STANDARD & POOR'S

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Philadelphia; General Obligation; General Obligation Equivalent Security; Joint Criteria

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Credit Profile		
US$94.695 mil rev rfdg bnds (City of Philadelphia Neighborhood Transformation Initiative) ser 2012		
Long Term Rating	BBB+/Positive	New
US$22.27 mil GO rfdg bnds ser 2012A due 09/15/2012		
Long Term Rating	BBB+/Positive	New
Philadelphia GO		
Long Term Rating	BBB+/Positive	Upgraded

Rationale

Standard & Poor's Ratings Services raised its long-term rating and underlying rating (SPUR) on Philadelphia's general obligation (GO) debt one notch to 'BBB+' from 'BBB'. The outlook is positive.

The upgrade reflects our assessment of the city's progress in eliminating a large general fund deficit in fiscal 2011 and projected general fund surplus in fiscal 2012.

Standard & Poor's also raised its long-term rating and SPUR on Philadelphia Redevelopment Authority's; Philadelphia Industrial Development Authority's; and Philadelphia Municipal Authority's GO-equivalent appropriation debt, supported by the city, one notch to 'BBB+' from 'BBB'.

At the same time, Standard & Poor's assigned its 'BBB+' long-term rating and positive outlook to the city's series 2012A GO refunding bonds and Philadelphia Redevelopment Authority's series 2012 revenue refunding bonds, issued for the city and its Philadelphia Neighborhood Transformation Initiative.

The rating also reflects what we view as the city's:

- Proactive administration that has taken action to rebalance operations during a difficult recession, evidenced by surpluses in fiscal years 2010 and 2011 and a projected surplus in fiscal 2012 that have helped reverse a trend of general fund deficits;
- Fiscal oversight provided by the Pennsylvania Intergovernmental Cooperation Authority (PICA), as well as the discipline of an instituted five-year plan requirement; and
- Economic diversification, despite the recession, into more growth-oriented sectors, such as health care, higher education, and services, which should position the city for growth as recovery ensues.

We believe somewhat offsetting factors include the city's:

- Continued cost pressures related to health care and pensions and the recession's effect on the city, which we believe have pressured, and will continue to pressure, operations; and
- High, in our opinion, overall net debt due, in large part, to significant deficit financing related to fiscal distress in the early 1990s, a 1999 pension bond issuance, a significant neighborhood revitalization program, and the issuance of general-fund-supported debt to finance the construction of two new stadiums -- Officials, however,

expect additional planned GO debt issuance to be modest.

The city's full-faith-and-credit GO pledge secures the 2012A GO refunding bonds. A service agreement with Philadelphia secures the authority's 2012 bonds; according to the service agreement, the city agrees to make sufficient payments to the trustee to cover bond debt service. The city's obligations under the service agreement are absolute and unconditional; according to home-rule charter, the city is required to budget and appropriate sufficient funds to meet mandated contracts and raise sufficient revenue to pay all budgeted obligations. Officials intend to use bond proceeds to refund various series of the city's bonds for debt service savings.

As is the case with most U.S. cities, Philadelphia has been struggling to offset the effects of the severe national recession. Reserves declined significantly in fiscal years 2008 and 2009 due, in large part, to the economic slowdown, reaching a low of a negative $137.2 million in fiscal 2009. In response to declining revenue, Mayor Michael Nutter's administration took proactive actions on spending to restore operational balance. These actions included staff cutbacks, a hiring freeze, overtime cost reductions, and the curtailment of certain nonessential services. Philadelphia also eliminated its reserve for wage increases and suspended its plan to further reduce business privilege and wage taxes until fiscal 2015. In addition, the commonwealth legislature gave its approval for a temporary five-year sales tax increase to 8% from 7% and allowed the city to defer $230 million of payments -- $150 million in fiscal 2010 and $80 million in fiscal 2011 -- into the pension fund for two years. Finally, the legislature also allowed the city to extend the amortization of the unfunded pension liability to 30 years from 20 years. The city also raised real estate taxes by 9.9% in fiscal 2011.

