balance deficit was $275 million (-7.6% of General Fund revenues).

The fiscal 2010 budget built on the expenditure savings and efficiencies from the recovery plan developed in fiscal 2009. The updated 5-year plan included additional gap-closing measures such as further staff reductions, increases in certain fees, savings in employee pension and health benefit areas, and other, mostly expenditure-side adjustments. The plan also included a temporary increase in the city's sales tax by 1% for five years, several changes to pension fund assumptions, including extending the amortization of the city's unfunded liability to 30 years from 20, and the deferral of a portion of its required pension payments in fiscal 2010 and 2011, generating $150 million and $80 million savings, respectively. These changes received the approval of the Pennsylvania legislature in September 2009. The plan requires the city to repay the deferred pension payments in fiscal 2013 and 2014 (earlier this year, the city issued bonds through PAID to prepay these obligations for budgetary savings and no change in payment structure). With these enhancements, the city ended fiscal 2010 with a budgetary basis surplus of $23 million, inclusive of a $70 million late state aid payment, much of which the city received after the fiscal 2010 accrual period. At the end of fiscal 2010, the General Fund deficit was reduced to $114 million (-3.1% of revenues) on a budgetary basis. On a GAAP basis, the city ran an additional $55 million operating deficit, increasing the total General Fund balance deficit to $130 million (-3.6% of revenues) and the undesignated fund balance deficit to $252 million (-6.9% of revenues).

The fiscal 2011 budget included a property tax increase of 10% which netted the city approximately $80 million in additional revenues. The city also benefitted from a full year of the increased sales tax, resulting in an additional $37 million over fiscal 2010. Overall, the city ran a surplus of approximately $114 million on a budgetary basis, increasing the budgetary fund balance to just above zero. On a GAAP basis, the city ran a $106 million surplus, but the General Fund deficit remained at $24 million, or -0.6% of revenues; the unassigned General Fund balance deficit was $46 million, or -1.2% of revenues. The city's fiscal 2012 budget reflected moderate increases in tax revenues, net of the removal of approximately $500 million in social service-related aid (and the corresponding expenditures) that was transferred to the Grants Revenue Fund. The fiscal 2012 unaudited financial report indicates that the city ended the year with a $147 million surplus on a budgetary basis, increasing General Fund balance to $147 million (4.2% of General Fund revenues). The report also indicates an $112.5 million surplus on a GAAP basis, increasing total GAAP General Fund balance to $88.6 million (2.5% of General Fund revenues), a positive figure for the first time since fiscal 2008.

The city continues to face pressure from the significant unfunded liability in its pension plan, which was 47% funded at the July 1, 2010 valuation. The city's Annual Required Contribution (ARC) for fiscal 2011 was $716 million, which represented a considerable 21% of audited General Fund operating expenditures.

The city's finances are subject to oversight by a state body, the Pennsylvania Intergovernmental Cooperation Authority (PICA, special tax rating of Aa2/stable outlook), with well-established five-year planning and quarterly monitoring procedures in place. State oversight will continue until long-term bonds issued by PICA to finance the city's early 1990's accumulated operating and capital deficits are fully retired (scheduled final maturity is in 2023).

LARGE, REGIONALLY-IMPORTANT ECONOMY; WEAK SOCIOECONOMIC INDICES REMAIN STABLE

The city is the economic center of a large, multi-state region, with a diverse, significantly-sized tax base of over $60 billion, with a stabilizing health care and higher education presence, although looming Federal spending cuts could affect these areas of the economy in the future. The city is also a center for tourism and experienced strengthened hotel occupancy in 2011; hotel development since 1993 has almost doubled the number of rooms available in the city.

Prior to 2010, the city had experienced a long trend of industry and population loss since 1950, with a particularly sharp economic retreat hitting in the late 1980's and early 1990's. The late 1990's saw a resumption of growth, with employment up 5.7% between 1998 and 2001. After a decline between 2001 and 2003, reflecting the earlier slowdown in the national economy, modest growth in employment resumed, increasing by 1.1% in 2005, 0.9% in 2006, 0.7% in 2007, and 0.2% in 2008. In 2009, annual employment growth reversed sharply, with a 3.1% drop in employment levels for the year, but was flat for 2010 and showed slight increase of 0.6% in 2011. For the first six months of 2012, the city has continued to experience minimal, but overall positive growth. The city's five-decade trend of population loss reversed in 2010, with a slight increase in population, which sits at 1.5 million, making it the fifth largest city in the nation.

Resident wealth indicators remain low, with 2010 per capita and median family incomes only about 77% and 72% of the national median, respectively, although these have not changed appreciably since 2000. Unemployment rates remain high at 10.8% in September 2012, well above the state (7.5%) and the nation (7.6%). The city's taxable base has grown over the past few years, averaging 1.6% annually since 2006; full valuation growth has been more rapid, averaging 3.4% annually since 2006. The city did not have the significant run-up in real estate values during the last decade and has subsequently not suffered from the drop in values that other areas have experienced. The $63 billion tax base does benefit from significant diversity, with the 10 largest tax payers comprising less than 4% of total valuation.

