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**RESEARCH**

## Summary:

# Philadelphia, Pennsylvania; General Obligation; General Obligation Equivalent Security

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### Credit Profile

| | | |
|---|---|---|
| US$203.8 mil GO rfdg bnds ser 2008A due 12/15/2032 | | |
| *Long Term Rating* | BBB/Stable | New |
| Philadelphia Auth for Indl Dev pension fdg bnds ser 1999A (FSA) | | |
| *Unenhanced Rating* | BBB(SPUR)/Stable | Affirmed |
| **Pennsylvania Convention Ctr Auth, Pennsylvania** | | |
| Philadelphia, Pennsylvania | | |
| Pennsylvania Convention Ctr Auth (Philadelphia) rfdg rev bnds | | |
| *Long Term Rating* | BBB/Stable | Affirmed |
| **Philadelphia Redev Auth, Pennsylvania** | | |
| Philadelphia, Pennsylvania | | |
| Philadelphia Redev Auth (Philadelphia) ser 86 subser 2 | | |
| *Long Term Rating* | BBB/Stable | Affirmed |

## Rationale

Standard & Poor's Rating Services assigned its 'BBB' rating, and stable outlook, to Philadelphia, Pa.'s series 2008A general obligation (GO) refunding bonds.

At the same time, Standard & Poor's affirmed its 'BBB' rating and underlying rating (SPUR) on the city's parity debt. The outlook is stable.

The ratings reflect the following weaknesses:

- The city's operating results have been historically erratic, although its financial position has improved over the past three years.
- The city continues to face cost increases related to health care and pensions, which, coupled with expiring union contracts and expected continued tax rate cuts, will pressure future financial operations.
- There are continuing longstanding fiscal problems at the Philadelphia School District and Philadelphia Gas Works (PGW), which in the past have required financial assistance from the city.

The city's overall net debt burden is high, due in large part to previous pension bond issuance, a significant neighborhood revitalization program, and general-fund-supported debt to finance the construction of two new stadiums. A large $3.0 billion expected pension bond issuance now being considered will increase debt even higher, but will be tempered by the city significantly funding its pension liability and reducing its annual required pension contributions. Given that the current unfunded pension liability is factored into our analysis as a contingent liability, the additional debt incurred for the pension bond issuance is viewed as credit neutral.

Also reflected in the rating are the following credit strengths:

- The Pennsylvania Intergovernmental Cooperation Authority (PICA) provides continued fiscal oversight.
- The city is located in the center of a diverse regional economy that, despite the addition of several notable development projects, has experienced only modest growth over the past several years.

The city will use bond proceeds to refund its series 2003B GO bonds.

The Philadelphia regional economy is highly diversified, with an emphasis on health care services, pharmaceutical manufacturing, education services, and tourism. However, out-migration from the city to the suburbs, relatively high business costs, a large number of poorly educated workers living in Philadelphia, and high tax rates have served to constrain economic growth.

In an effort to stimulate growth, since 1995, the city has cut the wage tax rate by 13% and the gross receipts portion of the business privilege tax by 50%, and expects to continue to do so through 2013. However, the combination of these cuts and an expected 11% decline in real estate transfer taxes are expected to limit future budgetary resources and flexibility.

Better-than-projected growth in wage, business privilege, and real estate transfer taxes has enabled the city to post positive financial operations over the past two years. On a GAAP basis, Philadelphia's unreserved general fund balance at fiscal year-end 2007 was $153 million (4% of expenditures), up from $111 million the previous year and negative $36 million at fiscal year-end 2005. On a legally enacted basis, which includes unearned business privilege tax receipts, the city had a $295 million balance.

Year-to-date fiscal 2008 operations project an $89 million operating deficit, better than originally budgeted. However, there is some uncertainty associated with the city's proposed five-year financial plan (2009-2013), which incorporates $121 million of the existing $156 million fund balance over the life of the plan to balance operations. The five-year plan also incorporates the repayment of the balance of a $43 million loan by the financially challenged PGW. PGW paid $20.5 million to the city in December 2007 and is to pay the balance to the city by the end of August 2008. The plan also includes $78 million in casino revenues from two casinos that have yet to be constructed. Also of note are the potential effects that the economic slowdown will have on revenues and service delivery. Realty transfer taxes are $8 million below budget and sales tax collections have flattened. While the city has budgeted conservatively for the slowdown, the length and depth of the recession and its effect on the five-year plan are yet to be determined.

