



New Issue: MOODY'S ASSIGNS A2 RATINGS TO CITY OF PHILADELPHIA'S (PA) \$22.1 MILLION G.O. REFUNDING BONDS, SERIES 2012A AND PHILADELPHIA REDEVELOPMENT AUTHORITY'S (PA) \$93.0 MILLION REVENUE REFUDING BONDS, SERIES 2012

Global Credit Research - 02 Apr 2012

A2 LONG-TERM RATING AND STABLE OUTLOOK AFFIRMED ON \$3.7 BILLION IN PARITY GO AND UNCONDITIONAL DEBT OBLIGATIONS

PHILADELPHIA (CITY OF) PA
Cities (including Towns, Villages and Townships)
PA

Moody's Rating

ISSUE	RATING
Revenue Refunding Bonds, Series 2012	A2
Sale Amount \$93,020,000	
Expected Sale Date 03/30/12	
Rating Description General Obligation Limited Tax	
General Obligation Refunding Bonds, Series 2012A	A2
Sale Amount \$22,060,000	
Expected Sale Date 03/30/12	
Rating Description General Obligation	

Moody's Outlook N/A

Opinion

NEW YORK, April 02, 2012 --Moody's Investors Service has assigned A2 ratings to the City of Philadelphia's (PA) \$22.1 million General Obligation Refunding Bonds, Series 2012A, and to the Philadelphia Redevelopment Authority's \$93.0 million Revenue Refunding Bonds, Series 2012, secured by the city's unconditional obligation to make payments for debt service and therefore rated the same as the general obligation debt. Concurrently, we have affirmed the A2 rating and stable outlook assigned to the city's \$3.7 billion of outstanding general obligation bonds and unconditional General Fund obligations.

SUMMARY RATING RATIONALE

The A2 general obligation rating reflects continued improvement in the city's financial operations, which deteriorated in fiscal 2008 and 2009, stabilized in 2010 and returned to surplus operations in fiscal 2011, although the city will continue to face challenges in the coming years. In response to the significant financial stresses that began in fiscal 2008, city officials created a fiscal recovery plan that included a temporary sales tax increase and pension deferral in fiscal 2010 and 2011. As required, the plan was approved by the Commonwealth of Pennsylvania (G.O. rated Aa1 with a negative outlook) at the end of September 2009, allowing the sales tax increase to be implemented at the beginning of October. Although fiscal 2010 results were favorable, net of a \$70 million late state aid payment (received in fiscal 2011), the General Fund balance remained negative, both on a budgetary and GAAP basis. Fiscal 2011 ended with a surplus, increasing budgetary fund balance to just above zero, although GAAP General Fund balance remained negative. The fiscal 2012 budget reflects an additional surplus and is projected to increase GAAP General Fund balance to a positive figure.

The city's financial flexibility is relatively constrained over the course of its five-year plan, in part due to the significant costs required to repay the deferred pension contributions in 2013 and 2014. We believe that growth in the local economy could remain weak, potentially affecting wage tax collections and other economically sensitive revenues. The city continues to face ongoing economic challenges, weak demographics and high unemployment, modest property value growth, and a heavy burden of tax-supported debt and unfunded pension liability. The city's weak credit characteristics are mitigated by the fact that it is subject to a state oversight board, with well-established five-year planning and quarterly monitoring procedures.

STRENGTHS

- Large, diverse tax base; economic center for a multistate region
- Improved financial operations
- Strong state oversight and comprehensive five-year financial planning

CHALLENGES

- Constrained financial flexibility given very narrow reserve levels
- Limited tax base growth, weak demographics and high unemployment
- Very high debt burden and fixed expenditure pressure

DETAILED CREDIT DISCUSSION

FISCAL RECOVERY PLAN RESULTS IN SURPLUS OPERATIONS IN FISCAL 2010 AND 2011; ADDITIONAL SURPLUS EXPECTED IN FISCAL 2012

Net of a \$70 million late state aid payment, the city returned to surplus operations in fiscal 2010 (on a budgetary basis) after two years of significant operating deficits. During fiscal 2009, the city outlined a \$1 billion shortfall in its five-year financial forecast and developed a fiscal recovery plan to reduce the budget gap, including the delay until 2014 of scheduled city-funded wage tax reductions as well as various expenditure cuts, such as a reduction in force, employee furloughs, a hiring freeze, and reduced overtime. Despite these efforts, mid-year revenue estimates revealed continued deterioration and ongoing weakening of the pension fund, driving the city to announce an additional shortfall of \$1 billion across the five-year plan. The city ended fiscal 2009 with a budget deficit of \$277 million, (before adjustments) resulting in a General Fund deficit of \$137.2 million (-3.5% of General Fund revenues), on a budgetary basis, inclusive of a late state aid payment of \$55 million that was remitted in fiscal 2010. On a GAAP basis, the total General Fund balance deficit was \$76 million (-2.1% of General Fund revenues) and unreserved General Fund balance deficit was \$275 million (-7.6% of General Fund revenues).

