MOODY'S
INVESTORS SERVICE

New Issue: Moody's assigns A2 to Philadelphia's, PA $57.3M Lease Revenue Bonds, 2014B

Global Credit Research - 30 May 2014

Maintains A2 on $3.9B GO and guaranteed bonds

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

Moody's Rating

ISSUE	RATING
Lease Revenue Refunding Bonds, 2014 Series B	A2

Sale Amount	$57,300,000
Expected Sale Date	07/01/14
Rating Description	General Obligation

Moody's Outlook STA

Opinion

NEW YORK, May 30, 2014 --Moody's Investors Service has assigned an A2 rating to the Philadelphia Authority for Industrial Development, PA's $57.3 million Lease Revenue Refunding Bonds, Series 2014B.

The bonds are secured by the City of Philadelphia's unconditional obligation to make debt service payments from the General Fund under a series of lease agreements with the authority. While this pledge is not a direct general obligation of the city, we see the "absolute and unconditional" nature of the agreement to be of equivalent credit quality to the city's general obligation pledge. We therefore rate these bonds on parity with the city's General Obligation bonds.

We maintain the A2 rating on $3.9 billion of GO bonds and other unconditional General Fund obligations. The outlook is stable.

Proceeds of the current issue will be used to refund the authority's multi-modal Series 2007B-4 bonds and terminate related portions of the associated swap. The deal will effectively convert that series into fixed rate debt and achieve net present value savings of approximately 2%.

SUMMARY RATING RATIONALE

The A2 rating reflects the city's large tax base, and its position as a regional economic center anchored by a significant non-profit institutional presence and a number of major corporations and other large employers. The rating also incorporates the city's heavy debt burden, high fixed costs, and below-average financial position, which has historically been pressured because of reliance on economically sensitive revenues.

The stable outlook reflects the improving trends in most of the city's important tax revenues, driven by an improving economy and growth in the tax base. Many of the weak socioeconomic characteristics of the city -- such as a high poverty rate, an aging population, and a contracting tax base - have shown some more positive trends in recent years. Although the city faces numerous pressures in the long term, including large unfunded pension liabilities and costs related to labor and health care, strong management, comprehensive financial planning, and a generally strengthening tax base will keep the city's credit profile stable.

STRENGTHS

Regional economic center with major institutional presence

Comprehensive long-term financial planning

Recent trend of improving revenues

Reversal of decades-long contraction in tax base and loss of population

CHALLENGES

Below-average socio-economic characteristics

Long-term demographic decline

Weaker than average reserve levels

Exposure to economically sensitive revenues

Heavy unfunded pension liabilities

Large debt burden

DETAILED CREDIT DISCUSSION

VOLATILE REVENUE COMPOSITION, HISTORICALLY NARROW RESERVES

The city's financial position is characterized by a volatile and economically sensitive revenue mix and historically narrow reserves.

The city mostly funds its nearly $4 billion General Fund budget with wage taxes (approximately 40% of revenues), property taxes (14%), business income and receipts taxes (12%), and sales taxes (7%).

Wage tax and business tax revenue fell during the economic downturn, pressuring the city's financial position and contributing to a GAAP-basis General Fund balance as low as negative $130 million (-4% of revenues) in 2010.

The city took a number of favorable steps to manage the steep loss of revenue, including increasing property taxes nearly 10%, reducing employees by more than 1,500, winning higher pension contributions from some collective bargaining groups, and temporarily increasing the city sales tax rate to 2% from 1%. The city also deferred a portion of its pension contributions in 2010 and 2011. The deferral has been fully repaid. Both the temporary sales tax increase and the pension deferral required, and received, state approval.

These measures, combined with conservative budgeting and the economic recovery, have driven a rebound in the city's finances. In 2013, the city added $196 million to its General Fund balance to bring it to $284 million, or 8% of revenues, the highest level since 2007.

The city projects a $177 million deficit for 2014. A deficit of this magnitude could result in downward pressure to the city's credit rating. The composition of economically sensitive revenues, combined with heavy pension contribution requirements and other fixed costs, leave the city vulnerable to future economic downturns, especially if reserves fall substantially from current levels.

Ultimately, the city's conservative budgeting, comprehensive long-term financial planning, and efforts to contain costs will contribute to the maintenance of adequate reserves and ongoing stability. The city is under oversight from the Pennsylvania Intergovernmental Cooperation Authority (PICA), which continues to monitor and help stabilize the city's financial operations.

LARGE ECONOMIC CENTER WILL CONTINUE TO LAG NATION

The Philadelphia economy will continue to face relative economic weakness, including weak socioeconomic factors and high unemployment. The median family income of Philadelphia residents is equal to 72.7% of the US median, lower than cities of comparable size in the US. Unemployment is typically higher than state and national levels, and the poverty rate as of 2012 was quite high at 26.9%.

Philadelphia benefits greatly from its role as a regional economic center for a multi-state area, and is home to dozens of institutions that anchor the tax base. The city has seen some economic revitalization in recent years,

reversing a decades-long trend of population loss, and attracting population that is young and well-educated.

