

New Issue: [Redevelopment Auth. of The City of Phil, PA](#)

REVISED-- MOODY'S ASSIGNS Baa1 UNDERLYING RATING AND NEGATIVE OUTLOOK TO \$126 MILLION ISSUE FROM REDEVELOPMENT AUTHORITY OF PHILADELPHIA

RATING BASED ON UNCONDITIONAL CITY PLEDGE TO PAY DEBT SERVICE

Philadelphia (City of) PA
 Municipality
 PA

Moody's Rating

ISSUE	RATING
Taxable Revenue Bonds, Series 2005A	Baa1
Sale Amount	\$26,000,000
Expected Sale Date	02/04/05
Rating Description	Revenue
Qualified Redevelopment Revenue Bonds, Series 2005B (AMT)	Baa1
Sale Amount	\$45,000,000
Expected Sale Date	02/04/05
Rating Description	Revenue
Revenue Bonds, Series 2005C	Baa1
Sale Amount	\$55,000,000
Expected Sale Date	02/04/05
Rating Description	Revenue

Opinion

NEW YORK, Feb 1, 2005 -- Moody's has assigned an underlying Baa1 rating and negative outlook to the Redevelopment Authority of Philadelphia's \$26 million Taxable Revenue Bonds, Series 2005A; \$45 million Qualified Redevelopment Revenue Bonds, Series 2005B (AMT); and \$55 million Revenue Bonds, Series 2005C. These bonds are being issued as part of the City of Philadelphia Neighborhood Transformation Initiative and proceeds will finance a program of demolition, clearance, and transformation of certain blighted areas of the City of Philadelphia in order to spur economic development. Bond repayment will come from unconditional General Fund payments made by the City of Philadelphia under a service agreement with the Authority, which payments represent the sole source of security for the bonds.

The Baa1 rating reflects the credit quality of the City of Philadelphia, whose General Obligation bonds are also rated Baa1, and the unconditional nature of the city's obligation to service these bonds from current revenues in each fiscal year. The city's G.O. rating, in turn, reflects weak long-term demographic and economic trends, property values that have grown only modestly over the last decade, and a heavy burden of tax-supported debt. Mitigating these weaknesses, city finances are subject to oversight by a state body, with well-established five-year planning and quarterly monitoring procedures in place. Although the city's budgetary management has been effective, contributing to maintenance of a positive unreserved General Fund balance for over a decade, three years of large operating deficits have depleted reserves and created a negative unreserved fund balance as of the end of fiscal 2004.

The negative outlook reflects this trend of declining finances which, net of a late \$90 million payment from the state in fiscal 2004, is expected to carry over into fiscal 2005. The city's General Fund cash balance, which had been adequate in previous years, is also budgeted to be very narrow at the end of fiscal 2005, in part due to recent employee contract negotiations which added greater-than-anticipated costs to the City's budget and prompted a revision of the five-year financial plan. The city's financial challenges have also been the result of stagnant tax receipts due to the weak economy, additional financial contributions to the Philadelphia School District (rated Ba2) and the suspension of annual payments from the Philadelphia Gas Works.

At this time, Moody's has affirmed the Baa1 rating and negative outlook on the city's \$1 billion in outstanding general obligation debt as well as approximately \$2.6 billion in other unconditional General Fund obligations. The current bonds are expected to be insured by Financial Guaranty Insurance Company (FGIC), and subject to receipt of the insurance policy will also be assigned FGIC's current financial strength rating of Aaa.

BONDS SECURED BY UNCONDITIONAL CITY PAYMENTS

Proceeds of the current bond sale will fund the city's Neighborhood Transformation Initiative, a program of demolition, clearance, and transformation of certain blighted areas in the city, in order to spur economic development. The sole source of repayment and bond security is a pledge by the Authority of payments to be received from the city under a service agreement between the city and the Authority. The city is unconditionally obligated to make such payments from current revenues in the General Fund each year. This legal obligation is similar to those associated with approximately \$2.6 billion of other outstanding debt obligations of the city, including its pension and convention center obligations. In view of the city's strong financial oversight and resulting reasonable level of financial flexibility in its General Fund, these obligations have all been rated at the same level as the city's unlimited tax G.O. bonds. The City is required to balance its budget each year and to raise taxes if necessary to achieve such balance (?).

WEAK LONG-TERM DEMOGRAPHIC AND ECONOMIC TRENDS. MODERATE GROWTH RESUMED IN LATE 1990's, BUT GAVE WAY TO NATIONAL SLOWDOWN IN 2001

Philadelphia has 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. Total employment in the City is still down more than 10% from its level in 1988. The late 1990's saw a resumption of growth, with employment up 4% between 1997 and 2000, and then down about 2% between 2000 and 2003, reflecting the slowdown in the national economy. Per the City's financial plan(?), employment is expected to be flat or slightly down for 2005. A modest decline of about 0.5% was seen in 2004. Manufacturing has continued to decline in importance, and diversified services now account for 45% of total employment (or more than 50% including the finance/insurance/real estate sector). Population loss during the 1990's was just over 4%, though this was only about half the loss that had been estimated prior to the 2000 census count. With an estimated 1.48 million residents, the city remains the nation's fifth most populous.

