New Issue: Philadelphia (City of) PA

MOODY'S ASSIGNS MIG 1 RATING TO THE CITY OF PHILADELPHIA'S (PA) $200 MILLION TRANS

AFFIRMS Baa1 LONG-TERM RATING AND STABLE OUTLOOK AFFECTING APPROXIMATELY $4.57 BILLION OF PARITY DEBT OUTSTANDING

Municipality
PA

Moody's Rating

ISSUE	RATING
Tax and Revenue Anticipation Notes, Series A of 2007-2008	MIG 1

Sale Amount	$200,000,000
Expected Sale Date	07/31/07
Rating Description	Tax and Revenue Anticipation Notes

Opinion

NEW YORK, Jul 25, 2007 -- Moody's Investors Service has assigned a MIG 1 rating to the City of Philadelphia's Tax and Revenue Anticipation Notes, Series A of 2007-2008, which mature on June 30, 2008. Issued to fund temporary cash flow imbalances in the city's General Fund during the upcoming fiscal year, the notes are secured by a pledge of taxes and revenues to be received by the General Fund during fiscal 2008. The city has covenanted to make deposits into a dedicated repayment fund held by the note trustee on May 30, 2008 (full principal amount) and June 27, 2008 (full interest requirement).

The best-quality short-term note rating reflects (i) the city's strong financial management practices and state-board oversight, producing relatively good financial results that have improved over the past three years, (ii) its long and successful track record as an issuer of short-term notes, (iii) General Fund cash flow projections for 2008 that indicate an ending cash balance of $431 million after note repayment, (iv) an additional $339 million of cash projected to be available in the Capital Improvement Fund, Grants Revenue Fund and other funds outside the General Fund, and (v) conservative estimates for fiscal 2008 revenues as well as the year-end Grants Fund balance, which together could understate the total ending fiscal 2008 cash balance to a moderate degree.

The affirmation of the Baa1 long-term rating reflects the city's improving, although still weak, demographic and economic trends, modest property value growth, 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. The city's budgetary management has been effective, which contributed to maintenance of a positive unreserved General Fund balance for over a decade; three years of large operating deficits, however, depleted reserves and created a negative unreserved fund balance as of the end of fiscal 2004. The city returned to surplus operations in fiscal 2005 and 2006. Moody's stable outlook reflects the expectation that financial operations will remain fairly stable going forward, as well as a Five Year Plan, expected to be approved by the city's oversight board soon, that demonstrates narrow, but adequate reserves for the next few years.

GENERAL FUND PROJECTIONS INDICATE RELATIVELY COMFORTABLE CASH BALANCE AFTER NOTE REPAYMENT

The city is a regular issuer of temporary cash flow notes, reflecting its essentially level monthly expenditure patterns (except for the pension contribution that is typically made in the first month of the year) and uneven revenue collections. For example, the majority of receipts from the property tax and business privilege tax are collected in the second half of the fiscal year. In addition, state aid reimbursements for human services programs normally delay cash flow receipts to the city. The city's last five short-term note sales (other than the current issue) have ranged between $300 million and $370 million; this year's issuance is significantly smaller than in recent years due to improved cash balances.

The city's cash flow projections indicate an expected ending General Fund cash balance in June, 2008, after note repayment, of $431 million, down from an assumed opening balance of $490 million. The ending balance represents approximately 11.6% of total cash receipts anticipated during the year, a relatively comfortable cushion to absorb any risks in the revenue and expenditure forecasts. The city's cash forecasts have been fairly reliable historically, reflecting strong budgetary practices. The 2008 cash flow projections reflect the formal budget for the year.

CASH IN OTHER FUNDS PROVIDES ADEQUATE CUSHION

The city projects an additional $339 million of cash to be available in other funds as of the end of June 2008. Thus, on a consolidated cash basis, the city projects an ending balance at June, 2008, after note repayment, of $770 million, which represents a comfortable 20.6% of total anticipated receipts for the year. Approximately $244.4 million of this additional projected cash will be in the Capital Improvement Fund, which reflects the proceeds of an anticipated GO bond issue later this year. The balance of the projected additional funds resides in a variety of other funds, including a Grants Revenue Fund, which is projected to have $70 million at the end of the year, although that fund has typically been above projections in past years.

STRENGTHENING FINANCIAL OPERATIONS REPLENISH RESERVES TO ADEQUATE LEVELS

Prudent financial processes, cautious revenue forecasting, and growth in tax receipts resulted in two years of surplus operations that increased reserves since substantial operating deficits in 2002 through 2004 reduced unreserved General Fund balance to -$148 million, or a negative 4.8% of 2004 General Fund revenues. Prior to 2004, the city had maintained a positive unreserved General Fund balance for 11 years, even with gradual reductions in the city's wage tax rate since 1996, intended to enhance the city's competitive position relative to the MSA. Through 2007, the rate has been reduced by approximately 14%, with an additional reduction included in the 2008 budget. Facing somewhat unfavorable results from employee negotiations three years ago, the city expanded its efforts to reduce the city workforce, including 200 layoffs.

Philadelphia's responsibility for both city and county government services, a 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 response to these challenges, 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.

