STANDARD & POOR'S RATINGS SERVICES
McGRAW HILL FINANCIAL

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Summary:

Philadelphia Authority for Industrial Development
Philadelphia; General Obligation; General Obligation Equivalent Security; Joint Criteria

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Credit Profile		
US$53.545 mil city agreement rev rfdg bnds (Philadelphia) (Cultural And Commercial Corridors Program) ser 2016A		
Long Term Rating	A+/Stable	New
US$6.005 mil city agreement rev rfdg bnds (Philadelphia) (Philadelphia Central Library Project) ser 2016B		
Long Term Rating	A+/Stable	New

Rationale

Standard & Poor's Ratings Services assigned its 'A+' long-term rating to the Philadelphia Authority for Industrial Development (PAID), Pa.'s series 2016A and 2016B city agreement revenue refunding bonds. At the same time, Standard & Poor's affirmed its 'A+' long-term rating and underlying rating (SPUR) on the city of Philadelphia's general obligation (GO) debt and GO-equivalent debt supported by the city and issued by the Philadelphia Municipal Authority (PMA) and the Philadelphia Redevelopment Authority (PRA). The outlook is stable.

Standard & Poor's also affirmed its 'AAA/A-1+' and 'AAA/A-1' ratings on certain GO and PAID debt, with PNC Bank, Bank of New York Mellon, and TD Bank providing liquidity support.

The city's GO bonds are secured by its full faith and credit GO pledge. The GO-equivalent debt represents limited obligations of the issuing authority, payable solely from revenue under a service agreement or prime lease (as applicable) between it and the city. Under the agreement, Philadelphia agrees to pay a service fee – and - under the lease, a rental payment; both the service fee and rental payment will be made out if its general fund sufficient to cover all bond principal and interest payments. While the service fee and rental payments are payable only from current city revenue, the agreement and lease provide that so long as any bonds remain outstanding, Philadelphia's obligation to pay the amounts is absolute and unconditional. As such, we view the obligations as GOs of the city and rate them on parity with Philadelphia's GO debt.

Proceeds will refund outstanding bonds for debt service savings.

The rating reflects our assessment of the following factors for the city:

- Adequate economy, with access to a broad and diverse metropolitan statistical area (MSA);
- Strong management, with "good" financial policies and practices under our Financial Management Assessment methodology;
- Weak budgetary performance, with a slight operating deficit in the general fund and an operating deficit at the total governmental fund level in fiscal 2015;
- Weak budgetary flexibility, with an available fund balance in fiscal 2015 of 4% of operating expenditures;

- Very strong liquidity, with total government available cash that we expect will decline in the near term relative to its fiscal 2014 level at 10.2% of total governmental fund expenditures and 1.7x governmental debt service, and access to external liquidity we consider exceptional;
- Weak debt and contingent liability position, with debt service carrying charges at 7.3% of expenditures and net direct debt that is 60.6% of total governmental fund revenue, as well as a large pension and other postemployment benefit (OPEB) obligation; and
- Strong institutional framework score.

Adequate economy

We consider Philadelphia's economy adequate. The city, with an estimated population of 1.6 million, is located in Philadelphia County in the Philadelphia-Camden-Wilmington, Pa.-N.J.-Del.-Md. MSA, which we consider to be broad and diverse. The city has a projected per capita effective buying income of 77.8% of the national level and per capita market value of $87,329. Overall, the city's market value grew by 0.8% over the past year to $136.3 billion in 2016. The city's unemployment rate was 8% in 2014.

Philadelphia is the commonwealth's largest and the nation's fifth-largest city by population. Its economy is heavily influenced by health care and higher education, though we do not believe the existence of related institutions understate the city's wealth and income indicators.

