FitchRatings

RATING ACTION COMMENTARY

Fitch Rates Philadelphia Auth for Industrial Development Revs 'A-'; Outlook Negative

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Fitch Ratings - New York - 05 Mar 2021: Fitch Ratings has assigned an 'A-' rating to the city of Philadelphia, PA Authority for Industrial Development's city service agreement revenue refunding bonds, series 2021 (federally taxable). The Rating Outlook is Negative.

Fitch has also affirmed the 'A-' rating and revised the Rating Outlook to Negative from Stable on the following:

--Philadelphia Issuer Default Rating (IDR);

--Philadelphia Municipal Authority (PMA) bonds;

--Philadelphia Authority for Industrial Development (PAID) bonds;

--Philadelphia Redevelopment Authority (PRA) bonds;

--Philadelphia Parking Authority (PPA) parking system revenue bonds, series 1999A;

--Philadelphia general obligation (GO) bonds.

The PAID series 2021 bonds will refund all of the outstanding principal and associated interest on the PAID series 1999B and the principal and $15 million in interest payments on the 2012 bonds. The bonds are expected to sell on April 7 via competition.

SECURITY

The series 2021 bonds to be issued by PAID and the outstanding obligations of PAID, PMA, PRA, and PPA are payable from annual service fee or lease rental payments by the city under non-cancellable agreements from any lawfully available source. The city's obligation to make payments is absolute and unconditional. State law and the city charter obligate the city council to appropriate annual payments through final maturity, and Fitch rates these on par with the city's GO bonds and IDR given the lack of optionality. GO bonds are backed by the city's full faith and credit and are payable from an ad valorem tax without limitation as to rate or amount.

ANALYTICAL CONCLUSION

The Outlook revision to Negative from Stable reflects the anticipated material decline in general fund reserves in fiscal 2021 driven in large part by pandemic related revenue loss and spending pressures including public safety. Fitch believes the lower reserve balances reduce the city's overall financial resilience and leaves it more vulnerable to near-term revenue risks and to a large projected budget gap for fiscal 2022.

The 'A-' ratings continue to reflect the city's fundamentally sound economic base and solid revenue growth prospects post-pandemic, broad legal control over key revenue items, and a moderate long-term liability burden. These strengths are offset by the city's workforce-related expenditure constraints and only adequate gap-closing capacity prior to the pandemic, which has exacerbated pressure on its overall credit profile.

ECONOMIC RESOURCE BASE

Philadelphia serves as a regional economic center in the Northeast, with a stable employment base weighted toward the higher education and healthcare sectors. The population was approximately 1.6 million in 2019, which reflects 3.8% growth since 2010.

The city is experiencing a significant economic disruption due to the coronavirus pandemic with job losses and unemployment rates that exceeded the state and national average. An increase in unemployment to 9.3% in December 2020 from 5.4% from the prior year and company mandates directing employees to work remotely for health and safety reasons have adversely impacted the city's ability to collect wage and earnings taxes critical to the general fund budget on non-residents.

The city estimates that 40% of wages are generated from workers who reside outside of the city and anticipates that between 10% to 15% of the commuter population will continue to work remotely post-pandemic due to shifts in work requirements. Prior to the current pandemic, jobs expansion had been steady and strong from 2015 through 2019, but comparatively low wealth levels and modest population increases persist.

KEY RATING DRIVERS

Revenue Framework: 'aa'

Wage and earnings, property and business income and receipts (BIRT) and transfer taxes are Philadelphia's primary revenue sources. Fitch expects them to remain pressured in the near term but return to growth in excess of inflation as public health and economic conditions continue to stabilize. Philadelphia retains essentially unlimited independent legal ability to raise revenues.

Expenditure Framework: 'a'

Pre-pandemic expenditure growth has been measured, reflecting ongoing budgetary control efforts. However, the future trajectory of spending will likely exceed baseline revenue growth, requiring continued proactive budgeting. The city has made substantial budget cuts in response to the pandemic and clearly identified options for cutting spending further if revenues fail to meet expectations. However, Fitch believes that some of these measures could prove challenging to institute. The city has just adequate expenditure flexibility notwithstanding moderate fixed costs given a highly unionized workforce and a statutorily-defined collective bargaining framework.

Long-Term Liability Burden: 'aa'

Long-term liabilities are expected to remain moderate relative to Philadelphia's very large economic resource base.

