S&P Global Ratings

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Summary:

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

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Credit Profile		
US$282.905 mil GO rfdg bnds ser 2016 due 08/01/2041		
Long Term Rating	A+/Negative	New
US$82.72 mil city agmt rev rfdg bnds (Philadelphia) ser 2016 due 04/01/2039		
Long Term Rating	A+/Negative	New
Philadelphia GO		
Long Term Rating	A+/Negative	Outlook Revised

Rationale

S&P Global Ratings revised the outlook on its 'A+' rating on Philadelphia's general obligation (GO) and GO-parity debt to negative from stable. The 'A+' rating is affirmed.

The action reflects our concerns that the city's rising retirement costs coupled with ongoing operating pressures could weaken its already adequate reserves to less than 1% of expenditures over the next one year to two years.

S&P Global also affirmed its 'AA+/A-1+' and 'AA+/A-1' rating on certain PAID debt, with PNC Bank and TD Bank providing liquidity support.

At the same time, S&P Global Ratings assigned its 'A+' rating and negative outlook to the city's series 2016 GO refunding bonds and Philadelphia Municipal Authority's series 2016 city agreement revenue refunding bonds.

The city's full-faith-and-credit-GO pledge secures the GO bonds. The authority's city agreement revenue refunding bonds are limited obligations of the city, payable solely from rental payments from the city to the authority under the prime lease dated June 1, 2009, and amended in 2016. Although current city revenue secures rental payments, the prime lease provides that as long as the 2016 bonds remain outstanding, Philadelphia's obligation to pay rent is absolute and unconditional.

Officials intend to use series 2016 GO bond proceeds to current refund the city's series 2006, 2007A, 2008A, 2009A, and 2011 GO bonds and series 2016 revenue refunding bond proceeds to refund the city's series 2009 lease revenue bonds. City projections have net present value savings from the refundings totaling $59 million, taken throughout the bonds' life. There is no restructuring of any maturity.

The rating reflects our opinion of the city's:

- 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 (FMA) methodology;

- Weak budgetary performance, with a trend of operating deficits over the past three years and additional operating deficits in the general fund expected in fiscals 2017 and 2018;
- Very weak budgetary flexibility and limited capacity to reduce expenditures as evidenced by ongoing operating deficits, gradually declining fund balances, and weak and declining pension funded levels;
- Very strong liquidity, with total government available cash that we expect will decline in the near term relative to its fiscal 2016 levels at 10.5% of total governmental fund expenditures and 2.9x governmental debt service, and access to external liquidity we consider exceptional;
- Weak debt and contingent liability position, with debt service carrying charges at 3.6% of expenditures and net direct debt that is 45.5% of total governmental fund revenue, as well as a large pension and other postemployment benefit (OPEB) obligation and the lack of a plan to sufficiently address the 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 MSA, which we consider broad and diverse. The city has a projected per capita effective buying income of 79.9% of the national level and per capita market value of $87,205. Overall, the city's market value grew by 223.6% over the past year to $136.3 billion in 2016. The county unemployment rate was 6.9% in 2015.

Philadelphia is the commonwealth's largest and the nation's fifth-largest city by population. Its economy heavily centers on health care and higher education, but we do not believe the existence of related institutions understate the city's wealth and income. Some of the city's leading employers are Albert Einstein Medical, Children's Hospital of Philadelphia, Southeastern Pennsylvania Transit Authority, and Comcast Cablevision of Willow Grove Inc. Development citywide is significant: 48 major projects totaled nearly $7.4 billion as of June 2016.

Strong management

We view the city's management as strong, with good financial policies and practices under our FMA 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 Pennsylvania Intergovernmental Cooperation Authority (PICA) with the most recent report for the period ended June 30, 2016, released on Aug. 15, 2016.

Philadelphia annually produces formal rolling five-year financial plans that elected officials review and PICA approves. The five-year plan factors in all known effects on revenue and expenditures and expected tax-rate reductions and labor cost increases, as well as identifies risks to the plan. In cases where material challenges occur after the five-year plan's introduction, PICA requires the city to submit a revised plan. Management updates its six-year capital improvement plan (CIP) 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, the city has not deposited any funds.

Weak budgetary performance

Philadelphia's budgetary performance is weak in our opinion. The city had slight operating deficits of 0.7% of expenditures in the general fund and 1% of expenditures across all governmental funds in fiscal 2016. We expect further operating deficits in future years and continued long-term budgetary pressures associated with the city's significantly underfunded pension system.

Philadelphia's charter requires it to issue an annual financial report (AFR) within 120 days of the close of each fiscal year. Although unaudited, we have used the fiscal 2016 AFR as the base year due to our understanding that there have not been material changes historically between the total governmental fund results shown in the AFR and the comprehensive annual financial report.

