



Fitch Rates Philadelphia, Pennsylvania's \$145MM 2009 Water & Sewer Revs 'A-'

Ratings

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Fitch Ratings-New York-09 April 2009: Fitch Ratings assigns an 'A-' rating to the City of Philadelphia (the city), PA's approximately \$145 million water and wastewater revenue bonds, series 2009. The bonds are scheduled for negotiated sale the week of April 27, 2009. Proceeds from the series 2009 bonds will provide financing for various capital improvement projects. At this time, Fitch also affirms the 'A-' rating on the city's \$1.58 billion of outstanding parity bonds. The Rating Outlook is Stable.

The underlying 'A-' rating for the combined water and wastewater system (the system) reflects independent rate-setting authority and an affordable rate structure, manageable capital needs relative to the overall size of the system and its customer base, ample water supply coupled with substantial treatment capacity at all facilities, and a relatively stable service area. The system's strong credit characteristics are tempered by historically weak collection rates, narrow debt service coverage levels, weak legal provisions, and a high amount of water loss. Fitch believes maintenance of the system's currently healthy rate stabilization fund (RSF) and overall liquidity will be critical to ensuring an adequate operating cushion given the weak collection rates and typically slim debt service coverage levels.

The system serves approximately 472,000 retail accounts throughout the city and in neighboring suburban areas pursuant to long-term wholesale agreements for water and sewer service. Similar to the city's population trend, the system's customer base continues to decline incrementally as retail accounts have dropped by about 1.5% annually since 2000. Average daily water demand is significantly below the system's permitted water supply and treatment capacity at all facilities. Daily wastewater flows are well within treatment plant permit limits. No concentration exists among retail and wholesale customers, and user charges remain affordable despite the city's income levels, which rank well below regional, state and national figures. Annual rate hikes ranged between 4%-6.5% between fiscal years 2006 and 2009, and yearly increases through fiscal 2012 are forecast to fall between 5.5% and 7.1%. Legal provisions are weak, essentially requiring 1.2 times (x) coverage of senior-lien debt service from both net operating revenues and withdrawals from the RSF. The additional bonds test is based on projected compliance with the rate covenant.

Although offset by a high fixed cost burden, related primarily to debt service, the system generates strong operating margins despite historically weak collection rates of about 85%. Financial operations are adequate as management consistently budgets to meet the rate covenant. As such, the system's financial forecast through fiscal 2015 shows annual debt service coverage remaining at 1.2x. The narrow debt service coverage is balanced by the system's strong cash position driven primarily by the RSF. Despite a nominal draw of approximately \$9.8 million in fiscal 2008, the system ended the year with a healthy balance of \$183.1 million in the RSF, leaving the system with almost 250 days of cash available for operations. The system's financial forecast through fiscal 2015 shows a substantial draw-down in the RSF to approximately \$17.5 million to support the maintenance of 1.2x coverage of debt service through the projection period. However, Fitch believes the system is likely to outperform its financial forecast given its demonstrated history of maintaining strong cash reserves and generating solid operating margins.

The system's proposed capital improvement plan (CIP) for fiscal 2010-2015 totals slightly more than \$1.0 billion, up almost \$85 million over the fiscal 2008-2013 CIP, though still manageable. About one-third of the CIP will address ongoing combined sewer overflow (CSO) projects, which Fitch believes is moderate given the age of the system. Almost 70% of capital financing for the CIP will be derived from revenue bonds with new money issuance planned in fiscal years 2010 and 2012. The balance of funding is expected to come from state loans and excess operating revenues and reserves.

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