Operating Performance: 'bbb'

Significant post-pandemic revenue shortfalls are expected to unwind recent gains in the city's fiscal resilience, including higher reserves, which were built upon improved budgetary management practices and robust revenue growth. Fitch believes the city maintains sufficient budget flexibility to resolve current and forecasted revenue gaps and gradually recover financial flexibility as the economy recovers. However, existing headwinds are pronounced and will necessitate a timely and sufficient policy response from the city in order to maintain the current assessment.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--Sustainable budgetary actions that realign spending with revenue and position the city on a path to rebuild reserves to pre-pandemic levels.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--Failure to implement available policy measures and a credible plan that will materially address existing budget gaps resulting in a further erosion of the city's gap-closing capacity and liquidity.

--The inability to manage expenditures pressures over the next several years including labor contracts, contributions to the school district and retirement benefit costs.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit [https://www.fitchratings.com/site/re/10111579].

CURRENT DEVELOPMENTS

Sector wide Coronavirus Implications

The outbreak of coronavirus and related government containment measures worldwide has created an uncertain global environment for U.S. state and local governments and related entities. Fitch's ratings are forward-looking in nature, and Fitch will monitor the severity and duration of the budgetary impact on state and local governments and incorporate revised expectations for future performance and assessment of key risks.

While the initial phase of economic recovery has been faster than expected, GDP in the U.S. is projected to remain below its 4Q19 level until at least 3Q21. In its baseline scenario, Fitch anticipates a slower recovery in early 2021 with vaccine rollout to vulnerable, key workers and older individuals in 1H21, but limited for most of the population until late 2021. Additional details, including key assumptions and implications of the baseline scenario and a downside scenario, are described in the report "Fitch Ratings Coronavirus Scenarios: Baseline and Downside Cases - Update", published on Dec. 7, 2020, and "Fitch Ratings Updates Coronavirus Scenarios for U.S. State and Local Government", published on Dec. 16, 2020 on www.fitchratings.com.

Improved Financial Reserves Tapped to Address Pandemic Pressures

The city entered the current downturn better prepared for economic weakness than it has been in many years. Unrestricted general fund reserves equaled $448 million on a GAAP basis, equivalent to 9.7% of general fund spending at the end of fiscal 2019. Revenue pressures associated with the pandemic and civic unrest in fiscal 2020 led to a sizable operating deficit which reduced the unrestricted general fund balance to approximately $414.5 million. The unrestricted fund balance including $34 million budget stabilization reserves (BSR) held outside of the general fund were equal to a lower but still adequate

8.4% of spending. The 2020 ending fund balance is net of one-time transfers out for a budget stabilization contribution ($34.2 million), $227 million contribution to the school district as part of the city's multi-year plan to increase funding for the coterminous SDP and $22 million in an additional pension contribution.

However, Fitch expects the city's financial position to materially worsen in fiscal 2021. Based on year-to-date results, the city anticipates a $261.6 million operating deficit, approximately 5.3% of projected general fund spending. The city's pre-pandemic fiscal 2021 budget had projected a modest $36.2 million deficit; however, the assumptions were revised in the final adopted budget to reflect a $223 million general fund deficit due to severe revenue pressures associated with stay-at-home orders. The current projection for fiscal 2021 reflects a $41 million projected shortfall in local tax revenue including $17 million reduction in wage taxes, $10 million in property taxes and $62 million in other taxes, and $50 million in pandemic related spending, offset somewhat by $48 million in positive sales and BIRT collections. Overall general fund expenditures are projected to exceed budget by $129 million as a result of expenditure pressures associated with the current health crisis, November elections, protests, and prison costs due an increased census.

At the start of fiscal 2021, the city made more than $300 million in spending reductions compared to the original pre-pandemic budget. The city also included $40.6 million in new revenues, and savings associated with staff reductions, a hiring freeze, and reduced discretionary spending. The city will realize approximately $130 million in aggregate debt service savings over fiscal 2021 and fiscal 2022 from the current issuance which is expected to yield negative present value savings over the life of the bonds. Other gap closing measures included $10 million in delayed pay-as-you-go capital spending and reductions in the police department budget. The city has also earmarked a $22 transfer to the pension fund, above the city's fiscal 2021 revenue recognition policy pension payment, which provide modest additional financial cushion in fiscal 2021.

City Faces Large Fiscal 2022 Budget Gap

The city is currently working on its fiscal 2022 budget and five-year plan. Early estimates indicate a $400 million budget gap for fiscal 2022 based on current trends and without consideration of additional federal aid, reimbursements or budget balancing actions. These assumptions may be revised pending the enactment of the federal COVID-19 relief package recently approved by the U.S. House of Representatives and as the city implements other budgetary strategies to maintain positive general fund reserves at year end.