Philadelphia reassessed its property tax base at full market value in tax year 2014, resulting in roughly 25,000 formal appeals out of 579,000 properties. The majority of these appeals have been resolved. Fewer appeals were filed for tax year 2015 and these, along with the remaining 2014 appeals, are expected to be resolved in the near term. Development throughout the city is significant, with 38 major projects totaling nearly $4.7 billion as of October 2015.

Strong management

We view the city's management as strong, with "good" financial policies and practices under our Financial Management Assessment methodology, indicating financial practices exist in most areas, but that governance officials might not formalize or monitor all of them on a regular basis.

Management develops revenue and expenditure assumptions during budget preparation based on an evaluation of past trends adjusted for internal and external forecasts. Budget officials use regional economic models for revenue forecasting and consult with regional Federal Reserve Bank officials. The city submits quarterly reports to elected officials and the Pennsylvania Intergovernmental Cooperation Authority (PICA), with the most recent report for the period ended Sept. 30, 2015 released on Nov. 16, 2015. Philadelphia annually produces formal rolling five-year financial plans that elected officials review and PICA approves. 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 six-year capital improvement plan (CIP) is updated annually and identifies funding sources for each project. The city has a formal investment policy. In April 2011, the city adopted an amendment to the home rule charter calling for a budget stabilization reserve but, since its enactment, no funds have been deposited.

Mayor Michael Nutter--who is nearing the end of his second successive term--will be replaced in January 2016 by Mayor-elect Jim Kenney. We understand the current finance director--who has filled the role since his 2008 appointment--will continue in the new administration. Given the uncertainty associated with mayoral transitions, we view the continuity in the role of finance director favorably.

Weak budgetary performance

Philadelphia's budgetary performance is weak in our opinion. The city had slight deficit operating result in the general fund of 1.1% of expenditures, and deficit results across all governmental funds of 5.2% in fiscal 2015.

Philadelphia's charter requires it to issue an annual financial report (AFR) within 120 days of the close of each fiscal year. Though unaudited, we have used the 2015 AFR as the base year given our understanding that historically there have not been material changes between the total governmental fund results shown in the AFR and the comprehensive annual financial report (CAFR).

Financial statements are audited according to generally accepted accounting principles (GAAP), though management also reports results on a budgetary basis given the significant amount of business income and receipts tax (BIRT) payments received in advance of being earned on the modified accrual basis. We understand Philadelphia has reported--and prepared the five-year financial plan submitted to PICA--on a budgetary basis for more than 10 years due to city-adopted legislation that changed the definition of BIRT but not the related cash flow. Ultimately that legislation resulted in the shifting of the city's April/May BIRT collections (roughly one-half of the annual receipts) to the subsequent fiscal year on a modified accrual basis. We continue to adjust the city's GAAP results to reflect the budgetary basis because we believe the BIRT receipts should be recognized in the fiscal year in which they are collected and view the budgetary basis as representative of the city's revenue profile. Moreover, we believe the disclosure provided on a budgetary basis is robust and well vetted. Additionally, we removed $6.7 million of nonrecurring expenditures from both the general and total governmental funds.

Philadelphia's primary revenue sources within its general fund are wage and earnings tax receipts (35% of the total, according to fiscal 2015 unaudited actual results), real property taxes (14%), and BIRT (12%). While we believe there is some volatility in this revenue stream, 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. Current projections for fiscal 2016, based on the city manager's report for the period ended Sept. 30, 2015, show revenues exceeding the adopted budget by $24 million (primarily due to positive variances in real estate transfer taxes and sales tax receipts) and expenditures exceeding the adopted budget by $23.3 million (primarily due to negative variances in personal services and purchase of services stemming from the Papal visit). Among the city's principal revenue sources; projections for wage and earnings tax receipts are essentially flat relative to the adopted budget while real property taxes and BIRT are up 0.4% and 0.7%, respectively.

