New Issue: Philadelphia (City of) PA Wtr. & Sew. Ent.

MOODY’S ASSIGN A3 RATING AND STABLE OUTLOOK TO CITY OF PHILADELPHIA’S $145 MILLION WATER AND WASTEWATER REVENUE BONDS, SERIES 2009 AND AFFIRMS THE A3 RATING IN CONJUNCTION WITH REMARKETING OF 2005B VARIABLE RATE REFUNDING BONDS WITH LOC SUPPORT

A3 RATING APPLIES TO $1.7 BILLION IN OUTSTANDING RATED DEBT, INCLUDING THE CURRENT ISSUES

Water/Sewer
PA

Moody's Rating

<table>
<thead>
<tr>
<th>ISSUE</th>
<th>RATING</th>
</tr>
</thead>
<tbody>
<tr>
<td>Water and Wastewater Revenue Bonds, Series 2009</td>
<td>A3</td>
</tr>
<tr>
<td>Sale Amount</td>
<td>$145,000,000</td>
</tr>
<tr>
<td>Expected Sale Date</td>
<td>04/27/09</td>
</tr>
<tr>
<td>Rating Description</td>
<td>Revenue</td>
</tr>
</tbody>
</table>

Opinion

NEW YORK, Apr 23, 2009 -- Moody's Investors Service has assigned the A3 underlying rating and stable outlook to the City of Philadelphia's $145 million Water and Wastewater Revenue Bonds, Series of 2009. The bonds are secured by the net revenues of the water and sewer system (the system). Concurrently, Moody's affirms the A3 rating and stable outlook on the system's $1.7 billion in outstanding debt. The rating affirmation is also in conjunction with the remarketing of the city's Water and Wastewater Revenue Refunding Bonds, Variable Rate Series 2005B to substitute an existing Financial Security Assurance (FSA) insurance policy with a letter of credit and reimbursement agreement. Pursuant to an Endorsement and Release Agreement between FSA, U.S. Bank N.A. (fiscal agent), Citigroup Global Markets (remarketing agent) and the city the FSA insurance policy will be cancelled on the effective date of the letter of credit (expected to be during first week of May 2009). The letter of credit agreement is being reviewed by Moody's Municipal Structured Products Group and a separate rating report will be issued at or prior to closing.

The A3 underlying rating reflects the system's strong management, improved financial operations, significant cash balances in the Rate Stabilization Fund, ongoing improvements addressing environmental concerns and an above average debt position. Although conservative projections show that management may draw on the Rate Stabilization Fund over the next several years to meet the 1.2x net revenue coverage mandated by the rate covenant, recent improvements to financial operations, as well as anticipated ongoing rate increases, will likely mitigate the dependence on this fund. The closed-loop system is effectively segregated financially from the city's general funds and accounts, with a daily sweep of customer revenues to a third-party fiscal agent. In addition, a moderate portion of revenues is related to wholesale services provided under contract to various suburban communities outside of the City.

STRONG OPERATING AND FINANCIAL MANAGEMENT

The management team of this large combined water and wastewater system has produced a strong record of operational and financial achievements over the past decade. Operational achievements include continued improvements in environmental compliance, the launch of a proactive water main replacement program that has significantly reduced the number of main breaks, and the installation of automatic meters for a significant proportion of residential customers. In addition to the resulting improvements in billing accuracy, the billing cycle was accelerated to a monthly basis, and both have led to an increase in 120 day payment patterns from 87.3% in fiscal 2000 to 91% consistently for the three fiscal years ending in 2007. Operating costs have been well-managed, with significant reductions in some areas such as contracted electricity costs and a projected $197 million in savings over the life of a contract for the management outsourcing of the biosolids recycling center. As discussed in detail below, management has been able to maintain significant cash balances that support the system's working capital needs, help with rate stabilization, and provide for contingencies.

Rate-setting authority resides solely with the water department, with no authorization required from city council, although the water department is required to provide at least 30 days advance notice to city council of any proposed rate changes. Water and sewer rate increases are generally approved for four years at one
time; the last rate study incorporated fiscal years 2005 through 2008 and went through a required hearing process with little dispute. The current rate filing affected fiscal years 2009 through 2012 and was approved in October 2008 and effective November 1, 2008. The proposed rate increases are expected to be 7.8% in fiscal 2009, 6.4% in 2010, 6.6% in 2011, and 6.5% in 2012. The city's rates remain very competitive and are approximately one-half of many regional providers.