Due to these actions and rebounding tax revenue, Philadelphia eliminated the $137 million general fund deficit within two years. The fiscal 2010 general fund generated a $23.1 million surplus on a budgetary basis and reduced the negative fund balance to $114 million. In fiscal 2011, the city generated a $114.1 million surplus that effectively eliminated the accumulated general fund deficit. Year-end general fund balance remained, in our opinion, thin at just $92,000 compared to a $3.5 billion general fund budget. Better-than-expected wage and business privilege tax revenue generated positive results. In addition, the city experienced its first full year of the 1% sales tax increase. Officials are projecting fiscal 2012 to end with another surplus of $68.4 million, boosting reserves to $68.5 million.

While Philadelphia has made strong strides to restore general fund balance, we believe that within the next few years, the city will remain challenged as it copes with a slow national economic recovery and the need to play catch up with the repayment of deferred pension payments in fiscal years 2013 and 2014, as well as the temporary sales tax increase's expiration in 2014. In addition, most of the city's labor agreements remain in arbitration, leading to uncertainty regarding future labor costs. Philadelphia's long-term liabilities, including pension and health care costs, also remain a concern; the Nutter administration, however, has made good progress in changing pension benefits for future employees, which will contain long-term costs. The proactive actions the Nutter administration has taken to balance operations and PICA's oversight, which requires the city to submit five-year financial plans, somewhat mitigate our concern over these issues. This, in turn, has contributed to a level of budgetary discipline, longer forecasting, and strong financial reporting.

Standard & Poor's considers Philadelphia's financial management practices "strong" under its Financial Management Assessment (FMA) methodology, indicating practices are strong, well embedded, and likely sustainable.

In our opinion, debt has increased considerably over the past 12-15 years due to debt issued for pension funding, urban renewal, and the construction of two sports stadiums. In our view, overall net debt is a moderate $4,712 per capita, or a high 17.1% of market value. What we view as the high overall debt-to-market value ratio is due to a significant amount of overlapping debt from the Philadelphia School District and a depressed market value due to an antiquated property tax assessment system. In our opinion, debt-to-personal income, which was also, in our view, a moderate 2.7%, is a better measure. Carrying charges for tax-supported debt were, what we consider, a manageable 3.6% of fiscal 2011 total governmental expenditures. We consider the amortization of tax-supported GO debt below average with officials planning to retire 39% over 10 years and 100% by 2042.

Outlook

The positive outlook reflects Standard & Poor's view that with the combination of continued prudent financial management and oversight from PICA, the city will likely continue to maintain balanced operations and build on its general fund reserves. We believe that if the economic recovery is slow to gain momentum, stagnates, or retrenches, Philadelphia's strong management practices will allow it to continue to take the necessary actions to address imbalances and balance its five-year financial plan, especially in light of its need to make catch-up pension payments in fiscal years 2013 and 2014 and offset lost revenue once the temporary sales tax increase expires in 2014. Should the city be successful in further rebuilding reserves, we could consider an upgrade within the outlook' two-year period.

Finances

The fiscal 2013 proposed budget and the 21st five-year plan

Philadelphia presented its proposed fiscal 2013 budget and 21st five-year plan, for fiscal years 2013-2017, to the city council on March 8, 2012. The fiscal 2013 budget totals $3.6 billion, a 3.4% increase over the fiscal 2012 budget. The increase is primarily due to rising pension and health care costs as the city begins to repay its pension deferral from fiscal years 2010 and 2011. The budget also includes 400 new police officers, increasing the city's police force to 6,500. The budget also includes money for the design of a new police headquarters morgue and health offices, as well as increased funding for the office of property assessment to complete the city's property revaluation. In addition, the budget assumes modest growth in wage taxes of 3.4%, sales taxes of 3.5%, and business income and receipt taxes of 2.5%. Based on the proposed commonwealth budget, however, Philadelphia is expecting a $40.9 million cut in commonwealth aid, mostly for health-and-human-services-related spending. In addition, the city will complete a citywide property revaluation in fiscal 2013. The budget recommends the adoption of a formula for calculating the tax rate to generate the same level of property tax revenue in fiscal 2013 that was generated in fiscal 2012.