Commonwealth aid represents just 5.7% of fiscal 2015 general fund revenue. Medicaid spending, however, is primarily recorded through the city's health choices behavioral health fund where commonwealth aid represents nearly all revenue. Commonwealth aid across these two funds represents 17.4% of total governmental fund revenue. Although we believe state aid represents a relatively small share of the city's budget, we believe it could challenge liquidity in fiscal 2016 due to the commonwealth's budget impasse.

Philadelphia's budgets and five-year financial plans are based on conservative revenue forecasts, with actual collections generally exceeding projections in recent years. As such, we expect positive revenue variances in fiscal 2016 to narrow the budget gap. Current projections have 2016 general fund revenue at $3.9 billion compared with expenditures of just over $4 billion.

While Philadelphia has proactively managed its budget since posting a cumulative $137 million deficit in fiscal 2009, we believe it still faces significant spending pressure. Supporting this view is the five-year financial plan that shows declining general fund balances through fiscal 2017 (bottoming at $34 million) before rising incrementally in the final years. The plan incorporates rising labor costs pursuant to recently reached labor agreements, but does not project wage increases beyond contract expiration. We believe the existence of labor contracts with all of the city's largest unions represents a credit positive as it eliminates budgetary uncertainty at least through the contract term.

Weak budgetary flexibility

Philadelphia's budgetary flexibility is weak, in our view, with an available fund balance in fiscal 2015 of 4% of operating expenditures, or $151.5 million.

This ratio was calculated using the unaudited fiscal 2015 budgetary basis information for the reasons stated above.

The $151.5 million general fund balance for fiscal 2015 is down from the balances in 2013 and 2014 ($256.9 million and $202.1 million, respectively) but up from the $146.8 million that was recorded at 2012 year-end. The 2016 budget includes the use of reserves, though we expect positive revenue variances to narrow the gap given the city's conservative revenue assumptions. Current estimates for 2016 show an $82.2 million general fund balance at year-end (2% of expenditures), which is better than the adopted budget's ending fund balance of $69.3 million (1.7% of expenditures). While the city's five-year plan shows reserves declining to $34 million in fiscal 2017 (0.8% of expenditures), we expect the city to continue to outperform projections and maintain reserves in excess of 1% of expenditures.

Standard & Poor's no longer believes the city has demonstrated a willingness to raise taxes given the length of time that has elapsed since the last property tax increase for the benefit of its general fund. Rather, recent property tax increases have been for the city's school district; Philadelphia last raised the property tax rate for its general fund operations in fiscal 2011. We also note that following the recommendations of two tax reform commissions, the city has reduced its BIRT rate as well as its wage tax in an effort to stimulate the economy.

Very strong liquidity

In our opinion, Philadelphia's liquidity is very strong, with total government available cash that we expect will decline in the near term relative to its fiscal 2014 levels at 10.2% of total governmental fund expenditures and 1.7x governmental debt service in 2014. In our view, the city has exceptional access to external liquidity if necessary.

We believe the city has exceptional access to external liquidity as it has issued multiple security types frequently in the past 15 years, and we do not consider its investments aggressive. City officials expect cash flow to become constrained in February despite having issued their annual tax revenue anticipation note this summer should there be a continuation of the commonwealth budget impasse. As a result, we understand if the commonwealth budget is not adopted within the next few weeks, the city will begin evaluating cash management strategies. Given the city's projected spending of general fund reserves through fiscal 2017, we believe this score could weaken.

We do not believe the various liquidity facility agreements supporting the service- and lease- agreements debt issuances exposes the city to nonremote contingent liability risk. With certain limited exceptions, the agreements expressly prohibit the acceleration of the service fees supporting debt service on the related obligations or credit facility payments. The exception is the debt issued to fund the city's stadium projects; in those cases the agreements allow for a term-out but not principal acceleration.

Nor do we believe the city's swaps create nonremote contingent liability risk given the wide margin between the city's rating and 'BBB-' rating trigger. The mark-to-market across its six swap agreements is negative $76.8 million from the city's perspective, which is 15% of the current notional amount.