SYSTEM IS FINANCIALLY SEGREGATED FROM CITY'S GENERAL FUNDS

By covenant in the bond ordinance, the city is required to deposit all water and wastewater funds with an independent fiscal agent (currently, Wachovia Bank N.A.; senior unsecured rated Aa2) and to keep such funds separate and apart from general city funds and accounts. Although the Water Revenue Bureau within the city's Revenue Department performs billing and collection for customers located in the city, there is a daily sweep of collected funds to the fiscal agent. Per the bond ordinance, the city may not borrow any water or wastewater funds for other city purposes, including temporary or seasonal cash flow needs. These provisions were put in place to protect water and wastewater bondholders during the early 1990's, when the city's General Fund was experiencing significant financial stress. The city's general obligation bonds are currently rated Baa1 with a stable outlook.

The ordinance does permit an annual transfer to the city of up to $4,994,000, but not to exceed the actual amount of interest earnings on the system's debt service reserve fund. Apart from this, the water and wastewater system is a financial closed-loop, with all revenues and cash balances available for system purposes only, including capital purposes.

STABLE SERVICE AREA

The city's water department supplies water and provides wastewater treatment services to residents of Philadelphia and portions of Bucks, Montgomery and Delaware Counties (G.O. rated Aa1, Aaa and Aa2, respectively), although over 90% of customers are residents of the city and approximately 9% are from Bucks County. Philadelphia has experienced a long trend of industry and population loss since 1950, with a particularly sharp economic retreat hitting in the late 1980's and early 1990's. The late 1990's saw a resumption of growth, with employment up 5.7% between 1998 and 2001, and then down about 1.6% between 2001 and 2003, reflecting the slowdown in the national economy. The decline flattened in fiscal 2004 and then grew by about 1.0% in 2005, 0.9% in 2006, and 0.7% in 2007. Although employment continued to grow for 2008 (overall annual growth was 0.2%), employment growth halted in October and turned negative in every month from November through March. Manufacturing has continued to decline in importance, and as of 2005, diversified services account for 54% of total employment (or more than 60% including the finance/insurance/real estate sector). Population loss during the 1990's was just over 4%, although this was only about half the loss that had been estimated prior to the 2000 census count. With an estimated 1.45 million residents, the city is the nation's sixth most populous. Unemployment rates in the city have increased and as of February, were 9.6%, above state (8.2%) and national (8.9%) medians. The suburban portions of the service area are wealthier and have historically been somewhat faster-growing than the city, but are much less significant to the system as they account for less than 10% of total customer revenues.

IMPROVED FINANCIAL OPERATIONS IN RECENT YEARS; SIGNIFICANT CASH BALANCES MAINTAINED

The system has built and maintained a strong level of cash balances over recent years in the Rate Stabilization Fund and the Residual Fund. The combined balance in these funds at the end of fiscal 2008 was approximately $183.1 million, up from fiscal 2006 when the combined balance was approximately $154 million. Both funds are pledged as security for bondholders, and are in addition to a Debt Service Reserve Fund equal to maximum annual debt service. Additionally, the system's unrestricted cash position has improved annually since fiscal 2003 from $37.7 million to $51 million in fiscal 2008.

The significant Rate Stabilization Fund (RSF) and Residual Fund were built up through conservative annual budgeting and multi-year financial planning. While the rate covenant in the bond ordinance requires 1.2x debt service coverage, transfers from the Rate Stabilization Fund may be used to "manage to" the required level. Since fiscal 2001, transfers were made to the Rate Stabilization Fund from the Revenue Fund in all but three years, 2003, 2005 and 2008, respectively, due to positive operations. The city notes that the last few years of strong operations have benefited from the once-healthy economic conditions and sizeable rate increases. In fiscal 2008, the city budgeted to draw $39 million from the RSF, although an increase in rates and investment income reduced the RSF draw to $9.7 million. The 2008 draw left $183 million in the fund, well in excess of the system's policy of maintaining the fund at a minimum of $45 million in this fund. The fiscal 2009 budget includes another projected draw from the rate stabilization fund in the amount of $32.283 million and is currently projected at $42.5 million, although management expects better-than-budgeted financial performance to again reduce the amount of the final draw to the RSF as in previous years.

Although better-than-projected financial results have historically kept the RSF at significantly higher levels, conservative projections continue to reflect the depletion of the RSF to about $45 million at the end of six-year periods. In the future, department officials report that RSF draws may become more frequent as management utilizes RSF funds to mitigate rate increases. Maintenance of the current rating is predicated on
the system's ability to adequate debt service coverage through growth in net operating revenues while still maintaining satisfactory reserve levels.