The fiscal 2013 budget conforms to the 21st five-year plan. The plan assumes modest growth in wage, real estate transfer, and business income and receipt taxes. Sales taxes will decline in fiscal 2015 after the temporary 1% increase sunsets; officials, however, expect sales tax revenue to grow modestly in fiscal years 2016 and 2017. We understand pension and health care cost increases, especially in fiscal years 2013 and 2014, will be the primary driver of expenditure growth as the city repays its pension deferral. As such, Philadelphia is projecting operating deficits of $15.5 million in fiscal 2013, $19.4 million in fiscal 2014, and $11.2 million in fiscal 2015 before it posts surpluses of $14.3 million and $14.7 million in fiscal years 2016 and 2017, respectively. Officials are projecting general fund balance to remain positive over the entire five-year plan. The city council must approve the budget and five-year plan before Philadelphia can submit them for PICA's approval.

Fiscal 2012

Philadelphia's fiscal 2012 budget was $3.5 billion, almost 10% less than the fiscal 2011 budget. Management attributes the large decline to its decision to move approximately $495.1 million of health-and-human-services-related expenditures paid for by commonwealth reimbursements into the grants revenue fund from the general fund. This accounting change should improve the general fund's cash flow and year-end finances since, what we view as, significant delayed commonwealth reimbursements will no longer distort it. Philadelphia is projecting to end fiscal 2012 with a surplus of $68.4 million, which would increase general fund balance to $68.5 million. Officials expect to end the fiscal year with expenditures of $20.3 million in excess of budgeted amounts due to public-safety-related overtime and higher-than-expected fuel costs. They, however, have revised revenue estimates upward by $33.4 million due mainly to unbudgeted one-time revenue, including additional commonwealth pension aid. The city also revised its projections for business income and receipt taxes upward by $17 million. Philadelphia, however, revised its projections downward for wage taxes by $25.6 million, sales taxes by $6.3 million, real estate transfer taxes by $5 million, and other taxes by $2.8 million.

Philadelphia also faces a significant number of property tax appeals for fiscal 2012. After the city calculated its property tax bills for fiscal 2012, the state tax equalization board (STEB) released a common level ratio of 18.1% for the city, which was significantly less than previous years and significantly less than the 32% established predetermined ratio the city used when calculating its tax bills. We understand the discrepancy led to approximately 2,000 property tax appeals with a potential tax refund exposure of $36 million for the city; the city billed 577,000 properties and had a property tax budget of $486.7 million for fiscal 2012. Both the city and Philadelphia School District appealed STEB's common level ratio. While STEB has not made a final decision, it tentatively stated the common level ratio should be 25.2%, which would reduce the city's tax refund exposure to $16 million. Management indicates it would credit any refunds to fiscal 2013 tax bills.

Strong oversight by PICA

We view PICA's strong financial controls and oversight, which have been in place since Philadelphia encountered financial stress in the early 1990s, as credit strengths. Since 1992, PICA has provided the city with financial oversight. In the early 1990s, PICA provided deficit and capital financing by issuing special tax bonds on behalf of the city, of which, as of Feb. 29, 2012, $494.7 million (AA/Stable) remains outstanding. A 1.5% income tax surrendered by the city to PICA secures the bonds. While PICA no longer maintains the authority to issue additional new-money debt on behalf of Philadelphia, it maintains oversight of the city's finances as long as PICA's bonds remain outstanding. This oversight function includes the power to review and approve annual five-year financial plans and quarterly variance reports, as well as, if warranted, certify noncompliance by the city with the five-year plan; we understand this could trigger the commonwealth's withholding of state aid.