Weak debt and contingent liability profile

In our view, Philadelphia's debt and contingent liability profile is weak. Total governmental fund debt service is 7.3% of total governmental fund expenditures, and net direct debt is 60.6% of total governmental fund revenue.

The city identified approximately $395 million of additional general fund debt plans over the next two years exclusive of refundings.

In our opinion, a credit weakness is Philadelphia's large pension and OPEB obligation. The city's combined required pension and actual OPEB contributions totaled 12.1% of total governmental fund expenditures in 2014. Of that amount, 11.0% represented required contributions to pension obligations, and 1.1% represented OPEB payments. The city made 105.7% of its annual required pension contribution in 2014. The funded ratio of the largest pension plan is 48.9%.

The city produces two actuarial required contribution (ARC) calculations annually; one is based on its minimum municipal obligation (MMO) and the other on a decades-old policy that amortizes its pension unfunded actuarial accrued liability (UAAL) much more rapidly than the MMO. We base the city's pension ratios on the MMO because we view its amortization period of roughly 24 years as consistent with those of other local governments.

The city maintains two defined-benefit plans--the city plan and the gas works plan. The city plan covers all officers and employees of the city as well as those of three quasigovernmental agencies, while the gas works plan covers employees of the Philadelphia Gas Works (PGW). The city plan's funded status was 45.8% as of July 1, 2014. The city considered selling the PGW (a discretely presented component unit of the city) and applying a portion of the proceeds to the city plan to improve its funded status. While sale was not authorized by council, we believe the city has taken steps to accelerate the full funding of its pension--which is due to occur in 2039--by lowering the assumed rate of return and therefore increasing the annual contribution as well as actively seeking, and indeed obtaining, material pension reforms through collective bargaining. In addition, the permanent 1% increase in the sales tax rate that became effective July 1, 2014, will ultimately benefit the pension fund after school district distributions and certain debt service payments. We will continue to monitor the city's proposals in connection with its sizable pension liability, and would view the lack of a specific and credible plan as a credit weakness that could negatively affect this factor score. In particular, we will evaluate whether plans would significantly improve pension funding in a timely fashion. As of July 1, 2013, the date of the most recent actuarial valuation, the UAAL for the city's OPEB was $1.7 billion.

Strong institutional framework

The institutional framework score for Philadelphia is strong.

Outlook

The stable outlook reflects Standard & Poor's view of the city's strong management practices coupled with PICA's oversight. As such, we expect the city to continue to actively address the budgetary imbalances in its five-year plan and narrow the out year gaps. We do not expect to change the rating within the next two years.

Downside scenario

Failure to adequately address the city's fiscal imbalance and underfunded pension plan could result in negative rating change. In particular, a continuation of budgetary pressure resulting in very weak flexibility or adequate liquidity could pressure the rating downward.

Upside scenario

While unlikely over the outlook horizon, a trend of improved fund balances and progress in mitigating pension exposure, coupled with continued economic expansion, could result in an upgrade.

Related Criteria And Research

Related Criteria

- USPF Criteria: Local Government GO Ratings Methodology And Assumptions, Sept. 12, 2013
- USPF Criteria: Financial Management Assessment, June 27, 2006
- USPF Criteria: Debt Statement Analysis, Aug. 22, 2006
- Criteria: Methodology And Assumptions: Approach To Evaluating Letter Of Credit-Supported Debt, Feb. 20, 2015
- USPF Criteria: Municipal Applications For Joint Support Criteria, June 25, 2007
- Criteria: Joint Support Criteria Update, April 22, 2009
- USPF Criteria: Assigning Issue Credit Ratings Of Operating Entities, May 20, 2015
- Criteria: Use of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Institutional Framework Overview: Pennsylvania Local Governments

