FitchRatings

FITCH RATES PHILADELPHIA, PA'S $115MM GO AND REV RFDG BONDS 'A-'; OUTLOOK STABLE

Fitch Ratings-New York-04 April 2012: Fitch Ratings has assigned the following rating to the city of Philadelphia, PA (the city) general obligation (GO) bonds and the Philadelphia Redevelopment Authority revenue bonds:

--$22,060,000 GO refunding bonds, series 2012A, 'A-';
--$93,020,000 Philadelphia Redevelopment Authority revenue refunding bonds, series 2012 'A-'.

The revenue refunding bonds are expected to sell through a negotiated sale the week of April 16 while the GO refunding bonds will sell the week of April 23 via negotiated sale. Both series of bonds will be used to refund outstanding bonds for cost savings with no extension of maturity dates.

In addition, Fitch affirms the following ratings:

--$1.3 billion in outstanding GO bonds at 'A-';
--$245.3 million in lease revenue bonds issued by the Philadelphia Municipal Authority (PMA) at 'A-';
--$1.9 billion in bonds issued by the Philadelphia Authority for Industrial Development (PAID) at 'A-';
--$245.8 million in bonds issued by the Philadelphia Redevelopment Authority (RDA) at 'A-'.

The Rating Outlook is Stable.

SECURITY

The city's GO bonds are secured by the city's full faith and credit general obligation and its ad valorem tax pledge, without limitation as to rate or amount. Bonds issued by the RDA, PAID and PMA are secured by an annual service fee payable by the city under a non-cancelable service agreement with the city. The city's obligation to make payments required by the service agreements is absolute and unconditional.

RATING RATIONALE:

DIMINSIHED FINANCIAL FLEXIBILITY: Financial flexibility is constrained by a high overall tax burden, negative general fund balance position and a high level of fixed costs.

STRONG FINANCIAL MANAGEMENT: Fitch views positively management's efforts in recent years to contain costs and raise available revenues to address an ongoing budget imbalance, although significant budgetary pressures remain.

SIZEABLE DEBT BURDEN: Debt ratios are exceptionally high and with limited growth prospects for the city's tax base and population, will remain elevated over the long term.

LARGE UNFUNDED PENSION LAIBILITY: The city's pension fund is poorly funded, although Fitch views favorably the current administration's recent efforts to implement various pension reforms.

WEAK SOCIOECONOMIC PROFILE: Wealth levels remain notably low and above-average unemployment persists. Despite this weakness, Philadelphia remains an important center for health care and higher education with good prospects for long-term economic stability.

CREDIT PROFILE

IMPORTANT ECONOMIC CENTER TEMPERED BY CHALLENGING DEMOGRAPHICS

Philadelphia is both a city and county with an estimated population of slightly more than 1.5 million. The city serves as a regional economic center with a stable employment base weighted in the higher education and healthcare sectors. Led by the University of Pennsylvania, Jefferson Health System, and Temple University, the city is home to several large colleges and universities and is anchored by multiple hospitals and health systems.

Above average unemployment and weak income indicators persist, although current data suggests some recent improvement. Unemployment, measured at 10.1% in December 2011, remains elevated but showed year-over-year improvement after trending downward over the latter half of the prior year. The unemployment rates of the broader metropolitan statistical area (MSA) and state were appreciably lower at 7.1% and 7.3%, respectively.

Income levels grew at a slightly better clip over the prior decade in comparison to the state and nation but continue to approximate just 65% of the wealthier MSA and 75% of the commonwealth and nation. The city's poverty rate stands at 25%, sixth-highest among the nation's 50 largest cities. Population decline appears to have abated after nearly 50 years of population loss. The city's population increased slightly during the prior decade. The housing downturn has had a relatively modest impact on the city to date. The average Philadelphia residential home value was down on a cumulative basis just 18% from the peak of the housing market in 2007, compared to an average of 33% for the top 20 largest U.S. cities.

BUDGET BALANCING PLAN IMPLEMENTED AMID FALLING REVENUES

Recessionary pressure in recent years coupled with a depressed housing market prompted significant decline in tax revenues between fiscals 2008-2010 leading to multiple years of large operating deficits. Management responded favorably with significant mid-year expenditure cuts in fiscal 2009, including employee reductions, a hiring freeze, furloughs, a reduction in the number of active fire companies and a decrease in overtime and certain city services. The city also suspended through fiscal 2014 long-running annual rate cuts in its wage and business privilege taxes as part of a comprehensive budget-balancing plan.

The fiscal 2010 general fund budget continued the positive cost containment implemented in the prior year and included the imposition of a temporary five-year sales tax increase and the partial deferral of annual pension costs over the ensuing two fiscal years. In total, the administration's efforts would have produced an operating surplus if not for a late state-aid payment that was received early in fiscal 2011. Instead, the fiscal year ended with a $54.7 million general fund deficit on a GAAP basis, although the unreserved fund balance improved slightly from -$274.5 million to -$251.8 million, still equal to an insufficient -6.8% of spending.