Resident wealth indicators are low, with per capita and median family incomes only about 77% and 74% of the national average, respectively, and 23% of residents below the poverty level. A relatively large portion of the city's job base is in low-paying sectors, with healthcare, social services, and state & local government accounting for about 30% of total jobs (a large share of which are likely held by city residents, as opposed to commuters). In addition, the city unemployment rate has ranged from 125% to 150% of the national average over the past decade and was 7.6% in October of 2004, above the state and nation (both 5.1%).

The city's property tax base has grown modestly over the past decade, although it has picked up in recent years, averaging 2.8% growth annually since 1998. The \$39 billion tax base does benefit from significant diversity, with the 10 largest tax payers comprising less than 5% of total valuation.

FISCAL CHALLENGES MITIGATED BY EFFECTIVE MANAGEMENT AND STATE OVERSIGHT

Philadelphia's responsibility for both city and county government services, trend of loss of middle-class residents, already high tax rates and sluggish tax base growth have combined to present significant challenges to the maintenance of balanced financial operations. The city's finances are subject to oversight by a state body, the Pennsylvania Intergovernmental Cooperation Authority (PICA), with well-established five-year planning and quarterly monitoring procedures in place. State oversight is to continue until long-term bonds sold by PICA to finance the city's early 1990's accumulated operating and capital deficits are fully retired (scheduled final maturity is in 2022). In addition, the city's financial management processes have been prudent, with cautious revenue forecasts, moderate contingency reserves, and other smaller layers of cushion included in recent years' annual budgets.

Philadelphia's home rule charter technically does not permit the city to maintain a General Fund surplus, and therefore the city budgets annually to utilize any surplus generated in prior years. A positive unreserved General Fund balance was maintained for over a decade, but has now been substantially depleted by three consecutive years of operating deficit, (2002, 2003, and 2004).. Fiscal 2004 figures show a decline in unreserved General Fund balance to -\$148 million, although this is partially due to a late payment from the state of \$90 million, received in September, 2004. Given the receipt of the state payment in fiscal 2005, the city is currently projecting surplus operations for the year. However, had the \$90 million payment been recognized in fiscal 2004, the City would be likely to record its fourth year of deficit operations in 2005. We note that the City's ending balances on a budget basis in recent year's have been modestly higher than the unreserved GAAP balance, due to changes in some tax payment dates that were positive on a cash basis but not on GAAP basis.

Recent year's results have been partially due to gradual reductions in the city's wage tax rate since 1996, intended to enhance the city's competitive position relative to its PMSA. To date, the rate has been reduced by about 13%, with a further reduction included in recently-introduced 2006 budget. Facing somewhat unfavorable results from recent employee negotiations, the city has recently expanded its efforts to reduce

the city workforce, including 200 layoffs. The city's current five-year plan shows narrow, but positive reserve levels through fiscal 2010. Moody's negative outlook reflects our concern that the city's financial operations may not yet have stabilized, and that the city could face continued operating deficits going forward.

The mayor recently introduced the fiscal 2006 budget, which includes no use of General Fund balance. The budget anticipates modest growth in local tax collections, most significantly the wage tax (+1.25%, net of annual reduction) which accounts for about 1/3 of total revenue. Intergovernmental revenue from the federal government and Commonwealth of Pennsylvania is assumed to show a slight decline (-1.38%). At the same time, General Fund spending is budgeted to increase by 2.5%. The budget also assumes a significant drop in the real estate transfer tax, which has been growing rapidly, but is expected to fall off in anticipation of rising interest rates.

\$7 BILLION OF TAX SUPPORTED DEBT NOW OUTSTANDING; CITY'S ANNUAL SERVICING BURDEN IS HIGH BUT MANAGEABLE

With this issue, Philadelphia's total tax-supported debt is now \$7 billion. The ratio of debt to full property value is very high at 18%. This is the highest ratio 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. convention center, stadiums, blight remediation), the PICA deficit-funding bonds sold in the early 1990's, and a \$1.3 billion pension bond issued several years ago. In addition, the school district has faced significant capital needs associated with its aging facilities. With city G.O. bond issuance tightly constrained by a debt cap in the Pennsylvania Constitution, there will likely be continued use of non-G.O. debt structures similar to the current bonds.

Outlook

Moody's rating outlook for Philadelphia is negative, reflecting the City's recent and continuing trend of declining finances. While the city's available cash balance will remain adequate through the year, current projections have very narrow balances at the end of fiscal 2005. Although the negative unreserved General Fund balance for fiscal 2004 was exacerbated by a late state payment, the city has little room for continued operating deficits going forward. Moody's believes that balanced operations (net of the late payment) in fiscal 2005, and continued balance in the adopted fiscal 2006 budget are important to preserving credit quality..

KEY STATISTICS

Population: 1.48 million

2004 full value: \$39.2 billion

Full value per capita: \$25,798

Per capita income as % of state: 79.1%

Median family income as % of state: 75.3%

Direct debt burden: 11.9%

Total/Overlapping debt burden: 17.9%

FY2004 unreserved General Fund balance: -\$148 million (-4.8%)

Post-sale parity debt affected: \$3.6 billion

Analysts

Geordie Thompson
Analyst
Public Finance Group
Moody's Investors Service

Timothy Blake
Backup Analyst
Public Finance Group
Moody's Investors Service

Bill Leech
Senior Credit Officer

Contacts

Journalists: (212) 553-0376
Research Clients: (212) 553-1653

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