Financial Management Assessment: 'Strong'

Standard & Poor's considers Philadelphia's financial management practices "strong" under its FMA methodology, indicating practices are strong, well embedded, and likely sustainable.

Management develops revenue and expenditure assumptions based on past trends, and it adjusts them for internal and external forecasts. Budget officials use regional economic models for revenue forecasting, and management consults with regional Federal Reserve Bank officials when developing estimates; it also reviews the surveys of professional forecasters. Management tracks revenue daily and expenditures monthly. It delivers formal revenue reports to elected officials monthly. The city manager's quarterly report, which it delivers to elected officials and PICA, is comprehensive. Budget officials meet quarterly with the officials of each large city department. They generally amend the budget one time annually, normally at the introduction of the next year's budget. Budget officials, however, give city departments target budget reductions of usually about 1%-3% of departmental budgets; the city holds these in reserve and can sweep them out, if needed.

In addition to the current-year budget, Philadelphia annually produces formal rolling five-year financial plans that elected officials and PICA review. The five-year plan takes into account all known effects on revenue and expenditures, factors in expected tax rate reductions and labor cost increases, and identifies risks to the plan. In cases where material challenges arise after the five-year plan's introduction, PICA requires the city to submit a revised plan. Philadelphia's formal six-year capital improvement plan (CIP) includes the current budget year. Management updates the CIP annually; once the city council approves the CIP, Philadelphia submits it for PICA's oversight. In addition, management identifies funding sources for each project in the CIP. A city council ordinance in 1994 adopted the city's formal investment management policy; a city council ordinance revised the policy in 2001. The policy outlines permissible investments and forbids investment in certain derivatives, such as inverse floaters, leveraged variable-rate debt, and interest- or principal-only debt.

Debt

Philadelphia's debt obligations include its own GO debt, as well as other contracts and leases to support the issuance of debt by public authorities related to the city, of which it is obligated to budget an appropriate tax or other general revenue to pay debt service. These include Philadelphia Municipal Authority, Philadelphia Industrial Development Authority, Philadelphia Parking Authority, and Philadelphia Redevelopment Authority. In addition to GO and GO-related debt issuance, the city is an annual issuer of tax and revenue anticipation notes (TRANs) during the fiscal year; it repays the TRANs by the close of the fiscal year. Philadelphia issued $173 million of TRANs (SP-1+) on Dec. 7, 2011, which mature on June 29, 2012. Due to the city's improved finances, the fiscal 2012 TRAN borrowing was $112 million less than the fiscal 2011 TRAN issuance; the city also issued the TRANs much later in the fiscal year, which we understand will translate into significant debt service savings.

Pension/Other Postemployment Benefits

Pensions

Philadelphia provides various pension, life insurance, health, and medical benefits for its employees. As of July 1, 2010, there were 65,447 members in the plan -- 37,519 of which were nonactive -- receiving benefits. With the adoption of the city's 18th five-year financial plan, the city made several assumptions related to pensions. As part of its efforts to respond to the recession and decline in general fund revenue in 2008-2009, the commonwealth General Assembly gave Philadelphia permission to partially defer $150 million of pension payments in fiscal 2010 and $98 million in fiscal 2011; the city, however, must repay both amounts in full by fiscal 2014. In addition, the amortization of the unfunded liability was reset to 30 years and the pension board lowered the assumed rate of return to 8.25% from 8.75%. The pension board voted to reduce the assumed rate of return further to 8.15% in October 2010 and 8.1% in March 2012. Based on Philadelphia's most recent actuarial report, dated July 1, 2011, the unfunded accrued pension liability was $4.77 billion, or 49.7% funded, up slightly from 2010 when it was 47%

funded but down from 59.8% six years earlier.

