FitchRatings

RATING ACTION COMMENTARY

Fitch Upgrades Philadelphia Gas Works Revs to 'A'; Outlook Stable

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Fitch Ratings - New York - 15 Aug 2025: Fitch Ratings has upgraded the ratings on following bonds issued by the city of Philadelphia on behalf of Philadelphia Gas Works (PGW) to 'A' from 'A-':

--Approximately $1.1 billion of outstanding gas works revenue bonds, various series (senior 1998 ordinance).

The Rating Outlook is Stable.

PGW's Standalone Credit Profile (SCP) is as assessed at 'a'. The SCP represents the credit profile of the utility on a standalone basis irrespective of its relationship with and the credit quality of the city of Philadelphia, PA (Issuer Default Rating: A+).

RATING ACTIONS

ENTITY / DEBT	RATING	PRIOR
Philadelphia (PA) [Gas]		
Philadelphia (PA)		A-

VIEW ADDITIONAL RATING DETAILS

The upgrade to 'A' reflects the utility's sustained strong financial performance, demonstrated by healthy operating margins, consistently lower leverage and a sound liquidity position. The upgrade further reflects rate relief that PGW is expected to receive beginning in FY 2026. PGW recently reached a $62 million base rate increase and has filed a Joint Petition for Settlement in the case. The settlement and Administrative Law Judge recommendation will be reviewed by the PUC in November.

Leverage, measured as net adjusted debt to adjusted funds available for debt service, was 5.1x in FY 2024, marking the fifth consecutive year below 6x. Although leverage is projected to rise modestly in FY 2025 following issuance of $315 million in September 2024, Fitch expects leverage to trend near historical levels by FY 26 supported by the base rate increase. Fitch's forward-looking scenario analysis indicates that financial metrics should remain stable based on projected healthy operating margins, providing sufficient leverage headroom at the 'A' rating.

The rating further reflects PGW's strong revenue defensibility assessment, which is supported by its mostly monopolistic position as a natural gas distribution services provider and affordable rate offerings. However, it is limited by a service area that is midrange and a rate-setting authority that is subject to regulatory approval by the PUC. The system's midrange operating risk profile reflects an increased operating cost burden, substantial but manageable capital needs, and diverse natural gas supply sources.

SECURITY

The senior 1998 general ordinance bonds are secured by net revenues of the city of Philadelphia's gas works utility, in addition to a debt service reserve fund.

KEY RATING DRIVERS

Revenue Defensibility - 'a'

Rate Regulated System, Revenues Not Completely Monopolistic

The strong revenue defensibility assessment is underpinned by strong revenue source supply from sources other than PGW and subjects PGW to rate regulation and approval by the PUC, which are limiting factors in the overall assessment. While PGW's service area is subject to customer choice for gas supply, all retail customers within PGW's service territory receive gas distribution services solely from PGW.

Rates that are subject to regulatory approval often lead to a lag in potential revenue recovery and limit overall financial flexibility, in Fitch's view. The pending rate increase — together with PGW's approved rate structure which provides for the timely recovery of costs related to natural gas supply, transportation and storage, capital improvements, social programs, and efficiency initiatives — indicates a generally supportive regulatory regime that has allowed the system to maintain a stable financial profile.

Operating Risk - 'bbb'

Midrange Operating Cost Burden, Elevated but Manageable Life-Cycle Needs

The system's midrange operating risk profile is driven by its rising operating cost burden and historical capital spending patterns that are commensurate with system needs. The system's operating cost burden increased to almost $16/MCF in FY 2024, up from approximately $14/MCF the year prior. While total operating expenses decreased by 9.3% in 2024, the system's operating cost burden increased due to lower volumes. In 2023 and 2024, the winter season was warmer than typical for PGW, which resulted in falling volumes. Costs are not expected to rise sharply in the near term, but management is projecting moderate cost increases in its five-year financial forecast.

Fitch assesses operating cost flexibility as neutral based on varying supply arrangements, as well as adequate storage and distribution infrastructure. PGW receives gas through nine city gate stations from two interstate natural gas pipeline companies. The system's purchasing activities include long-term, seasonal, spot and swing gas transactions that are supplemented by off-system storage and liquefaction capabilities.