The proposed plan proposes a large $3.0 billion pension bond issuance that would increase the funding level to 95% from a low 52% currently. While the pension bond issuance is large, the city will use a portion of proceeds to refund outstanding pension bonds and offset the current large unfunded contingent pension liability.

We consider Philadelphia's management practices strong under our Standard & Poor's Financial Management Assessment (FMA). An FMA of strong indicates that practices are strong, well embedded, and likely sustainable. Concern over Philadelphia's financial condition is mitigated, to a degree, by the oversight provided by PICA, which requires the city to submit five-year financial plans. This, in turn, has resulted in a level of budgetary discipline and strong financial reporting. Nevertheless, the city's financial condition remains tenuous and will continue to be challenged by weak demographic trends, uneven revenue growth, policies of tax reductions to spur economic expansion, and items in the out-years of the financial plan that are not fully within the city's control.

Overall net debt burden is high, at $4,952 per capita and roughly 18% of market value, especially high given household effective buying income, at about 75% of the national average. Debt levels have increased considerably in recent years as a result of debt issued for pension funding, urban renewal, and the construction of two sports stadiums. Carrying charges, inclusive of pension debt and debt secured by service agreements, are roughly 5% of general fund expenditures.

We have assigned Philadelphia a Standard & Poor's Debt Derivative Profile (DDP) overall score of '2' on a scale of '1' to '4', with '1' representing the lowest risk and '4' the highest. The overall score of '2' reflects our view that Philadelphia's general fund-related swap portfolio represents a neutral credit risk at this time.

## Outlook

The stable outlook reflects the combination of oversight from PICA and the expectation of continued prudent financial management, ensuring that future budgetary growth is appropriately matched to revenues. Standard & Poor's expects that as the economy continues to slow, the city's strong management practices will allow it to adjust to potential revenue shortfalls and rising operating costs without materially affecting results (as elaborated on in its five-year financial plan).

**Ratings Detail** (As Of 03-Apr-2008)

| | | |
|---|---|---|
| Philadelphia Auth for Indl Dev pension fdg bnds ser 1999A (MBIA) | | |
| *Unenhanced Rating* | BBB(SPUR)/Stable | Affirmed |
| Philadelphia Auth for Indl Dev pension fdg bnds ser 1999B (AMBAC) | | |
| *Unenhanced Rating* | BBB(SPUR)/Stable | Affirmed |
| Philadelphia Auth for Indl Dev pension fdg bnds ser 1999C (MBIA) | | |
| *Unenhanced Rating* | BBB(SPUR)/Stable | Affirmed |
| Philadelphia GO (CIFG) | | |
| *Unenhanced Rating* | BBB(SPUR)/Stable | Affirmed |
| Philadelphia GO (FGIC) | | |
| *Unenhanced Rating* | BBB(SPUR)/Stable | Affirmed |
| Philadelphia GO (FSA) | | |
| *Unenhanced Rating* | BBB(SPUR)/Stable | Affirmed |
| Philadelphia GO (XL CAP) | | |
| *Unenhanced Rating* | BBB(SPUR)/Stable | Affirmed |
| Philadelphia Redev Auth rev bnds (City Of Philadelphia Neighborhood Transformation Initiative) ser 2002A dtd 04/15/2002 due 07/15/2026 | | |
| *Unenhanced Rating* | BBB(SPUR)/Stable | Affirmed |
| Philadelphia Redev Auth (Philadelphia Neighborhood Transformation Initiative) (FGIC) | | |
| *Unenhanced Rating* | BBB(SPUR)/Stable | Affirmed |
| **Pennsylvania Convention Ctr Auth, Pennsylvania** | | |
| Philadelphia, Pennsylvania | | |
| Pennsylvania Convention Ctr Auth (Philadelphia) ser 2005A (MBIA) | | |
| *Unenhanced Rating* | BBB(SPUR)/Stable | Affirmed |
| **Philadelphia Auth for Indl Dev, Pennsylvania** | | |
| Philadelphia, Pennsylvania | | |
| Philadelphia Auth for Indl Dev (Cultural & Commercial Corridors Prog) rev bnds (FGIC) | | |
| *Unenhanced Rating* | BBB(SPUR)/Stable | Affirmed |

Many issues are enhanced by bond insurance.

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