Approximately $20 million has been expended annually from internal funds for capital maintenance and improvements, a trend that is expected to continue and that reduces the need for additional debt finance. These transfers are in addition to a requirement of the bond ordinance to transfer a minimum annual amount to the capital account (approximately $16 million in recent years and expected to equal $17 million in 2009) to support plant renewal and replacement.

In fiscal 2008, the water department replaced a portion of its Debt Service Reserve Fund, which was sized at approximately $175 million, with a surety bond for $67 million, netting $64.3 which was placed in a new fund called the Special Water Infrastructure Account to be used for the cost of renewals, replacements and improvements. At this time, there are no additional plans to obtain any additional surety bonds and system management plans on spending the balance down for various capital improvements over the next two years.

**ABOVE AVERAGE DEBT LOAD; IMPROVED COVERAGE FROM RECURRING REVENUES**

The system's above average debt load mainly reflects major investments in the early 1990's to improve environmental compliance, plus a significant ongoing program to replace aging water and sewer mains throughout the city. The debt ratio has improved slightly to 71% in fiscal 2008 (from 83% in 2006), but remained more than twice the national median for combined water and wastewater systems (as calculated by Moody's), although similar to some other large urban systems. Despite the debt load, in recent years, sizeable rate increases, significant increases in interest income revenue, and expenditure controls have resulted in debt service coverage levels from net recurring revenues that have improved from a recent low of 1.04 times in 2004 to 1.27 times in fiscal 2008.

Transfers from the RSF are used to mitigate customer rate increases. Despite an estimated $180 million in additional debt expected to be issued in fiscal 2010, the proposed rate increases in 2010 and 2011 (and through 2012) are expected to be similar to previous years at 6.4% and 6.6%. An additional planned debt issuance of $350 million in fiscal 2013 is projected to result in a more sizeable rate increase of 10.8% in fiscal 2013. The additional debt will also serve to keep the debt ratio at elevated levels. The system's current CIP (2009-2014) is approximately $985 million and will focus on replacement of aging water and sewer mains, improvements to the wastewater treatment plants, and combined sewer overflow needs. Transfers from the RSF in excess of actual debt service flow to the Residual Fund, which is also a pledged fund, but not utilized in the calculation of debt service coverage.

The system has a manageable amount of variable rate debt, with $536 million or 21% of the system's outstanding debt in a variable rate mode. Providing some potential pressure are the terms of repayment of bank bonds on the Bank of America, N.A. irrevocable letters of credit for the Series 1997B Bonds ($81 million) and for the current remarketing of 2005B Bonds ($84 million). Repayment provisions for bank bonds in the Bank of America LOCs have repayment of draws made on the liquidity facility divided into semi-annual payments after a 60 day period, with final term out in three years. The 1997B facility is set to expire in September 2011 and the 2005B facility will expire in May 2012, 3 years following the execution date. Liquidity support is provided for the system's $371 million in outstanding 2003 Bonds by a FSA insured, Duxia standby bond purchase agreement. Management reports $245 million in bank bonds of the 2003 Bonds as of April 9, 2009. Positively, the system has ample liquidity to handle bond term-out demands, should they arise and the term out provisions for the 2003 bank bonds are favorable, with a 6 month grace period before a 7 year term out with semi-annual installments.

The city currently has two floating-to-fixed rate swaps on water and sewer debt outstanding, one related to the 2003 variable rate issue and the other related to the 2005 variable rate issue. Both swaps have Citigroup Financial Products (senior secured rated Aaa) as the counterparty. For each swap, the city makes payments based on a fixed rate (4.52% and 4.53%, respectively) and receives payments based on the lesser of the Actual Bond Rate or a percentage of one-month LIBOR. The swaps may be terminated if the rating on the city's water and wastewater revenue bonds falls below investment grade by any rating agency. The combined mark-to-market valuation of these two swaps as of March 31, 2009 was a significant $85 million in favor of the counterparties, although we believe the system's strong liquidity position and the city's ability to bond out for termination payments adequately addresses the risk in the unlikely event of a termination. The swaps are also insured by FSA and there is no termination event tied to FSA.