Philadelphia has taken steps to reduce its future pension benefits through arbitration with its various labor unions. All new police employees hired after Jan. 1, 2010, will have the option of participating in the defined-benefit pension plan, albeit with a higher contribution rate of 6% of annual salary; if they do not elect to participate in the defined-benefit plan, they can enter into a hybrid pension plan that includes defined-benefit and defined-contribution aspects. The city received similar terms through arbitration awards with its firefighters and deputy sheriffs unions. In addition, new employees at the register of wills must join the hybrid pension plan. Finally, all new correctional officers must also join the hybrid pension plan and all existing employees must make higher pension contributions.

Other postemployment benefits

Philadelphia self-administers a single-employer, defined-benefit plan. The city also provides health care for five years subsequent to separation for eligible retirees. In addition, it provides lifetime insurance coverage for all eligible retirees and funds its retiree benefits through pay-as-you-go financing. Philadelphia's annual other postemployment benefits (OPEB) expense is calculated based on the annual required contribution (ARC) of the employer, an amount actuarially determined in accordance with the parameters of Government Accounting Standards Board Statement 45. The ARC represents a level of funding that, if paid on an ongoing basis, should cover normal costs annually and amortize any unfunded actuarial liabilities over a period not to exceed 30 years. For fiscal 2011, Philadelphia paid $65.5 million, or 65%, of its $101.2 million ARC for retiree health care. As of the most recent valuation date, July 1, 2010, the unfunded actuarial accrued OPEB liability was $1.2 billion with 0% funded.

Economy

The 130-square-mile Philadelphia is the nation's fifth-largest city, and it anchors the nation's sixth largest metropolitan statistical area (MSA). The city's population increased by 0.6% to 1.526 million at the 2010 U.S. Census, the first population increase in six decades. The Philadelphia MSA covers 5,118 square miles and encompasses a population of roughly six million. The Philadelphia regional economy is, in our view, highly diversified with an emphasis on health care services, pharmaceutical manufacturing, aerospace manufacturing, education services, and transportation services. The city is at the center of the nation's largest concentration of health care resources within a 100-mile radius, and it has the second-largest concentration of college students on the East Coast at 101 degree-granting institutions; total student enrollment is more than 300,000. Employment diversity has buffered the Philadelphia economy from a more-severe downturn, but it has also limited its expansion since many of its sectors that form the region's core economy grew slowly in the last economic expansion. While Philadelphia enjoys a moderate cost of living compared with many other large metropolitan areas, its relatively high business costs, large number of poorly educated workers, and high tax rates have inhibited growth. A trend of out-migration from 1970-2000 fostered a large disparity in education and income between central city and suburban residents. After a period of steady growth, median household income declined slightly to $35,952 in 2010, or 71.5% of the commonwealth's average and 70.2% of the nation's average.

We consider growth prospects good for the metropolitan area's core of knowledge-based industries -- including health services, pharmaceuticals, education, and biotechnology -- due mainly to a highly educated workforce drawn from suburban areas. According to IHS Global Insight, approximately 23.1% of the area employment base consists of education and health care services while trade and transportation and utilities account for 17.7% and professional and business services account for 16%. Significant sector presence is attributable to numerous hospitals, which employ more than 100,000, and private colleges and universities, which employ more than 50,000. Although recent mergers have hampered growth in the pharmaceutical sector, GlaxoSmithKline is currently building a new 205,000-square-foot headquarters at the Navy Yard that will house 1,300 employees.

Philadelphia's leisure and hospitality sector, which accounts for about 8% of the employment base, continues to grow. In 2011, the Philadelphia Convention Center completed a $786 million renovation that increased the convention center's footprint to 2.3 million square feet. The convention center will have an estimated economic effect of $813 million on the city in 2012. Unemployment has historically been above commonwealth and national rates. Unemployment was 10.5% in 2011 compared with the nation's 8.3% and the commonwealth's 7.9%. IHS Global Insight is projecting a slight growth of 1% in the city's total employment in 2012, and it expects Philadelphia to reach its 2008 employment level by 2013.