Fitch also considers that the school district needs could increase and require additional fiscal support from the city (or commonwealth), beyond the levels incorporated into the current five-year plan. The city remains committed to providing additional funds to the school district and appropriated a $30 million increase to the city's annual contribution for fiscal 2021 increasing the contribution to $252 million. The annual contributions are projected to increase each year until the total reaches $288 million by fiscal 2024. The city is also collecting approximately $1.3 billion annually in local tax revenues annually that goes directly to the district.

Fitch expects that the city will develop a credible and sustainable plan to address the fiscal 2022 budget gap that preserves its current thin reserves and modest liquidity, leveraging its independent legal ability to increase revenues and adequate cost-cutting capacity. While Fitch believes that the city's financial operations will be stressed in the near-term, the city's finances are expected to gradually improve over time as the economy recovers given sound long-term economic fundamentals, including a stable population base. The city is likely to continue to benefit from its central location in a highly developed region, its relative affordability compared to other large Northeastern cities and the strong healthcare and higher education institutions that anchor its economy.

FAST Analysis and Financial Resilience

Fitch's baseline and downside scenarios reflect potential revenue declines in year 1 of 6.8% and 7.4%, respectively, although declines could differ based on actual results. The Fitch Analytical Stress Test (FAST) scenario analysis tool, which relates historical tax revenue volatility to GDP to support the assessment of operating performance under Fitch's criteria, has been adjusted to reflect GDP parameters consistent with Fitch's global coronavirus forecast assumptions. FAST is not a forecast, but it represents Fitch's estimate of possible revenue behavior in a downturn, based on historical revenue performance.

CREDIT PROFILE

Philadelphia has an extensive statutory and policy-based framework for timely and proactive budget management throughout the economic cycle, revolving around the Pennsylvania Intergovernmental Cooperation Authority's (PICA's) reporting and certification requirements, which has been in place for many years. The city's effort to rebuild flexibility during the recent period of economic recovery provides the city with adequate cushion to address the fiscal stress related to the current economic pressures.

Close monitoring of fiscal performance by PICA provides further assurance the city will quickly address the projected imbalances caused by pandemic driven economic downturns. The mayor submits annual five-year financial plans and quarterly intra-year updates to PICA. PICA must certify whether the plans resolve any projected deficits. If PICA certifies non-compliance, the city forfeits the PICA portion of the wage tax (approximately $496 million in fiscal 2020 or approximately 11% of general fund revenues), providing strong incentive for the city to maintain long-term fiscal balance.

LEASE AND SERVICE FEE AGREEMENT OVERVIEW

Fitch considers the credit quality of Philadelphia's lease and service fee agreement bonds equivalent to the city's general credit quality as expressed in the IDR, given the lack of optionality for the city in annually appropriating for payments used for debt service. Prior to the issuance of each series of bonds, the city enters into a non-cancellable agreement with the issuing authority that has been approved by the city council by ordinance. The agreements, all substantially similar in legal terms, require the city to appropriate annual lease rental or service fee payments from current revenues.

The city council ordinance approving the agreements also requires the council to budget and appropriate these payments annually. The city's charter explicitly allows the council to authorize service agreements that extend beyond one year, and they are valid and binding commitments of the city. Commonwealth law also authorizes the city to make contracts for more than one year and states that it is "the duty of [city] council to make subsequent appropriations from year to year as required for the purposes of such contracts."

Fitch views the combination of the commonwealth statutory language, the city charter provision authorizing multiyear commitments, and the non-cancellable nature of the absolute and unconditional obligations set forth in the agreement approved by local ordinance as eliminating any optionality on the part of the city to appropriate required annual payments.

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

RATING ACTIONS

ENTITY/DEBT	RATING			PRIOR
Philadelphia (PA) [General Government]	LT IDR	A- Rating Outlook Negative	Affirmed	A- Rating Outlook Stable
• Philadelphia (PA) /General Fund Contractual Obligations - Lease and Service Agreements/1 LT	LT	A- Rating Outlook Negative	Affirmed	A- Rating Outlook Stable
• Philadelphia (PA) /General Fund	LT	A- Rating Outlook Negative	Affirmed	A- Rating Outlook Stable

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APPLICABLE CRITERIA

U.S. Public Finance Tax-Supported Rating Criteria (pub. 27 Mar 2020) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

FAST States & Locals - Fitch Analytical Stress Test Model, v2.4.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Philadelphia Parking Authority (PA)	EU Endorsed, UK Endorsed

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