We consider capital planning and management to be strong based on the system's estimated age of plant of roughly 19 years and healthy capital spending for system needs. Capex to depreciation averaged 199% between 2020 and 2024, which reflects substantial investment in the system. Fitch views future capital investment needs as elevated. The

Financial Profile - 'a'

Strong and Improving Financial Profile, Low Leverage

PGW's strong financial profile reflects its low leverage ratio of 5.1x in FY 2024 and strong liquidity position. PGW's leverage ratio averaged 5.2x over the past five years, reflecting very stable historical financial performance. The system has managed to preserve its financial performance due to effective management of its distribution and supply costs, timely base rate increases, and flexible and revenue-neutral rate mechanisms (particularly its weather normalization adjustment) that allow the system to respond to lower demand and stabilize financial performance. Coverage of full obligations remains strong at 1.6x, while liquidity is sufficient with unrestricted cash equal to 91 days on hand. When factoring PGW's available lines of credit the liquidity cushion rises to 126 days on hand, and Fitch considers it neutral to the financial profile assessment.

Fitch's forward-looking analysis considers the potential trend of key ratios over a five-year period. The scenario is informed by management's financial planning forecast and assumptions including the $62 million base rate increase, capex primarily funded by internal funds and residual bond proceeds, and a modest debt issuance. Fitch's rating case indicates that leverage will approximate 6x throughout the five-year horizon, even as PGW undertakes it extensive capital plan. Management anticipates increases in operating expenses, but the base rate increase effective in 2026 is expected to be sufficient for PGW to maintain stable financial performance through 2029. PGW's liquidity profile, including cash levels and coverage, is expected to remain neutral over the five-year horizon.

Asymmetric Additional Risk Considerations

There are no additional asymmetric risks currently impacting the rating.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

-- Sustained leverage exceeding 8x in Fitch's rating case;

-- An increase in competitive pressures or weakening service area demographics that leads

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

-- Leverage ratio consistently below 5.0x in Fitch's rating case;

-- Adequate rate relief that supports an improved financial profile;

-- Improved revenue defensibility as evidenced by a significant strengthening in service area economics and demographics to offset competition and rate-regulated risk.

PROFILE

PGW is owned by the city of Philadelphia, PA (A+/Stable) and is responsible for the acquisition, storage and distribution of natural gas to residents and businesses located entirely within the city's limits. PGW is the exclusive distributor of natural gas within the limits of the city. However, customers can choose an alternate gas supplier pursuant to the Gas Choice Act. PGW maintains a distribution system with over 3,000 miles of gas mains and approximately 473,000 service lines serving approximately 518,000 customers in 2024.

The system is managed by the Philadelphia Facilities Management Corporation (PFMC), a not-for-profit corporation created for the sole purpose of operating the utility. PFMC is governed by a seven-member board of directors appointed by the mayor and is responsible for the hiring of PGW executive staff. PFMC has operated the system since 1973, pursuant to a two-year management agreement that extends automatically to successive two-year periods unless cancelled at least 90 days prior to the expiration date.

Fitch considers the system to be a related entity to the city of Philadelphia for rating purposes because PGW is owned by the city and accounted for as a component unit. PGW makes annual transfer payments to the city and oversight of the capital and operating budgets is provided by the Philadelphia Gas Commission, created by ordinance of the city council and consisting of the city's controller and two members appointed by the city council and the mayor. The rating on the bonds is not currently constrained by the Philadelphia's Issuer Default Rating. However, as a result of being a related entity, the bond rating could become constrained by a material decline in the general credit quality of the city.

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

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' 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. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/topics/esg/products#esg-relevance-scores.

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APPLICABLE CRITERIA

U.S. Public Sector, Revenue-Supported Entities Rating Criteria (pub. 10 Jan 2025) (including rating assumption sensitivity)

U.S. Public Power Rating Criteria (pub. 24 Feb 2025) (including rating assumption sensitivity)

APPLICABLE MODELS

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

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Philadelphia (PA)	EU Endorsed, UK Endorsed

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