Related Criteria And Research

- USPF Criteria: GO Debt, Oct. 12, 2006
- USPF Criteria: Key General Obligation Ratio Credit Ranges – Analysis Vs. Reality, April 2, 2008

Ratings Detail (As Of April 5, 2012)		
Philadelphia GO multi modal		
Long Term Rating	AAA/A-1+	Affirmed
Unenhanced Rating	BBB+(SPUR)/Positive	Upgraded
Philadelphia GO (wrap of insured) (CIFG & ASSURED) (SEC MKT)		
Unenhanced Rating	BBB+(SPUR)/Positive	Upgraded
Philadelphia GO (wrap of insured) (CIFG) (MBIA - National SEC MKT)		
Unenhanced Rating	BBB+(SPUR)/Positive	Upgraded
Philadelphia GO (AGM)		
Unenhanced Rating	BBB+(SPUR)/Positive	Upgraded
Philadelphia Redev Auth (Neighborhood Transformation Rev) (wrap of insured) (FGIC & AMBAC) (SEC MKT)		
Unenhanced Rating	BBB+(SPUR)/Positive	Upgraded
Philadelphia GO		
Unenhanced Rating	BBB+(SPUR)/Positive	Upgraded
Philadelphia Redev Auth		
Unenhanced Rating	BBB+(SPUR)/Positive	Upgraded
Philadelphia Auth for Indl Dev, Pennsylvania		
Philadelphia, Pennsylvania		
Philadelphia Auth for Indl Dev (Philadelphia) multi modal lse - 2007B-2		
Long Term Rating	AA+/A-1	Affirmed
Unenhanced Rating	BBB+(SPUR)/Positive	Upgraded
Philadelphia Auth for Indl Dev (Philadelphia) multi modal lse - 2007B-3		
Long Term Rating	AA/A-1	Affirmed
Unenhanced Rating	BBB+(SPUR)/Positive	Upgraded

Ratings Detail (As Of April 5, 2012) (cont.)		
Philadelphia Auth for Indl Dev (Philadelphia) GO (AGM)		
Unenhanced Rating	BBB+(SPUR)/Positive	Upgraded
Philadelphia Auth for Indl Dev (Philadelphia) GO (AMBAC & AGM) (SEC MKT)		
Unenhanced Rating	BBB+(SPUR)/Positive	Upgraded
Philadelphia Auth for Indl Dev (Philadelphia) GO (AMBAC & ASSURED GTY) (SEC MKT)		
Unenhanced Rating	BBB+(SPUR)/Positive	Upgraded
Philadelphia Auth for Indl Dev (Philadelphia) GO (FGIC) (National)		
Unenhanced Rating	BBB+(SPUR)/Positive	Upgraded
Philadelphia Auth for Indl Dev (Philadelphia) (Cultural & Commercial Corridors Prog) (wrap of insured) (FGIC) (MBIA - SEC MKT) (National)		
Unenhanced Rating	BBB+(SPUR)/Positive	Upgraded
Philadelphia Auth for Indl Dev pension fdg		
Unenhanced Rating	BBB+(SPUR)/Positive	Upgraded
Philadelphia Auth for Indl Dev (Cultural & Commercial Corridors Prog)		
Unenhanced Rating	BBB+(SPUR)/Positive	Upgraded
Philadelphia Mun Auth, Pennsylvania		
Philadelphia, Pennsylvania		
Philadelphia Mun Auth (Philadelphia) lse rev		
Long Term Rating	BBB+/Positive	Upgraded
Philadelphia Mun Auth (Philadelphia) lse (ASSURED GTY) (SEC MKT)		
Unenhanced Rating	BBB+(SPUR)/Positive	Upgraded
Philadelphia Redev Auth, Pennsylvania		
Philadelphia, Pennsylvania		
Philadelphia Redev Auth (Philadelphia) GO		
Unenhanced Rating	BBB+(SPUR)/Positive	Upgraded

Many issues are enhanced by bond insurance.