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Ratings

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Summary:
Philadelphia; Note

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Credit Profile		
US$300.0 mil tax and rev anticipation notes ser A of 2020-2021 due 06/30/2021		
Short Term Rating	SP-1+	New

Rating Action

S&P Global Ratings assigned its 'SP-1+' rating to Philadelphia's $300 million in series 2020-2021 tax and revenue anticipation notes (TRANs).

The rating reflects our opinion of the city's:

- Strong projected debt service coverage (DSC) of 2.6x at maturity with general fund cash; and
- Sophisticated management that has navigated various cycles and historically budgets conservatively with trends of year-end results better than budgeted.

We believe financial oversight from the Pennsylvania Intergovernmental Cooperation Authority (PICA) and the 2019 improvement in the city's general fund provide cushion for the upcoming years that are likely to generate revenue uncertainty.

The TRANs are a general obligation (GO) of Philadelphia, but the city has not pledged its taxing power and therefore is not required to levy ad valorem taxes for TRAN payments. The TRANs are payable from, and secured by, a pledge of general fund taxes and revenues. These amounts include general property taxes, wage taxes, business income and receipts (BIRT), sales taxes, and revenue from other governments.

TRAN proceeds will pay Philadelphia's general expenses prior to the receipt of income to be received in fiscal 2021 and pledged for note repayment. Principal and interest are due June 30, 2021, which coincides with the city's fiscal year-end. However, the repayment structure includes a fund held by the trustee into which officials are required to deposit the amount of principal borrowed on May 26, 2021, and the amount of interest due on June 25, with the final maturity of June 30, 2021. It is our understanding these aggregate deposits will be sufficient to pay TRAN principal and interest due at maturity.

Credit overview

Prior to fiscal 2018, Philadelphia had a long history of cash-flow borrowing to finance seasonal cash-flow needs. The city's reserves had grown to sufficient levels in fiscal years 2019 and 2020 that cash-flow borrowing was not necessary. The amount is higher than recent years and the city notes that the amount of borrowing is in part to safeguard against additional potential fluctuations in timing of revenues and serve as an additional cushion for intrayear fluctuations.

Based on projected preliminary cash flows, projected fiscal 2021 DSC of principal by general fund cash balances is, in our view, a very strong 3.9x on the May principal set-aside date and very strong DSC of principal and interest at maturity as very strong at 2.6x. Current projections include an overall increase in cash of 3%. The increase in due to the timing of BIRT revenue collections, which were delayed from the previous year beyond the usual timing. Thus July is anticipated to see a double payment in revenues. The only other revenue increase came from interfund transfers, where the city will use its rainy day fund deposit, made in the previous fiscal year. Otherwise, revenues are anticipated to fall, with sales tax, a highly cyclical revenue stream, estimated to decrease 20% on a cash basis. Declines in revenue align with our expectations regarding an overall economic slowdown due to COVID-19. To address the reduced revenue, the city has also slowed its expenditures by freezing positions and reducing capital expenditures. In addition, it will be exploring debt refunding opportunities, which would provide a current-year cash-flow break. Payroll and benefits remained basically level. The city anticipates spending the remainder of CARES Act money on specific grant/program-related operations outside of the general fund for 2021. It spent $100 million in CARES Act money in 2020 for general operations.

There is a degree of uncertainty with respect to revenues and Philadelphia has provided PICA with a contingency plan should additional cuts or expenditure reductions be necessary. We believe the city's high-level, strong and experienced management, and a history of conservative budgeting for expenditures and revenues overall provide us comfort regarding potential changes to the assumptions underlying the city's projections to reach sufficient coverage.

The city pools cash and investments in a consolidated cash account except those which, for legal or contractual reasons, cannot be commingled. The fund is segregated into two funds: an operating fund that contains the general fund and a capital fund that houses bond proceeds. The projected balance of the operating fund is $479.6 million, which is slightly lower than the general fund ($504.9 million) due to a deficit in the grants revenue and community development funds.

The 2019 comprehensive annual financial report (CAFR) posted a surplus for the third consecutive year, with reserves ending near 10% and a first ever transfer to the city's rainy day fund of $34 million in fiscal 2020, though 2021 reserves are estimated to be spent down to 5% of expenditures. The city's reserves were strengthening prior to the economic effects of COVID-19, but though we anticipate spend-downs of its reserves, we note that Philadelphia continues to make its pension payments to address this longer-term pressure despite its current budgetary pressures.

Environmental, social, and governance factors

Our rating incorporates our view regarding the health and safety risks posed by the COVID-19 pandemic. After years of growth, the city's finances have been directly weakened by the decline in revenues and the need to focus expenditures to address the health and safety of population. We view the social risk for Philadelphia as aligned with its larger city sector peers. We analyzed its environmental, and governance risks relative to its economy, management, financial measures, and debt and liability profile, and determined that all are in line with our view of the sector standard.

Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020