Financial statements are audited according to generally accepted accounting principles (GAAP), but management also reports results on a budgetary basis due to the significant amount of business-income-and-receipts-tax (BIRT) payments received in advance of being earned on a 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 half of 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 BIRT receipts should be recognized in the fiscal year in which they are collected. In addition, we 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.

The city's budgets and five-year financial plans reflect conservative revenue forecasts with actual collections generally exceeding projections recently. However, while actual results have typically performed better than budgeted, we believe the city still faces significant spending pressure. Although somewhat slowing down, the city has posted consecutive operating deficits since fiscal 2014 and the fiscal 2017 modified budget assumes another general fund operating deficit of $68.3 million, or a negative 1.6% of budgeted expenditures. In addition, the five-year financial plan shows declining fund balances through fiscal 2018, bottoming at $47 million, before rising incrementally in fiscal years 2019-2021. The plan incorporates rising labor costs pursuant to the recently reached labor agreement with one of its seven unions. However, it does not incorporate all potential wage increases for the remaining six labor union contracts, one of which expired in 2016 and the other five will expire in 2017. We believe this could add some budgetary uncertainty to the financial plan and could underestimate true labor costs.

Philadelphia's primary revenue sources within its general fund are wage-and-earnings tax receipts (34% of total general fund revenue, according to unaudited fiscal 2016 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.

Very weak budgetary flexibility

Philadelphia's budgetary flexibility is very weak, in our view, with an available fund balance that has consistently declined since fiscal 2013 and is projected to further decline over the next two years. Additionally, we believe the city has limited capacity to reduce expenditures.

Reflecting the city's ongoing budget pressure, fund balance declined from 7.4% of operating expenditures, or $256.9 million in fiscal 2013 to an unaudited 3.7%, or $148.3 million, in fiscal 2016. The city indicated that it could have posted stronger reserve levels in fiscal 2016 but chose to allocate about $19 million to fund its pension plan. The modified fiscal 2017 budget projects another operating deficit that could lower reserves to about $56.9 million, which would represent just 1.3% of budgeted general fund expenditures. In addition, the city's five-year plan shows reserves declining to $39.1 million, which would represent just 0.9% of expenditures. Although due to conservative revenue forecasts, we expect positive revenue variances to narrow the gap and contribute to stronger fiscal year-end results, we believe that, even at current levels, the city has limited flexibility to address any unanticipated changes with the budget.

We no longer believe the city has demonstrated a willingness to raise taxes due to 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 general fund operations in fiscal 2011. We also note that following the recommendation of two tax reform commissions, the city has reduced its BIRT rate and wage tax to stimulate the economy. Furthermore, we believe the city still faces significant cost pressures from its underfunded pension and OPEB, with limited ability to address these fixed costs.

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 2016 levels at 10.5% of total governmental fund expenditures and 2.9x governmental debt service in 2016. In our view, the city has exceptional access to external liquidity if necessary.

Philadelphia's frequent issuance of multiple security types during the past 15 years illustrates its exceptional access to external liquidity. We do not consider its investments aggressive.

We do not believe the various liquidity facility agreements supporting the service and lease agreement debt issuances expose the city to nonremote contingent liability risk. With certain limited exceptions, service 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, agreements allow for a term-out but not principal acceleration.

Furthermore, we do not believe the city's swaps create nonremote contingent liability risk due to the wide margin between its rating and 'BBB-' rating trigger. The mark-to-market-value across its six swap agreements is a negative $80.5 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 3.6% of total governmental fund expenditures, and net direct debt is 45.5% of total governmental fund revenue.

Principal debt amortization is average, in our opinion, with roughly 54.3% scheduled to be retired within 10 years. Including about $331 million of additional GO debt the city plans to issue over the next two years, as outlined in its six-year CIP, net direct debt would increase to about 49.4% of total governmental revenue.

In our opinion, Philadelphia's large pension and OPEB obligation is a credit weakness. Philadelphia's combined required pension and actual OPEB contribution totaled 13.3% of total governmental fund expenditures in fiscal 2015. Of that amount, 11.8% represented required contributions to pension obligations, and 1.4% represented OPEB payments. The city made 72% of its annual required pension contribution in fiscal 2015. The funded ratio of the largest pension plan is 44.7%.

Philadelphia produces two actuarial required contribution (ARC) calculations annually: one based on its minimum municipal obligation (MMO) and the other based on a decades-old policy that amortizes its pension unfunded actuarial accrued liability (UAAL) much more rapidly than the MMO. Therefore, 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 governments. While the $577.2 million contribution in fiscal 2015 only represented 72% of the ARC, it was 103.8% of the MMO.

Philadelphia 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. The gas works plan covers employees of Philadelphia Gas Works (PGW). The city plan's funded status was 45% as of July 1, 2015. The city considered selling PGW, which is a discretely presented component unit of the city, and applying a portion of sale proceeds to the city plan to improve its funded status. While the city council did not authorize the sale, 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. Although the city consistently contributed more than 100% of the MMO to the city plan since fiscal 2006, the plan's funded ratio declined from 51.6% in 2006 to 45% in 2015.