The fiscal 2004 deficit fund balance was exacerbated by a late payment from the state of $90 million, received in September, 2004. That state payment was booked in the fiscal 2005 year, which contributed to a GAAP surplus of $150 million, increasing total General Fund balance to $154 million (7.5% of General Fund revenues), although the unreserved GAAP General Fund balance was still negative at -$36 million. On a budget basis, however, the fiscal 2005 surplus increased General Fund reserves from -$47 million (-1.4% of General Fund revenues) to $96 million (a narrow 2.8% of General Fund revenues) and the fiscal 2006 surplus further increased reserves to $254 million (a satisfactory 7.4% of General Fund revenues). We note that the city's ending balances on a budgetary basis have been higher than the unreserved GAAP balance, due to changes in some tax payment dates that were positive on a cash basis but not on a GAAP basis.

Projected results for fiscal 2007, which ended on June 30, show a use of fund balance of approximately $38 million, reducing General Fund balance, on a budgetary basis, to $216 million, reflecting an adequate 5.7% of General Fund revenues. The use of reserves was driven by unanticipated expenditures payroll costs related to higher-than-expected prison population as well as a lump sum benefit payment.

The budget was passed in conjunction with the 2008-2012 Five Year Plan and is expected to be approved soon, with some changes, by PICA. The adopted budget anticipates growth in local tax collections, including an increase in revenues from the wage tax (2.9%) which accounts for about 1/3 of total revenue and where a program of gradual reductions in the tax rate is ongoing. The estimate for intergovernmental revenues assumes 1.2% growth over fiscal 2007. Overall, the fiscal 2008 budget assumes a 2.2% increase in General Fund revenues over 2007 projections and a 2.3% increase in General Fund expenditures, leading to a budgeted $87 million use of reserves. City officials report that there will be changes to the plan that could reduce the use of fund balance to a lesser level.

In addition to this use of reserves in fiscal 2008, the city's Five Year Plan currently calls for additional General Fund balance appropriations of $35 million from fiscal 2009 through fiscal 2012, although Moody's believes that this incorporates conservative revenue estimates. Moody's notes, however, that the fiscal 2012 ending fund balance would represent the low point at $46.6 million and, unlike the past several five-year plans, there is no year where reserves will dip to minimal levels (i.e. below $10 million). Despite the relative improvement, the city still faces financial challenges, including negotiations with police and fire personnel in the coming year. The Five Year Plan takes into account post-employment benefits for all existing retirees for the full five years, even though many will begin to drop off in 2009 and 2010 due to a five year cap on such benefits.

WEAK LONG-TERM DEMOGRAPHIC AND ECONOMIC TRENDS, ALTHOUGH SOME IMPROVEMENT INDICATED

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 5.7% between 1998 and 2001, and then down about 1.6% between 2001 and 2003, reflecting the slowdown in the national economy. The decline seemed to flatten in fiscal 2004, and then grow by about 1.1% in 2005 and 0.8% in 2006. Results for the first half of 2007 demonstrate continued growth, with each month showing an increase over the same month of the prior year. Manufacturing has continued to decline in importance, and diversified services now account for 54% of total employment (or more than 60% including the finance/insurance/real estate sector). Population loss during the 1990's was just over 4%, although this was only about half the loss that had been estimated prior to the 2000 census count. With an estimated 1.46 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 median, 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 and local government accounting for about 30% of total jobs (a large share of which are likely held by city residents, as opposed to commuters). Although city unemployment rates have averaged approximately 7.6% in recent years, it appears to be improving, and was 5.9% in May of 2007, although still above the state (4.1%) and nation (4.3%).

The city's property tax base has grown modestly over the past decade, averaging 2.7% growth annually since 2002. The $46.5 billion tax base does benefit from significant diversity, with the 10 largest tax payers comprising less than 5% of total valuation.

OVER $7.0 BILLION OF TAX SUPPORTED DEBT NOW OUTSTANDING; CITY'S ANNUAL SERVICING BURDEN IS HIGH BUT MANAGEABLE

Including this issue, Philadelphia's total tax-supported debt is just over $7.0 billion, inclusive of overlapping school debt. The ratio of debt to full property value is high at 15.4%, 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. 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 going forward.

Outlook

Moody's rating outlook for Philadelphia is stable, reflecting the city's return to surplus operations and the expectation of satisfactory reserves going forward. Moody's believes the city will continue to benefit from the five-year planning and quarterly monitoring procedures required by the state oversight board, as well as the conservative budgeting provided by the financial management team.

What could make the GO rating go UP:

- Continued strengthening of financial operations resulting in substantial fund balance improvement

- Improvement in economic/demographic trends

What could make the GO rating go DOWN:

- Financial deterioration in fiscal 2008 and beyond

KEY STATISTICS

2005 estimated population: 1.46 million

2007 full value: $46.5 billion

Full value per capita: $31,751

Per capita income as % of state: 79.1%

Median family income as % of state: 75.3%

Direct debt burden: 9.8%

Total debt burden: 15.4%

Payout of principal (10 years): 49.9%

FY2006 General Fund balance: $304.5 million (8.5% of General Fund revenues)

FY2006 Unreserved General Fund balance: $111.2 million (3.1% of General Fund revenues)

FY2006 General Fund balance (budget basis): $254 million (7.4% of General Fund revenues)

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