The fiscal 2010 budget built on the expenditure savings and efficiencies from the recovery plan developed in fiscal 2009. The updated 5-year plan included additional gap-closing measures such as further staff reductions, increases in certain fees, savings in employee pension and health benefit areas, and other, mostly expenditure-side adjustments. The plan also included a temporary increase in the city's sales tax by 1% for five years, several changes to pension fund assumptions, including extending the amortization of the city's unfunded liability to 30 years from 20, and the deferral of a portion of its required pension payments in fiscal 2010 and 2011, generating \$150 million and \$80 million savings, respectively. These changes received the approval of the Pennsylvania legislature in September 2009. The plan requires the city to repay the deferred pension payments in fiscal 2013 and 2014, as shown in the five-year plan. With these enhancements, the city ended fiscal 2010 with a budgetary basis surplus of \$23 million, inclusive of a \$70 million late state aid payment, much of which the city received after the fiscal 2010 accrual period. At the end of fiscal 2010, the General Fund deficit was reduced to \$114 million (-3.1% of revenues) on a budgetary basis. On a GAAP basis, the city ran an additional \$55 million operating deficit, increasing the total General Fund balance deficit to \$130 million (-3.6% of revenues) and the undesignated fund balance deficit to \$252 million (-6.9% of revenues).

The fiscal 2011 budget included a property tax increase of 10% which netted the city approximately \$80 million in additional revenues. The city also benefitted from a full year of the increased sales tax, resulting in an additional \$37 million over fiscal 2010. Overall, the city ran a surplus of approximately \$114 million on a budgetary basis, increasing the budgetary fund balance to just above zero. On a GAAP basis, the city ran a \$106 million surplus, but the General Fund deficit remained at \$24 million, or -0.6% of revenues; the unassigned General Fund balance deficit was \$46

million, or -1.2% of revenues. The city's fiscal 2012 budget reflects moderate increases in tax revenues, net of the removal of approximately \$500 million in social service-related aid (and the corresponding expenditures) that is being transferred to the Grants Fund.

From 1995 until fiscal 2010, Philadelphia had a program to gradually reduce the city's wage tax rate, intended to enhance the city's competitive position. Through fiscal 2009, the rate had been reduced by approximately 16%. In fiscal 2010, the city suspended the wage tax reductions due to its financial challenges, but expects to return to the reduction program in fiscal 2014.

The city's finances are subject to oversight by a state body, the Pennsylvania Intergovernmental Cooperation Authority (PICA, special tax rating of Aa2/stable outlook), with well-established five-year planning and quarterly monitoring procedures in place. State oversight will continue until long-term bonds issued by PICA to finance the city's early 1990's accumulated operating and capital deficits are fully retired (scheduled final maturity is in 2023).

LARGE, REGIONALLY-IMPORTANT ECONOMY; WEAK SOCIOECONOMIC INDICES

The City of Philadelphia is the economic center of a large, multi-state region, with a diverse, significantly-sized tax base of over \$60 billion, with a stabilizing health care and higher education presence, although looming Federal spending cuts could affect these areas of the economy in the future. The city is also a center for tourism and experienced strengthened hotel occupancy in 2011; hotel development since 1993 has almost doubled the number of rooms available in the city.

Prior to 2010, the city had 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. The late 1990's saw a resumption of growth, with employment up 5.7% between 1998 and 2001. After a decline between 2001 and 2003, reflecting the last slowdown in the national economy, modest growth in employment resumed, with growth of about 1.1% in 2005, 0.9% in 2006, 0.7% in 2007, and 0.2% in 2008. In 2009, annual employment growth reversed sharply, with a 3.1% drop in employment levels for the year, but was flat for 2010 and showed slight increase of 0.6% in 2011. The city's five-decade trend of population loss did reverse in 2010, with a slight increase in population, which sits at 1.5 million, making it the fifth largest city in the nation.

