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Ratings

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Summary:
Philadelphia; Note

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Credit Profile		
US$175.0 mil tax and rev antic nts ser 2016A due 06/30/2017		
Short Term Rating	SP-1+	New

Rationale

S&P Global Ratings assigned its 'SP-1+' rating to Philadelphia's series 2016-2017A tax and revenue anticipation notes (TRANs).

The rating reflects our opinion of the city's:

- Strong projected debt service coverage (DSC) of 3.38x at maturity; and
- Conservative budgeting practices that have resulted in a trend of actual coverage exceeding projections.

We believe financial oversight from Pennsylvania Intergovernmental Cooperation Authority and the recent modest improvement in general economic conditions provide additional support.

The TRANs are a general obligation of Philadelphia, but the city has not pledged its taxing power and therefore is not required to levy ad valorem taxes for TRAN payments. The TRANs are payable from, and secured by, a pledge of general fund taxes and revenues attributable to fiscal 2017. These amounts include general property taxes; wage taxes; business income and receipts (BIRT); sales taxes; and revenue from other governments.

TRAN proceeds will pay Philadelphia's general expenses prior to the receipt of income to be received in fiscal 2017 and pledged for note repayment. Principal and interest are due June 30, 2017, which coincides with the city's fiscal year-end. However, the repayment structure includes a fund held by the trustee into which officials are required to deposit the amount of principal borrowed on May 26, 2017, and the amount of accrued interest on June 27, 2017. It is our understanding these aggregate deposits will be sufficient to pay TRAN principal and interest due at maturity.

Philadelphia has a long history of cash-flow borrowing to finance seasonal cash flow needs. The principal amount for fiscal 2017 is flat relative to 2016 but up relative to the last three years ($175 million in both fiscal 2016 and 2017 compared with $130 million in 2015, $100 million in 2014, and $127 million in 2013). We do not view the increased par amounts in 2016 and 2017 as a credit negative given the strong coverage.

According to unaudited results, Philadelphia ended fiscal 2016 with a $447.4 million general fund cash balance after repayment of the annual TRAN borrowing. Unaudited coverage of principal and interest was 3.5x at maturity, better than the 2.5x projected at the time of the sale. The city's quarterly report for the period ended June 30, 2016, shows tax revenues exceeding the adopted budget by $39.1 million, with positive variances in sales tax receipts ($18.3 million), real estate transfer taxes ($15.7 million), wage and earnings tax receipts ($8.9 million), and BIRT ($1.3 million). Negative variances occurred in real property tax revenue ($7.7 million) due to the resolution of outstanding taxpayer appeals and other items ($5.4 million). Expenditures are projected to be $52.9 million above budget at $4.05 billion due to overtime, vehicle shortages, and costs related to the Papal visit.

Projected fiscal 2017 DSC of principal by general fund cash balances is, in our view, a strong 3.48x on the May principal set-aside date. We also view projected DSC of principal and interest at maturity as strong at 3.38x. In our view, the city uses conservative assumptions when preparing its cash flow projections. Revenues overall are budgeted to rise 3.1% year-over-year, while expenditures are up 5.9%. Wage and earnings tax receipts account for 35% of revenue and budgeted to rise 3.9% year-over-year despite the continuation of the wage tax cuts. Property taxes are budgeted at 15% of total receipts, after a modest 2.4% increase. Philadelphia is showing a new revenue stream in its fiscal 2017 cash flow statement; city council passed a sweetened-beverage tax that is scheduled to take effect Jan. 1, 2017 and will be levied at a rate of 1.5 cents per ounce. Officials report the city conducted a comprehensive study of beverage consumption and assumed the tax will negatively affect demand; the cash flow assumes the tax will generate $30.8 million (a small 1% of total revenue). We understand the $30.8 million of new revenue will be offset by a like amount of expenditures for new initiatives in the areas of education and parks. We also understand the tax is being challenged in the courts and that the city will minimize related expenditures until certain of the revenue stream's future.

The city pools cash and investments in a consolidated cash account except those which, for legal or contractual reasons, cannot be commingled. The fund is segregated into two funds: an operating fund that contains the general fund and a capital fund that houses bond proceeds. As of June 30, 2017, the projected balance of the operating fund is $357.9 million, which is slightly lower than the general fund ($427.6 million) due to a deficit in the grants revenue fund. Nevertheless, coverage based on $357.9 million is still strong at 2.99x.