STANDARD & POOR'S RATINGS SERVICES

RatingsDirect®

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

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Credit Profile		
US$197.68 mil go bnds ser 2013A due 07/15/2033		
Long Term Rating	A-/Stable	New
US$158.475 mil go rfgd bnds ser 2013B due 06/30/2039		
Long Term Rating	A-/Stable	New
Philadelphia GO		
Long Term Rating	A-/Stable	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 'A-' from 'BBB+'. The outlook is stable.

At the same time, Standard & Poor's assigned its 'A-' long-term rating to the city's series 2013A and 2013B GO bonds.

The upgrade reflects our assessment of the city's progress in restoring its general fund balance through cost containment as well as stronger revenue streams.

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 'A-' from 'BBB+'.

The 'A-' 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, 2011, and 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 overall net debt due largely 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 2013A and 2013B GO bonds. Officials intend to use bond proceeds for capital projects as well as the refunding of various series of the city's GO bonds for debt service savings.

The 134-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 such increase in six decades. Growth in the subsequent two years raised the population to about 1.548 million. The growth has not been uniform across age groups, and there has been a notable shift in the city's demographics. Between 2006 and 2012, people aged 20-34 became the largest share of the population. Employment within the city is concentrated in education and health services (32%), government (15%), and professional and business services (13%). Between 2002 and 2012, education and health services employment grew by 18% and leisure and hospitality by 16% while government contracted by 15%. Over this period, city-wide employment contracted by just 3%. Philadelphia's unemployment has historically been, and continues to be, above commonwealth and national rates. In 2012 the rate averaged 10.8% compared with the commonwealth's 7.9% and the nation's 8.1%. The city's largest employers include the University of Pennsylvania (16,539 employees), the University of Pennsylvania Health System (15,827), Drexel University (9,356), and Children's Hospital of Philadelphia (9,355).

The city is in the process of assessing all properties within its boundaries at actual market value, with notices of revised property values mailed in February 2013 and formal appeals requests due on Oct. 7, 2013. The so called Actual Value Initiative (AVI) has resulted in a 167% year-over-year increase in Philadelphia's fiscal 2014 taxable assessed value (AV) as it is the first city-wide reassessment in decades. We understand the property tax base will be reassessed annually. The $99.9 billion AV translates to roughly $65,000 per capita, which we consider strong. Future tax-base growth is likely with over 40 major projects under construction that have a combined value of $3.1 billion and, notably, only half of which received public subsidies.

The city has emerged from a period of significant financial stress that was largely attributable to the recession. Through proactive budget measures as well as rebounding tax revenue, Philadelphia eliminated a $137 million general fund deficit within two years. The fiscal 2010 general fund generated a $23.2 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 - attributable to better-than-expected wage and business privilege tax revenue and the first full year of a 1% sales tax increase - effectively eliminating the accumulated general fund deficit. Another surplus in fiscal 2012 raised the budgetary general fund balance to $146.8 million, or 4.2% of expenditures, which we consider good.

The adopted fiscal 2013 budget is $3.6 billion and includes a fund balance appropriation of $36 million as well as a 3.6% real estate tax increase. Based on data through the third quarter of the fiscal year, officials are projecting an operating deficit of just $5.8 million. Officials have increased revenue projections by $107.8 million due to, in our opinion, strong performance in business privilege tax receipts (a $40 million upward revision), wage and earnings tax receipts (a $24.1 million upward revision), and real estate taxes (a $20.2 million upward revision). Philadelphia, however, has also adjusted the expenditure budget upward by $95.3 million net of savings primarily in the area of debt service. The largest negative variances include $31.4 million to fund a portion of the International Association of Firefighters Local 22 arbitration award under appeal and $26.1 million related to wages and salaries. Overspending related to the latter category is primarily due to a wage reopener in the police contract and an increase in the prison census necessitating overtime. The city also added an $11.6 million expenditure in the 2013 budget for an out-of-contract bargaining unit award.

While Philadelphia has made strong strides to restore general fund balance, we believe that within the next few fiscal years, the city will remain challenged as it copes with a slow national economic recovery, as well as the temporary sales tax increase's expiration in 2014. Also in fiscal 2014, the city's property revaluation will likely result in a significant number of tax appeals. There is also an uncertainty over labor costs since the city remains in contract negotiations with several of its labor unions, and it is currently appealing an arbitration award to its firefighters union. The city has incorporated all of these challenges into the current five-year financial plan. Philadelphia's long-term liabilities, including pension and health care costs, also remain a concern. Mayor Michael Nutter's administration has made good progress in changing pension benefits for future employees, which will contain long-term costs. The administration's proactive actions 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 what we consider 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 to 15 years due to debt issued for pension funding, urban renewal, and the construction of two sports stadiums. The city's debt metrics also reflect a significant amount of overlapping debt from the Philadelphia School District. In our view, overall net debt is high at about $5,900 per capita and moderately high at 9.1% of market value. The latter indicator is much improved given the property tax base reassessment. 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 somewhat below average, with officials planning to retire 100% of principal by 2042.