Results for fiscal 2011 were positive, driven primarily by a nearly 10% property tax increase, a full year of the sales tax increase, nominal growth in general fund expenditures and receipt of a large state aid payment intended for the prior fiscal year. Fiscal 2011 ended with a sizeable $106.4 million general fund surplus on a GAAP basis as a result, which improved the unrestricted general fund balance (the sum of the unassigned, assigned and committed fund balance under GASB 54) to a still weak -$45.6 million. On a budgetary basis, the city reported a minimal year-end general fund balance of $92,000.

The city relies on annual cash flow notes for liquidity. The $173 million note issuance for fiscal 2012 was well below historical borrowings and the fiscal 2013 borrowing is expected to be similar in size. Year-end projections for fiscal 2012 indicate a general fund surplus on a budgetary basis of approximately $68.5 million, slightly better than year-end results included in the adopted budget. For the year, tax revenues are down somewhat relative to the adopted budget due to weaker than expected growth, but the negative variance is offset by several one-time revenues, including a $34 million state pension aid payment from the state.

BUDGETARY PRESSURE REMAINS

The proposed fiscal 2013 general fund budget raises spending by almost 3%, mostly due to the repayment of previously deferred pension costs. Total revenue is forecast to grow by just .5%, prompting a projected $15.5 million deficit and an ending fund balance (on a budgetary basis) of $53 million, equal to a narrow 1.5% of spending.

While most growth assumptions included in the budget appear reasonable, Fitch believes the city's exposure to potential state cuts, possible variances related to property tax revenue and a recent decision by the State Tax Equalization Board (STEB) concerning property tax appeals could exacerbate the budget gap already assumed for fiscal 2013. The proposed 2013 budget relies on an assumed amount of property tax revenue driven by the implementation of a revaluation of the city's entire property tax base, which city council is still debating and must ultimately approve. In addition, the proposed budget does not account for the recent adverse decision of the STEB, which could also impact the amount of property tax revenue incorporated into the coming year's budget.

ELEVATED LONG-TERM LIABILITIES

The city's aggregate debt burden, which includes debt associated with the Philadelphia School District, remains notably high at close to $4,500 per capita and 15% of market value, although Fitch notes that the market value ratio is somewhat overstated due to antiquated property assessment practices. As indicated above, the city expects to implement a more accurate assessment process based on full value in fiscal 2013.

The city's 2012-2017 government-wide capital improvement plan (CIP) totals $8.9 billion, of which about $6.1 billion is for the city's self-supporting airport and water and sewer utility system. Of the remaining $2.8 billion in capital projects, the city expects the state and federal government to fund about $1.9 billion while the balance, estimated at $889 million, will be derived almost entirely from city-supported annual debt issuance.

Pension funding continues to be a key credit concern for Fitch, despite the recent implementation of cost-saving changes to pension benefits for uniformed employees. The city funds on an annual basis a statutorily determined pension requirement, which is less than the actuarially required contribution amount. Full funding of the annual obligation resumed in fiscal 2012 following a partial deferral for budgetary relief in the previous two years. The proposed five-year plan shows annual pension payments rising by 14 % and 19% in fiscals 2013 and 2014, respectively to meet the repayment obligation. Pension costs through the life of the five-year plan are forecast to consume an above average 17% of annual general fund spending.

The most recent actuarial report shows a funded ratio of about 50% and an unfunded liability of about $4.7 billion. Using Fitch's more conservative 7% discount rate assumption, the city's pension plan would be 48% funded. The city's other post-employment benefit (OPEB) liability is also sizable at $1.2 billion based on the latest valuation available, although benefits are only provided for the first five years following retirement, and the city's five-year financial plan consistently includes the annual pay-as-you-go amount.

Contact:

Primary Analyst
Christopher Hessenthaler
Senior Director
+1-212-908-0773
Fitch, Inc.
One State Street Plaza
New York, NY 10004

Secondary Analyst
Eric Friedman
Director
+1-212-908-9181

Committee Chairperson
Amy R. Laskey
Managing Director

+1-212-908-0568

Media Relations: Sandro Scenga, New York, Tel: +1 212-908-0278, Email: sandro.scenga@fitchratings.com.

Additional information is available at 'www.fitchratings.com'. The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.

In addition to the sources of information identified in Fitch's Tax-Supported Rating Criteria, this action was additionally informed by information from Creditscope, University Financial Associates, S&P/Case-Shiller Home Price Index, HIS Global Insight, Zillow.com, National Association of Realtors. .

Applicable Criteria and Related Research:
--'Tax-Supported Rating Criteria' (Aug. 15, 2011);
--'U.S. Local Government Tax-Supported Rating Criteria' (Aug. 15, 2011).

Applicable Criteria and Related Research:
Tax-Supported Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=648898
U.S. Local Government Tax-Supported Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=648842