We believe this revitalization has largely been driven by the city's strong mix of hospitals and universities. Of the 10 largest employers in the city, nine are either higher education or healthcare entities, most prominently the University of Pennsylvania (Aa2 stable) and University of Pennsylvania Health System (Aa3 stable). The city is home to about 30 hospitals, including Thomas Jefferson University Hospital and the Children's Hospital of Philadelphia (Aa2 stable).

The city's strong non-profit sector provides some underlying strength to the economy that is not reflected in tax base valuation or socioeconomic statistics. Approximately 27% of the city's $137 billion base is exempt from property taxes (roughly $100 billion is taxable). About 155,000 college students are estimated to live in Philadelphia, and about 300,000 people commute from outside the city to work in Philadelphia. The traditional measures of tax base strength understate the city's economic resilience, although persistent poverty and weak income indices remain a challenge. We will continue to monitor the recent improvements in the city's tax base, although we believe it will be challenged to continue growing at the current pace in the long term.

SIGNIFICANT DEBT BURDEN, SOME VARIABLE RATE EXPOSURE

The city's debt burden is substantial, and we expect the cost of debt service to continue pressuring the city's budget for the long term. The city has about $3.9 billion of GO debt and other obligations on parity with its GO. PICA has approximately $409 million of bonds outstanding that were issued on behalf of the city and secured by a first lien on city wage taxes, and we include it in the city's debt burden. The city's total debt burden is equal to 4.4% of the city's full value, above-average for similar large cities, although it is closer to average relative to operating revenues (debt is 1.2 times revenues) and on a per capita basis ($2,864). The debt burden is equal to 7.7% of full value when the overlapping obligations of the Philadelphia School District (rated Ba2 negative) are taken into consideration.

About 8% of the city's debt is in variable rate mode, an exposure we consider manageable. The city has liquidity facilities for the debt and interest rate derivatives associated with the variable rate debt. As of the latest valuation, the city's swaps were valued at negative $65 million. In the case of all of the swaps, regularly scheduled payments are General Fund obligations of the city.

SIGNIFICANT PENSION EXPOSURE

The city will continue to face growing pressure from funding its pension obligations. Most of the city's 28,000 employees participate in a single plan: the Municipal Pension Plan. The cost of funding benefits to the plan's nearly 65,000 members are high, and will continue to increase. As of 2013, we estimate the adjusted net pension liability for the plan was equal to 2.5 times revenues and 9.5% of full value. Moody's uses the adjusted net pension liability to improve comparability of reported pension liabilities. The adjustments are not intended to replace the city's reported information, but to improve comparability with other rated entities.

The cost of contributing to the pension plan in 2013 was $769 million, or 21% of revenues. Included in this figure was debt service on pension bonds and the cost of amortizing $230 million of contribution deferrals in 2010 and 2011. The city's 5-year plan estimates pension contributions in the $550 million to $650 million range annually after this deferral is fully amortized in 2014.

One favorable development is the city's plan to sell the Philadelphia Gas Works (Baa2 positive) to a private investor for $1.86 billion, and use $420 million or more of the proceeds to increase pension funding. The city intends to continue contributing to the plan at current levels, meaning any decrease in the Minimum Municipal Obligation resulting from the sale would be re-invested in the plan to increase funding further. If it succeeds, this deal could lead to a stronger funded position for the plan and alleviate potential future funding strains.

STABLE OUTLOOK

The city has emerged from the recession with adequate finances and an improving economy. Most of the city's important revenue sources are on a positive trend. The long-term drags that have impeded the city's economy for decades - high poverty, below-average wealth, a contracting tax base - appear to be moderating somewhat. Although the city still faces numerous long-term pressures, we believe a strong management regime, comprehensive financial planning, and a generally strengthening tax base will keep the city's credit profile stable.

WHAT COULD CHANGE THE RATING UP:

Continuing growth in the tax base and strengthening of socio-economic profile

Expansion of reserves to levels consistent with higher rating categories

Substantial decrease of unfunded pension liabilities

WHAT COULD CHANGE THE RATING DOWN:

Resumption of tax base declines

Return to lower or negative fund balance levels

Failure to fund pension plan on a sound basis going forward

KEY STATISTICS:

Tax base size: Full Value: $99.9 billion

Full value per capita: $65,678

Median family income as % of US: 72.7%

Available fund balance as a % of revenues: 7.7%

5-year dollar change in adjusted fund balance as a % of revenues: 1.35%

Cash balance as a % of revenue: 12.7%

5-year dollar change in cash as a % of revenues: 5%

Institutional Framework: Aa

Operating History: 5-year average of operating revenues/operating expenditures: 0.99x

Net direct debt/full value: 4.4%

Net direct debt/operating revenues: 1.2x

3-year average Moody's ANPL/Full Value: 9.5%

3-year average Moody's ANPL/operating revenues: 2.53x

The principal methodology used in this rating was US Local Government General Obligation Debt published in January 2014. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

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