MOODY'S
INVESTORS SERVICE

Rating Action: Moody's assigns A2 to City of Philadelphia, PA's $98 million City Service Agreement Revenue Bonds, Ser. A&B of 2021; outlook stable

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New York, September 30, 2021 -- Moody's Investors Service has assigned an A2 rating to the City of Philadelphia's, PA's $89.225 million City Service Agreement Revenue Bonds, Series A of 2021 (Federally Taxable Social Bonds) and $8.81 million City Service Agreement Revenue Bonds, Series B of 2021 (Tax-Exempt Social Bonds). We maintain an A2 rating on the City of Philadelphia's outstanding general obligation unlimited tax (GOULT) debt as well as an A2 rating on its outstanding service fee and lease revenue bonds (non-pension related). We further maintain an A3 rating on the city's 1999, 2012 and 2021 pension obligation bonds.

The outlook is stable for all long-term rated securities.

Approximately $3.753 billion of tax-supported debt is outstanding for the city as of the June 30, 2021 fiscal year end.

RATINGS RATIONALE

The city's A2 GOULT rating considers its substantial and diverse economy, as well as continued economic and financial pressure stemming from ongoing effects of the coronavirus pandemic. At this time, the city continues to project a structural operating imbalance in its general fund through fiscal 2023, though federal relief monies are expected to offset revenue weakness in the near term. The city is expected to receive roughly $1.4 billion of federal aid through the American Rescue Plan Act (ARPA); federal aid will help smooth revenue weakness over the next three fiscal years, with an expectation of a full economic recovery in the city by 2023 and a return to structural operating balance by that time. The city expects to end fiscal 2021 with a fund balance of $79 million, or a weak 1.7% of revenue. However, as federal aid will be spent down gradually, the city will also retain nearly $800 million of ARPA monies at year end as an additional cushion to its slim fund balance position.

The city benefits from a diverse economy that has grown considerably in recent years, though one of its primary anchoring industries - higher education - has driven some of the overall weakness in the city's wage tax collections. Favorably, most higher education institutions in the city have returned to in-person learning for fall 2021, which will help to bolster economic activity throughout the city. A key positive rating driver for the city, especially in the current operating environment, is its demonstrated strong governance controls and prudent budget practices. The city has consistently outperformed projections over the last several years, and budget assumptions are generally conservative. Further, the city's reserve position was relatively strong prior to the onset of coronavirus, as compared to its positioning prior to other periods of recession. We expect Philadelphia's overall credit profile to remain stable as it weathers the pandemic and its aftereffects.

The A2 rating on the city's outstanding service fee bonds (non-pension related) and lease revenue bonds reflects the strong legal structure clearly laid out within the city's home rule charter, bond ordinances, and service fee/lease agreements. As stated in the documents, these service and lease rental payments are legal, valid and binding obligations of the city, payable out of current city revenues. While the city does not pledge its full faith and credit and unlimited taxing power, the city covenants to provide for payment in its annual budget (same line item as General Obligation debt) and these payments are absolute and unconditional without being subject to any contingencies. For these reasons, we do not differentiate regarding essentiality and render them in the same band of credit quality as an ad valorem pledge.

The A3 rating on the city's outstanding pension obligation bonds (POB) reflects the additional risk of a higher loss given default for these securities relative to the city's other service-fee and lease-rental debt. The POB debt originally funded a portion of the unfunded liability for the city's retirement system and are not secured by the city's unlimited taxing power. While the bonds carry the same security pledge as the city's other service agreement and lease bonds, we have notched these bonds based on purpose, as historically, pension bonds have realized less of a recovery in bankruptcy scenarios than other debt.

RATING OUTLOOK

The rating outlook is stable. We expect that city management will continue to prudently meet revenue shortfalls with budget cuts and other offsets that will enable Philadelphia to navigate its fiscal challenges without a material change to its long-term credit profile. As noted, federal ARPA monies will also serve to smooth revenue shortfalls over the next several years.

FACTORS THAT COULD LEAD TO AN UPGRADE OF THE RATINGS

- Growth in reserves and maintenance of fund balance at levels more commensurate with large city peers

- Sustained expansion in the tax base and strengthening of the socioeconomic profile

- Substantial decrease of unfunded pension liabilities

FACTORS THAT COULD LEAD TO A DOWNGRADE OF THE RATINGS

- Inability to regain structural balance in the near term

- Reserve draws that exceed current expectations leading to a deficit fund balance

- Emergence of a material strain on the city's liquidity

- Increased support to school district beyond current expectations reducing the city's financial flexibility

- Failure to fund pension plan on sound basis going forward

- Change in legal structure for bonds that are not backed by the city's General Obligation pledge

LEGAL SECURITY

The Series 2021 A&B bonds are payable by the Philadelphia Redevelopment Authority solely from certain service fee payments to be paid by the city of Philadelphia. These service fees are payable solely from current revenues of the city and are subject to annual appropriation, though the city has covenanted to provide for the service fee in its annual budget. The obligation of the city to pay the service fee is absolute and unconditional.

USE OF PROCEEDS

Proceeds from the Series 2021 A&B bonds will be used to support affordable housing and commercial revitalization efforts throughout the city. Proceeds will also be used to support construction job training initiatives, provide downpayment assistance for first time homeowners, stimulate small business growth and provide for neighborhood infrastructure improvements.

The city will self-designate these bonds as "Social Bonds", consistent with the "International Capital Market Association (ICMA) Social Bond Principles: Voluntary Process Guidelines for Issuing Social Bonds".

PROFILE

The city of Philadelphia, located along the southeastern border of the Commonwealth of Pennsylvania (Aa3 stable), is the largest city in the commonwealth and the sixth largest city in the United States with approximately 1.579 million residents (based on 2019 estimates).

METHODOLOGY

The principal methodology used in these ratings was Lease, Appropriation, Moral Obligation and Comparable Debt of US State and Local Governments Methodology published in June 2021 and available at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBM_1274696 . Alternatively, please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found at: https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_79004.

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