SIGNIFICANT DEBT BURDEN; MODERATE VARIABLE RATE EXPOSURE

Moody's expects the city to continue to have a significant debt burden with modest exposure to variable rate obligations. Philadelphia's total tax-supported debt is approximately $7.6 billion, inclusive of the city's $3.8 billion of general obligation debt and unconditional General Fund obligations, PICA deficit-funding bonds, and overlapping school district debt. The ratio of direct debt to full property value is high at 6.8%, climbing to 12.1% when overlapping debt is included, one of the highest ratios among the nation's 10 largest cities. The city's high debt burden reflects its dual city and county responsibilities, special efforts to promote economic development (e.g. stadiums, cultural assets, convention center and blight remediation), the PICA deficit-funding bonds, and $1.5 billion in pension bonds.

The city has moderate variable rate exposure representing approximately 9% of its total general obligation debt and unconditional General Fund obligations. The city's Series 2009B G.O. variable rate bonds are supported by a letter of credit from Royal Bank of Canada (RBC, rated Aa3/stable outlook) that expires in August of 2014. In conjunction with that issue, the city is party to a fixed payer swap with RBC for a notional amount equal to the remaining variable rate principal. The city also has exposure to variable rate debt through PAID Series 2007B bonds. Liquidity is provided by letters of credit from three providers, JP Morgan Chase Bank, N.A. (rated Aa3/stable outlook) for $117 million of principal, TD Bank, N.A. (rated Aa2/on review for downgrade) for $72 million, and PNC Bank, N.A. (rated A2/positive outlook) for $45 million. The JP Morgan Chase LOC expires in May of 2014; the PNC LOC expires in May 2014; and the TD Bank LOC expires in May of 2015. In conjunction with the PAID variable rate bonds, the city has entered into two fixed payer interest rate swaps, one with JP Morgan Chase for a notional amount of $217.3 million and one with Merrill Lynch Capital Services, Inc. (MLCS) for a notional amount of $72.4 million. In the case of all three of its fixed payer swaps, the city (either directly or through PAID) makes semi-annual payments based on a fixed rate and the counterparties make monthly payments based on the SIFMA Municipal Swap Index. The city is also a party to a basis swap, through PAID, with MLCS for a notional amount of $194 million. Under the swap, the city makes payments based on SIFMA and receives payments based on 67% of one-month LIBOR plus 20 basis points.

In the case of all of the swaps, regularly scheduled payments are General Fund obligations of the city. Early termination is optional for the city only. Termination events include either the city or the counterparty's rating falling below Baa3. Any termination payment by the city would be subordinate to the general obligation debt service payments.

Outlook

Moody's rating outlook for the City of Philadelphia's rating for general obligation and unconditional General Fund obligations is stable, reflecting the city's financial strengthening and stability, albeit at narrow reserve levels, a return to positive fund balance levels, and oversight by a state-appointed entity, including 5-year forecasting.

WHAT COULD MAKE THE RATING GO UP

- Sustained improvement to financial operations and an increase in General Fund balance well above the current levels

- Ability to navigate significant additional pension contributions and reduce unfunded pension liability

WHAT COULD MAKE THE RATING GO DOWN

-A return to deficit operations in fiscal 2013 or in subsequent years

- Stagnant or further weakened reserve levels

KEY STATISTICS

2010 population: 1.53 million

2011 full value: $63 billion

Full value per capita: $41,308

2010 Per capita income as % of nation: 77.3%

2010 Median family income as % of nation: 72.4%

Direct debt burden: 6.8%

Total debt burden: 12.1%

Payout of principal (10 years): 44.7%

FY2011 General Fund balance (budgetary basis): $92,000 (0% of General Fund revenues)

FY2011 General Fund balance (GAAP basis): -$23.9 million (-0.6 % of General Fund revenues)

FY2011 Unassigned General Fund balance (GAAP basis): -$45.7 million (-3.9% of General Fund revenues)

FY2012 General Fund balance (unaudited - budgetary basis): $147 million (4.2% of General Fund revenues)

FY2012 General Fund balance (unaudited - GAAP basis): $88.6 million (2.5% of General Fund revenues)

FY2012 Unassigned General Fund balance (unaudited - GAAP basis): $70.5 million (2.0% of General Fund revenues)

Post-sale parity debt outstanding: $3.83 billion

The principal methodologies used in this rating were General Obligation Bonds Issued by U.S. Local Governments published in October 2009 and Short-Term Cash Flow Notes published in May 2007. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

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