Outlook

The stable 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. We do not expect to change the rating in the next two years but note that rating direction will likely hinge on continued economic expansion as well as improved reserves.

Finances

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 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 2014. In addition, the commonwealth legislature gave its approval for a temporary five-year sales tax increase to 8% from 7% (expiring June 30, 2014) 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. The city also raised real estate taxes by 9.9% in fiscal 2011.

Fiscal 2014 proposed budget and the 22nd five-year plan

Philadelphia presented its proposed fiscal 2014 budget and 22nd five-year plan, for fiscal years 2014-2018, to the city council on March 14, 2013. The entire budget was voted out of the committee as a whole with a favorable recommendation on June 13, 2013, and the city expects the budget to pass on June 20. The budget totals $3.8 billion. Expenditures are budgeted to exceed revenue by $41.8 million, which when combined with positive adjustments and $41.7 million of expenditures related to potential labor obligations results in a projected ending fund balance of $87 million. Total tax revenues are estimated at $2.75 billion, an increase of 1.6% over fiscal 2013's projection. Growth is projected for all major taxes in fiscal 2014. The proposed fiscal 2014 budget includes the resumption of wage tax cuts that were suspended during the recession, though receipts are budgeted to rise 3.5% over 2013 estimates.

The proposed fiscal 2014 budget conforms to the 22nd five-year plan. The city council must approve the budget before Philadelphia can submit it to PICA for approval. The plan assumes modest growth in wage, real estate transfer, and business income and receipt taxes. Despite the sunset of the temporary 1% increase, sales tax revenues are also projected to grow in each year. Even with reserving for various unsettled labor contracts, including retroactive payments, the city's projections show positive general fund balances over the entire five-year plan.

Fiscal 2012

The city's general fund ended the fiscal year with a surplus of $146.7 million due to cost containment measures, the cancellations of prior-year obligations (so-called net adjustments that are below the line), and the receipt of one-time revenue. The city collected $34.9 million from the state for Act 205; $11 million from Philadelphia Parking Authority; and $12.5 million from Philadelphia Authority for Industrial Development. Also notable for fiscal 2012 was the city's shift to budgeting only the unreimbursable portion of Act 148 program expenditures. Historically, Act 148 revenues were not received in the same fiscal year that costs were incurred, resulting in an understated general fund balance. Also in fiscal 2012, the city moved 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 because they will no longer be distorted by significant delayed commonwealth reimbursements.

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 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 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, as well as review the surveys of professional forecasters. Management tracks revenue daily and expenditures monthly. It delivers formal revenue reports to elected officials monthly. The city prepares quarterly reports, which are delivered to elected officials and PICA. Budget officials meet quarterly with the officials of each large city department. They generally amend the budget once 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. In December 2012, Philadelphia issued $127 million of TRANs, which mature on June 26, 2013. Due to the city's improved finances, the fiscal 2013 TRAN borrowing was $46 million less than the 2012 TRAN and $158 million less than the 2011 TRAN.

Pensions

Philadelphia provides various pension, life insurance, health, and medical benefits to its employees. As of July 1, 2012, there were 64,485 members in the plan -- 38,179 of which were nonactive -- receiving benefits. 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 increase the amortization period of the unfunded liability to 30 years. It also allowed the city to defer to fiscal 2014 $150 million of pension payments in fiscal 2010 and $98 million in fiscal 2011. The city repaid both deferrals in November 2012, more than a year early, through the issuance of PAID refunding notes with a final maturity of April 1, 2014. The pension board has also lowered the assumed rate of return (in increments) to 7.95% in 2013, from 8.75% in 2009. Based on Philadelphia's most recent actuarial report, dated July 1, 2012, the unfunded accrued pension liability was $5.08 billion, or 48.1% funded, down slightly from 2011's 49.7% and down significantly from its 10-year peak of 63.3% in 2003.

Philadelphia has taken steps to reduce its future pension benefits through arbitration with its various labor unions. All new police, fire, and sheriff employees can either participate in a defined-benefit pension plan at an increased rate of contribution or enroll in a hybrid plan that includes defined-benefit and defined-contribution elements. New register of wills employees must enter the hybrid plan. The city is seeking similar concessions from its other bargaining units.