In February 2007, the city also entered into two forward starting swaps with A2-rated Merrill Lynch and Aa2-rated Wachovia Bank that were to become effective February 17, 2009 in anticipation of the current new money issuance, although the effective dates were pushed back to August 2010 in anticipation of the remaining $180 million that is to be issued in 2010. The total notional amount is $180 million and is split evenly between Merrill Lynch and Wachovia. Under the terms of the swaps, the city will make payments based on a fixed rate of 4.5% and receive payments based on SIFMA. The swap may be terminated if the rating falls below Baa2 by any rating agency, applying to both the issuer and the counterparty. Should the city decide to issue fixed rate bonds instead, the swaps will be terminated; as of March 31, 2009, the swaps had a mark-to-market valuation of approximately $22.6 million in favor of the counterparties.
The principal methodology used in rating the current issue was "Analytical Framework for Water and Sewer System Ratings," which can be found at www.moodys.com in the Credit Policy & Methodologies directory, in the Ratings Methodologies subdirectory. Other methodologies and factors that may have been considered in the process of rating this issuer can also be found in the Credit Policy & Methodologies directory.

The last rating action taken was on November 14, 2008 when the A3 rating was affirmed.

Outlook

The credit outlook for the city's Water and Wastewater Revenue Bonds remains stable. The outlook reflects our anticipation of continued good operating and financial management, including maintenance of healthy (though possibly reduced) balances in the Rate Stabilization and Residual Funds and/or satisfactory coverage. The system's debt load is expected to remain high and net revenue coverage, exclusive of RSF transfers, may return to narrow levels. The economic and demographic base of the service area, including that of the city of Philadelphia, is also expected to remain fairly stable over this period.

What could make the rating go UP:

- Maintenance of strong cash reserves and increased debt service coverage by operating net revenues
- Reduction in debt ratio

What could make the rating go DOWN:

- Reduction in cash reserves without improvements in coverage
- Violation of rate covenant
- Significant increase to debt ratio

Analysts

Kristina Alagar Cordero
Analyst
Public Finance Group
Moody's Investors Service

Geordie Thompson
Backup Analyst
Public Finance Group
Moody's Investors Service

Contacts

Journalists: (212) 553-0376
Research Clients: (212) 553-1653
information contained herein is obtained by MOODY'S from sources believed by it to be accurate and reliable. Because of the possibility of human or mechanical error as well as other factors, however, such information is provided "as is" without warranty of any kind and MOODY'S, in particular, makes no representation or warranty, express or implied, as to the accuracy, timeliness, completeness, merchantability or fitness for any particular purpose of any such information. Under no circumstances shall MOODY'S have any liability to any person or entity for (a) any loss or damage in whole or in part caused by, resulting from, or relating to, any error (negligent or otherwise) or other circumstance or contingency within or outside the control of MOODY'S or any of its directors, officers, employees or agents in connection with the procurement, collection, compilation, analysis, interpretation, communication, publication or delivery of any such information, or (b) any direct, indirect, special, consequential, compensatory or incidental damages whatsoever (including without limitation, lost profits), even if MOODY'S is advised in advance of the possibility of such damages, resulting from the use of or inability to use, any such information. The credit ratings and financial reporting analysis observations, if any, constituting part of the information contained herein are, and must be construed solely as, statements of opinion and not statements of fact or recommendations to purchase, sell or hold any securities. NO WARRANTY, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS, COMPLETENESS, MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE OF ANY SUCH RATING OR OTHER OPINION OR INFORMATION IS GIVEN OR MADE BY MOODY'S IN ANY FORM OR MANNER WHATSOEVER. Each rating or other opinion must be weighed solely as one factor in any investment decision made by or on behalf of any user of the information contained herein, and each such user must accordingly make its own study and evaluation of each security and of each issuer and guarantor of, and each provider of credit support for, each security that it may consider purchasing, holding or selling.

MOODY'S hereby discloses that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by MOODY'S have, prior to assignment of any rating, agreed to pay to MOODY'S for appraisal and rating services rendered by it fees ranging from $1,500 to approximately $2,460,000. Moody's Corporation (MCO) and its wholly-owned credit rating agency subsidiary, Moody's Investors Service (MIS), also maintain policies and procedures to address the independence of MIS's ratings and rating processes. Information regarding certain affiliations that may exist between directors of MCO and rated entities, and between entities who hold ratings from MIS and have also publicly reported to the SEC an ownership interest in MCO of more than 5%, is posted annually on Moody's website at www.moodys.com under the heading "Shareholder Relations - Corporate Governance - Director and Shareholder Affiliation Policy."