Ratings Detail (As Of December 21, 2015)		
Philadelphia GO		
Long Term Rating	A+/Stable	Affirmed
Philadelphia GO		
Long Term Rating	A+/Stable	Affirmed
Philadelphia GO		
Long Term Rating	A+/Stable	Affirmed
Philadelphia GO (AGM) (SEC MKT)		
Unenhanced Rating	A+(SPUR)/Stable	Affirmed
Philadelphia GO (BAM) (SECMKT)		
Unenhanced Rating	A+(SPUR)/Stable	Affirmed

Ratings Detail (As Of December 21, 2015) (cont.)		
Philadelphia JOINTCRIT		
Long Term Rating	AAA/A-1+	Affirmed
Unenhanced Rating	A+(SPUR)/Stable	Affirmed
Philadelphia GO		
Unenhanced Rating	A+(SPUR)/Stable	Affirmed
Philadelphia Redev Auth		
Unenhanced Rating	A+(SPUR)/Stable	Affirmed
Philadelphia Auth for Indl Dev, Pennsylvania		
Philadelphia, Pennsylvania		
Philadelphia Auth for Indl Dev (Philadelphia) city svc agreement rfdg rev bnds (Retirement Sys)		
Long Term Rating	A+/Stable	Affirmed
Philadelphia Auth for Indl Dev (Philadelphia) multi modal lse - 2007B-3		
Long Term Rating	AAA/A-1	Affirmed
Unenhanced Rating	A+(SPUR)/Stable	Affirmed
Philadelphia Auth for Indl Dev (Philadelphia) GO		
Long Term Rating	A+/Stable	Affirmed
Unenhanced Rating	NR(SPUR)	
Philadelphia Auth for Indl Dev (Philadelphia) JOINTCRIT		
Long Term Rating	AAA/A-1+	Affirmed
Unenhanced Rating	A+(SPUR)/Stable	Affirmed
Philadelphia Auth for Indl Dev (Philadelphia) (AGM)		
Unenhanced Rating	A+(SPUR)/Stable	Affirmed
Philadelphia Auth for Indl Dev pension fdg		
Unenhanced Rating	A+(SPUR)/Stable	Affirmed
Philadelphia Auth for Indl Dev (Cultural & Commercial Corridors Prog)		
Unenhanced Rating	A+(SPUR)/Stable	Affirmed
Philadelphia Auth for Indl Dev (Philadelphia) multi modal lse - 2007B-4		
Unenhanced Rating	NR(SPUR)	
Philadelphia Auth for Indl Dev (Philadelphia) GO		
Unenhanced Rating	A+(SPUR)/Stable	Affirmed
Philadelphia Mun Auth, Pennsylvania		
Philadelphia, Pennsylvania		
Philadelphia Mun Auth (Philadelphia) lse rev		
Long Term Rating	A+/Stable	Affirmed
Philadelphia Mun Auth (Philadelphia) GO		
Long Term Rating	A+/Stable	Affirmed
Philadelphia Mun Auth (Philadelphia) GO city agmt		
Long Term Rating	A+/Stable	Affirmed
Philadelphia Mun Auth (Philadelphia) GO city agmt (AGM)		
Unenhanced Rating	A+(SPUR)/Stable	Affirmed

Ratings Detail (As Of December 21, 2015) (cont.)		
Philadelphia Mun Auth (Philadelphia) lse		
Unenhanced Rating	A+(SPUR)/Stable	Affirmed
Philadelphia Redev Auth, Pennsylvania		
Philadelphia, Pennsylvania		
Philadelphia Redev Auth (Philadelphia) GO		
Long Term Rating	A+/Stable	Affirmed
Philadelphia Redev Auth (Philadelphia) GOEQUIV		
Long Term Rating	A+/Stable	Affirmed
Philadelphia Redev Auth (Philadelphia) (Neighborhood Transformation Initiative) GO		
Long Term Rating	A+/Stable	Affirmed
Philadelphia Redev Auth (Philadelphia) (Neighborhood Transformation Initiative) GO (BAM)		
Unenhanced Rating	A+(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.

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