Other Postemployment Benefits (OPEB)

Philadelphia self-administers a single-employer, defined-benefit plan. The city also provides health care for five years subsequent to separation to eligible retirees. In addition, it provides lifetime insurance coverage for all eligible retirees and funds its retiree benefits through pay-as-you-go financing. For fiscal 2012, Philadelphia paid $76.3 million, or 72%, of its annual required contribution for retiree health care. As of the most recent valuation date of July 1, 2011, the unfunded actuarial accrued OPEB liability was $1.2 billion with 0% funded.

Economy

Philadelphia's economy is heavily influenced by health care and higher education. The city is at the center of the nation's largest concentration of health care resources within a 100-mile radius. Its MSA plus nearby Mercer County, N.J., has the second-largest concentration of students on the East Coast; there are 101 degree-granting institutions with a total enrollment of 300,000 of which about 155,000 live in the city. We consider growth prospects good for the metropolitan area's core of knowledge-based industries due mainly to a highly educated workforce drawn from suburban areas. We also note Philadelphia's leisure and hospitality sector, which accounts for about 9% of the employment base, has continued 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 estimated economic impact of the convention center was $813 million in 2012.

We believe the sizable student population somewhat dampens the city's income indicators as its median household and per capita effective buying income measure 74% and 77% of the national averages, respectively. While Philadelphia enjoys a moderate cost of living compared with many large metropolitan areas, its relatively high business costs, large number of poorly educated workers, and high tax rates have inhibited growth. A trend of outmigration from 1970-2000 fostered a large disparity in education and income between central city and suburban residents.

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 June 14, 2013)		
Philadelphia GO multi modal ser 2009B		
Long Term Rating	AAA/A-1+	Affirmed
Unenhanced Rating	A-(SPUR)/Stable	Upgraded
Philadelphia GO rfdg bnds		
Long Term Rating	A-/Stable	Upgraded
Philadelphia Redev Auth (Neighborhood Transformation Rev) (wrap of insured) (FGIC & AMBAC) (SEC MKT)		
Unenhanced Rating	A-(SPUR)/Stable	Upgraded
Philadelphia GO		
Unenhanced Rating	A-(SPUR)/Stable	Upgraded
Philadelphia Redev Auth		
Unenhanced Rating	A-(SPUR)/Stable	Upgraded
Philadelphia Auth for Indl Dev, Pennsylvania		
Philadelphia, Pennsylvania		
Philadelphia Auth for Indl Dev rev bnds RMKTD 5/31/2012 ser 2007B-2		
Long Term Rating	AAA/A-1+	Affirmed
Unenhanced Rating	A-(SPUR)/Stable	Upgraded
Philadelphia Auth for Indl Dev (Philadelphia) city svc agreement		
Short Term Rating	SP-1+	Affirmed
Philadelphia Auth for Indl Dev (Philadelphia) city svc agreement rfdg rev bnds (Retirement Sys)		
Long Term Rating	A-/Stable	Upgraded
Philadelphia Auth for Indl Dev (Philadelphia) multi modal lse rev rfdg bnds ser 2007B-1		
Long Term Rating	AAA/A-1	Affirmed
Unenhanced Rating	A-(SPUR)/Stable	Upgraded
Philadelphia Auth for Indl Dev (Philadelphia) multi modal lse - 2007B-3		
Long Term Rating	AA/A-1	Affirmed
Unenhanced Rating	A-(SPUR)/Stable	Upgraded
Philadelphia Auth for Indl Dev pension fdg		
Unenhanced Rating	A-(SPUR)/Stable	Upgraded
Philadelphia Auth for Indl Dev (Cultural & Commercial Corridors Prog)		

Ratings Detail (As Of June 14, 2013) (cont.)		
Unenhanced Rating	A-(SPUR)/Stable	Upgraded
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	Upgraded
Philadelphia Mun Auth, Pennsylvania		
Philadelphia, Pennsylvania		
Philadelphia Mun Auth (Philadelphia) lse rev		
Long Term Rating	A-/Stable	Upgraded
Philadelphia Mun Auth (Philadelphia) lse		
Unenhanced Rating	A-(SPUR)/Stable	Upgraded
Philadelphia Redev Auth, Pennsylvania		
Philadelphia, Pennsylvania		
Philadelphia Redev Auth (Philadelphia) rev rfdg bnds (City of Philadelphia Neighborhood Transformation Initiative) ser 2012		
Long Term Rating	A-/Stable	Upgraded

Many issues are enhanced by bond insurance.