In addition, the city passed a permanent 1% increase in the sales tax rate that became effective July 1, 2014 that is expected to benefit the pension fund only after school district distributions and certain debt service payments. The city is projecting that this will result in an 80% funded pension plan at the end of 12 years. Nevertheless, we are concerned that these efforts may fall short of bringing stability to the pension system over time given recent market performance and other factors that could result in continued weak funded levels and increased budgetary pressures.

In addition to having to address its pension issues, the city still needs to address a sizable unfunded OPEB liability. As of July 1, 2014, the date of the most recent actuarial valuation, the OPEB UAAL was $1.7 billion. The city funds OPEB on a pay-as-you-go basis.

Strong institutional framework

The institutional framework score for Philadelphia is strong.

Outlook

The negative outlook reflects S&P Global Ratings' opinion of the city's ongoing budget and retirement cost pressures that continually threaten already very weak budgetary flexibility and are expected to translate into long-term pressures for the city. If the city is unable to address its structural imbalance and its pension and OPEB situation and reserves continue to decline, with no adequate management plans to address fiscal imbalance, we could lower the rating within the next one year to two years. Conversely, if management were to address the budgetary imbalances and retirement cost pressure adequately while it demonstrates improved fund balances, holding all other factors equal, we could revise the outlook to stable.

Ratings Detail (As Of November 7, 2016)		
Philadelphia GO		
Long Term Rating	A+/Negative	Outlook Revised
Philadelphia GO		
Long Term Rating	A+/Negative	Outlook Revised
Philadelphia GO (AGM) (SEC MKT)		
Unenhanced Rating	A+(SPUR)/Negative	Outlook Revised
Philadelphia GO (BAM) (SECMKT)		
Unenhanced Rating	A+(SPUR)/Negative	Outlook Revised
Philadelphia GO (BAM) (SECMKT)		
Unenhanced Rating	A+(SPUR)/Negative	Outlook Revised
Philadelphia GO		
Unenhanced Rating	A+(SPUR)/Negative	Outlook Revised
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+/Negative	Outlook Revised
Philadelphia Auth for Indl Dev (Philadelphia) multi modal lse - 2007B-3		
Long Term Rating	AA+/A-1	Affirmed
Unenhanced Rating	A+(SPUR)/Negative	Outlook Revised
Philadelphia Auth for Indl Dev (Philadelphia) GO		
Long Term Rating	A+/Negative	Affirmed
Unenhanced Rating	NR(SPUR)	
Philadelphia Auth for Indl Dev (Philadelphia) JOINTCRIT		
Long Term Rating	AA+/A-1+	Affirmed
Unenhanced Rating	A+(SPUR)/Negative	Outlook Revised
Philadelphia Auth for Indl Dev (Philadelphia) (AGM)		
Unenhanced Rating	A+(SPUR)/Negative	Outlook Revised
Philadelphia Auth for Indl Dev pension fdg		
Unenhanced Rating	A+(SPUR)/Negative	Outlook Revised
Philadelphia Auth for Indl Dev (Cultural & Commercial Corridors Prog)		
Unenhanced Rating	A+(SPUR)/Negative	Outlook Revised
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)/Negative	Outlook Revised
Philadelphia Mun Auth, Pennsylvania		
Philadelphia, Pennsylvania		

Ratings Detail (As Of November 7, 2016) (cont.)		
Philadelphia Mun Auth (Philadelphia) lse rev		
Long Term Rating	A+/Negative	Outlook Revised
Philadelphia Mun Auth (Philadelphia) GO		
Long Term Rating	A+/Negative	Outlook Revised
Philadelphia Mun Auth (Philadelphia) GO city agmt		
Long Term Rating	A+/Negative	Outlook Revised
Philadelphia Mun Auth (Philadelphia) GO city agmt (AGM)		
Unenhanced Rating	A+(SPUR)/Negative	Outlook Revised
Philadelphia Mun Auth (Philadelphia) lse		
Unenhanced Rating	A+(SPUR)/Negative	Outlook Revised
Philadelphia Redev Auth, Pennsylvania		
Philadelphia, Pennsylvania		
Philadelphia Redev Auth (Philadelphia) GO		
Long Term Rating	A+/Negative	Outlook Revised
Philadelphia Redev Auth (Philadelphia) GOEQUIV		
Long Term Rating	A+/Negative	Outlook Revised
Philadelphia Redev Auth (Philadelphia) (Neighborhood Transformation Initiative) GO		
Long Term Rating	A+/Negative	Outlook Revised
Philadelphia Redev Auth (Philadelphia) (Neighborhood Transformation Initiative) GO (BAM)		
Unenhanced Rating	A+(SPUR)/Negative	Outlook Revised

Many issues are enhanced by bond insurance.

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.