

Summary:

Philadelphia; Joint Criteria; Water/Sewer

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Credit Profile

US\$185. mil wtr & wastewtr rev bnds ser 2010C&D due 08/01/2040

<i>Long Term Rating</i>	A/Stable	New
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Philadelphia wtr & swr

<i>Long Term Rating</i>	A/Stable	Affirmed
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Rationale

Standard & Poor's Ratings Services assigned its 'A' long-term rating, and stable outlook, to Philadelphia's series 2010C water and wastewater revenues bonds and series 2010D taxable water and wastewater revenue build America bonds and affirmed its 'A' long-term rating and underlying rating (SPUR), with a stable outlook, on the city's existing water and wastewater revenue debt.

In our opinion, positive credit factors include the city's:

- Stable financial performance despite its reliance on rate stabilization support;
- Competitive rates, which will remain low despite planned increases through fiscal 2012; and
- Experienced management team that continues to emphasize, and is achieving, improved system maintenance, stronger collections, and more-comprehensive fiscal monitoring systems.

In our opinion, despite these positive credit factors, the rating remains restrained by the city's:

- Continued reliance on rate stabilization fund support to meet covenanted coverage;
- Overall service area economy, characterized by weak demographic trends, including a long-term population decline, resulting in overcapacity in the water system;
- Sizable capital improvement program (CIP) for the system, totaling \$1.24 billion for fiscals 2011-2016; and
- Highly leveraged system with a debt-to-plant ratio of 94%, which we consider high and which will increase with planned additional debt issuance.

Water and wastewater system revenues secure the bonds. Officials plan to use bond proceeds to finance projects in the CIP and fund a \$12.2 million swap termination payment for one of the 2007 swaption agreements. The city terminated its other 2007 swaption agreement by using fiscal 2010 operating funds. After the termination of its 2007 swaption agreements, the city will have only one water- and sewer-related swap outstanding.

Philadelphia's water and wastewater systems provide service to roughly 1.7 million and 2.2 million customers, respectively, in the city and suburbs. The systems predominantly serve retail residential customers. The number of retail accounts has remained relatively stable since 2001; both water and wastewater accounts total about 480,000 in 2010. The water department customer base, in which the city is the leading user, remains stable and diverse: The 10 leading customers accounted for approximately 12.5% of total billings in fiscal 2009. Overall system operations are strong, complying with environmental regulations and ample system capacity.

The city increased rates by 5.7% in fiscal 2011 as part of a four-year program begun in 2008. The average monthly

combined bill currently totals \$59.44. The city will increase rates by an additional 5.9% in fiscal 2012; officials expect rates to remain competitive and below average for the area. Management feels these rate increases are necessary to support increasing costs, especially in terms of chemical and fuel costs, and maintain coverage ratios and liquidity.

The city is projecting to end fiscal 2010 with a \$27.3 million draw on the rate stabilization fund; this is well below the \$51.0 million originally budgeted and the \$34.7 million used in fiscal 2009. Management attributes this to lower-than-expected debt service costs due to better-performing variable-rate debt and lower pension costs due to an \$18 million payment deferral resulting from the city's pension payment restructuring. The city also funded an additional \$15 million termination payment on one of its 2007 swaption agreements from operating revenues. City estimates have the rate stabilization fund totaling \$120.3 million at fiscal year-end 2010. Projections have debt service coverage (DSC), when including the transfer from the stabilization fund, at 1.2x, which we consider adequate. Without the transfer, DSC drops to just 1.06x.

The fiscal 2011 budget includes a \$34.6 million draw on the rate stabilization fund and the 5.7% rate increase that took effect on July 1, 2010. The city is projecting to maintain DSC at roughly 1.2x, including transfers from the rate stabilization fund. The updated six-year financial forecast includes additional draws on the rate stabilization fund through fiscal 2016 that are sufficient for the city to maintain 1.2x DSC; projections have the fund totaling \$48.2 million in fiscal 2016.

The fiscals 2011–2016 CIP totals \$1.2 billion, including a fiscal 2011 capital budget of \$171 million. The two largest projects include \$438.0 million for storm flood relief and \$308.7 million for treatment plant upgrades. The city expects to issue approximately \$135 million of water and sewer revenue bonds in fiscal 2014 and \$200 million in both fiscals 2015 and 2016, coupled with approximately \$215 million in Pennvest loans by 2012.

Standard & Poor's has assigned a Debt Derivative Profile (DDP) overall score of '2' to Philadelphia's water-and-sewer-enterprise-fund-related swap, on a scale of '1'-'4' with '1' representing the lowest risk and '4' the highest risk. The overall score of '2' reflects our view that the city's water-and-sewer-fund-related swap portfolio is currently a low credit risk.

(For additional information regarding the system, please see the article, published March 25, 2010, on RatingsDirect on the Global Credit Portal.)

Outlook

The stable outlook reflects Standard & Poor's opinion of the water department's improved financial position and operations, which we expect management will continue to maintain due to its conservative budgeting practices. We believe the water department will continue to adopt rate increases to maintain its adequate DSC as it plans to draw on its rate stabilization fund through 2016.

Related Criteria And Research

- USPF Criteria: Key Water And Sewer Utility Credit Ratio Ranges, Sept.15, 2008
- USPF Criteria: Standard & Poor's Revises Criteria For Rating Water, Sewer, And Drainage Utility Revenue Bonds, Sept. 15, 2008

Ratings Detail (As Of July 9, 2010)		
Philadelphia wtr & swr (wrap of insured) (AGM & BHAC) (SEC MKT)		
<i>Unenhanced Rating</i>	A(SPUR)/Stable	Affirmed
Philadelphia wtr & swr (wrap of insured) (AMBAC & ASSURED GTY) (SEC MKT)		
<i>Unenhanced Rating</i>	A(SPUR)/Stable	Affirmed
Philadelphia wtr & swr (wrap of insured) (FGIC) (MBIA - SEC MKT) (National)		
<i>Unenhanced Rating</i>	A(SPUR)/Stable	Affirmed
Philadelphia wtr & swr (FGIC)		
<i>Unenhanced Rating</i>	A(SPUR)/Stable	Affirmed
Philadelphia wtr & swr		
<i>Unenhanced Rating</i>	A(SPUR)/Stable	Affirmed
Philadelphia wtr & wastewtr		
<i>Unenhanced Rating</i>	A(SPUR)/Stable	Affirmed
Philadelphia wtr & wastewtr VRDB ser 2005B		
<i>Unenhanced Rating</i>	A(SPUR)/Stable	Affirmed
<i>Long Term Rating</i>	AAA/A-1	Affirmed, Removed from CreditWatch

Many issues are enhanced by bond insurance.

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