Resident wealth indicators remain low, with 2010 per capita and median family incomes only about 77% and 72% of the national median, respectively, with roughly a quarter of the population living below the poverty line. Unemployment rates remain high at 11.2% in January 2012, well above the state (8.3%) and the nation (8.8%). The city's taxable base has grown over the past few years, averaging 1.6% annually since 2006; full valuation growth has been more rapid, averaging 3.4% annually since 2006. The city did not have the significant run-up in real estate values during the last decade and has subsequently not suffered from the drop in values that other areas have experienced. The \$63 billion tax base does benefit from significant diversity, with the 10 largest tax payers comprising less than 4% of total valuation.

SIGNIFICANT DEBT BURDEN; MODERATE VARIABLE RATE EXPOSURE

Philadelphia's total tax-supported debt is approximately \$7.3 billion, inclusive of the city's \$3.7 billion of general obligation debt and unconditional General Fund obligations, PICA deficit-funding bonds, and overlapping school district debt. The ratio of direct debt to full property value is high at 6.7%, climbing to 11.6% when overlapping debt is included, 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. stadiums, cultural assets, convention center and blight remediation), the PICA deficit-funding bonds, and \$1.4 billion in pension bonds.

The city has moderate variable rate exposure representing approximately 9% of its total general obligation debt and unconditional General Fund obligations. The city's Series 2009B G.O. variable rate bonds are supported by a letter of credit from Royal Bank of Canada (RBC, rated Aa1/on review for possible downgrade) that expires in August of 2014. In conjunction with that issue, the city is party to a fixed payer swap with RBC for a notional amount equal to the remaining variable rate principal. The city also has exposure to variable rate debt through the Philadelphia Authority for Industrial Development's (PAID) Series 2007B bonds. Liquidity is provided by letters of credit from three providers, JP Morgan Chase (rated Aa1/on review for possible downgrade) for \$117 million of principal, Bank of America (rated A2/on review for possible downgrade) for \$72 million, and PNC Bank (rated A2/positive outlook) for \$45 million. The JP Morgan Chase and Bank of America LOCs expire in May of 2013; the PNC LOC expires in May 2014. In conjunction with the PAID variable rate bonds, the city has entered into two fixed payer interest rate swaps, one with JP Morgan Chase for a notional amount of \$217.3 million and one with Merrill Lynch Capital Services, Inc.

(MLCS) for a notional amount of \$72.4 million. In the case of all three of its fixed payer swaps, the city (either directly or through PAID) makes semi-annual payments based on a fixed rate and the counterparties make monthly payments based on the SIFMA Municipal Swap Index. The city is also a party to a basis swap, through PAID, with MLCS for a notional amount of \$194 million. Under the swap, the city makes payments based on SIFMA and receives payments based on 67% of one-month LIBOR plus 20 basis points.

In the case of all of the swaps, regularly scheduled payments are General Fund obligations of the city. Early termination is optional for the city only. Termination events include either the city or the counterparty's rating falling below Baa3. Any termination payment by the city would be subordinate to the general obligation debt service payments.

Outlook

Moody's rating outlook for the City of Philadelphia's general obligation rating is stable, reflecting indications of financial stability, albeit at narrow reserve levels, projected return to positive fund balance levels, and oversight by a state-appointed entity, including 5-year forecasting.

WHAT COULD MAKE THE RATING GO UP

- Continued improvement to financial operations and an increase in General Fund balance well above the current levels
- Ability to navigate significant additional pension contributions and reduce unfunded pension liability

WHAT COULD MAKE THE RATING GO DOWN

- A return to deficit operations in fiscal 2012 or in subsequent years
- Stagnant or further weakened reserve levels

KEY STATISTICS

2010 population: 1.53 million

2011 full value: \$63 billion

Full value per capita: \$41,308

2010 Per capita income as % of nation: 77.3%

2010 Median family income as % of nation: 72.4%

Direct debt burden: 6.7%

Total debt burden: 11.6%

Payout of principal (10 years): 44.8%

FY2011 General Fund balance (budgetary basis): \$92,000 (0% of General Fund revenues)

FY2011 General Fund balance (GAAP basis): -\$23.9 million (-0.6 % of General Fund revenues)

FY2011 Unassigned General Fund balance (GAAP basis): -\$45.7 million (-3.9% of General Fund revenues)

Post-sale parity debt outstanding: \$3.7 billion

PRINCIPAL RATING METHODOLOGY

The principal methodology used in this rating was General Obligation Bonds Issued by U.S. Local Governments published in October 2009. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

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