

## RATING ACTION COMMENTARY

# Fitch Upgrades Philadelphia's (PA) IDR to 'A+'; Rates PAID Rev Bonds 'A+' on Criteria Change

Thu 06 Jun, 2024 - 5:49 PM ET

Fitch Ratings - New York - 06 Jun 2024: Fitch Ratings has assigned a 'A+' rating on \$100 million Philadelphia Authority for Industrial Development (PAID) city service agreement revenue bonds (rebuild project) series 2024. The bonds will fund the city's rebuild program and is expected to sell on June 13, via negotiation.

Fitch has also upgraded Philadelphia's (PA) Issuer Default Rating (IDR) and the rating on the following Fitch-rated bonds to 'A+' from 'A':

- Unlimited tax general obligation (GO) bonds;
- Philadelphia Municipal Authority (PMA) bonds;
- Philadelphia Authority for Industrial Development (PAID) bonds;
- Philadelphia Energy Authority (PEA) Bonds;
- Philadelphia Redevelopment Authority (PRA) bonds;
- Philadelphia Parking Authority (PPA) parking system revenue bonds.

The Rating Outlook is Stable. The ratings have been removed from Under Criteria Observation.

Philadelphia (PA) [General Government]	LT IDR	A+ Rating Outlook Stable		A Rating Outlook Stable
	Upgrade			
Philadelphia (PA) /General Fund Contractual Obligations - Lease and Service Agreements/1 LT	LT	A+ Rating Outlook Stable	Upgrade	A Rating Outlook Stable
Philadelphia (PA) /General Fund Contractual Obligations - Parking Authority/1 LT	LT	A+ Rating Outlook Stable	Upgrade	A Rating Outlook Stable
Philadelphia (PA) /General Obligation - Unlimited Tax/1 LT	LT	A+ Rating Outlook Stable	Upgrade	A Rating Outlook Stable

**[VIEW ADDITIONAL RATING DETAILS](#)**

The upgrade to 'A+' from 'A' reflects implementation of Fitch's new "U.S. Public Finance Local Government Rating Criteria". The financial profile's 'bbb' resilience assessment reflects the city's high revenue control, given its ability to independently increase revenues, as well as low expenditure controls that give management the ability to adjust spending. The rating also reflects healthy general fund reserves.

Additionally, the ratings incorporate a +1 notch to reflect the fundamental strength of the city's economic base. This enhances the city's expected resilience to economic cycles and stress events relative to its elevated unemployment. This is also in relation to the national mark and median levels of household income, which are well below the median of Fitch's local government rating portfolio. Long-term liability (LTL) metrics are midrange on a composite basis.

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--A decline in available general fund reserve levels sustained below 5% of spending, which would lower Fitch's assessment of financial resilience to below 'bbb';

--A sustained approximate 80% to 90% increase in long-term liabilities and carrying costs absent a commensurate increase in personal income or governmental resources.

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

--Maintenance of unrestricted general fund reserves at or above 10% of general fund spending over time;

--A sustained improvement in local area economic fundamentals including population, unemployment and income metrics.

### **SECURITY**

The PAID revenue bonds (in addition to outstanding obligations of PRA, PEA and PMA) are payable from annual service fee payments by the city of Philadelphia under a non-cancellable agreement from any lawfully available source.

PPA revenue bonds are payable from revenues of the city's municipal parking system and an unconditional contractual requirement of the city to restore any draws or deficiencies in the bonds' debt service reserve fund. State law and the city charter obligate the city council to appropriate annual payments through final maturity. Fitch rates these on par with the city's IDR and GO bond ratings given the lack of optionality. Lastly, the 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.

### **FITCH'S LOCAL GOVERNMENT RATING MODEL**

The Local Government Rating Model (LGRM) generates Model Implied Ratings (MIR) which communicate the issuer's credit quality relative to Fitch's local government rating portfolio (the MIR will be the IDR except in certain circumstances explained in the applicable criteria). The MIR is expressed via a numerical value calibrated to Fitch's long-term rating scale that ranges from 10.0 or higher ('AAA'), 9.0 ('AA+'), 8.0 ('AA'), and so forth down to 1.0 ('BBB-' and below).

## **RATINGS HEADROOM & POSITIONING**

Philadelphia MIR: 6.97 ('A+')

-- Metric Profile: 5.97 ('A')

-- Net Additional Analytical Factor Notching: +1.0

Individual Additional Analytical Notching Factors:

-- Economic and Institutional Strength: +1.0

Philadelphia's MIR of 6.97 is at the upper end of the 6.0 to 7.0 range for its current 'A+' rating.

## **KEY RATING DRIVERS**

### **FINANCIAL PROFILE**

#### **Financial Resilience - 'bbb'**

Philadelphia's financial resilience is driven by the combination of its 'High' revenue control assessment and 'Low' expenditure control assessment, culminating in a 'Low Midrange' budgetary flexibility assessment.

-- Revenue control assessment: High

-- Expenditure control assessment: Low

-- Budgetary flexibility assessment: Low Midrange

-- Minimum fund balance for current financial resilience assessment:  $\geq 5.0\%$

-- Current year fund balance to expenditure ratio: 18.9% (2023)

-- Five-year low fund balance to expenditure ratio: 6.0% Analyst Input (vs. 8.4% 2023 Actual)

The revenue volatility metric is an estimate of potential revenue volatility based on the issuer's historical experience relative to the median for the Fitch-rated local government portfolio. The metric helps to differentiate issuers by the scale of revenue loss that would have to be addressed through revenue raising, cost controls or utilization of reserves through economic cycles.

-- Lowest three-year revenue performance (based on revenues dating back to 2005): 2.4% decrease for the three-year period ending fiscal 2009

-- Median issuer decline: -4.2% (2023)

### **Analyst Inputs to the Model**

The five-year low unrestricted general fund balance was adjusted to 6% from 8.4% five-year low (which occurred in fiscal 2020). The adjustment was made to account for risk in the city's financial plan and deficit projections, and the city's goal of maintaining general fund balance of at least 6%-8% of general fund balance. Fitch used the 6% because the city projects dropping below 6% in the five-year budget through fiscal 2029.

## **DEMOGRAPHIC AND ECONOMIC STRENGTH**

### **Population Trend - 'Weak'**

Based on the median of 10-year annual % change in population, Philadelphia's population trend is assessed as 'Weak'.

Population trend: 0.3% 2022 median of 10-year annual % change in population (22nd percentile)

### **Unemployment, Educational Attainment and MHI Level - 'Weak'**

The overall strength of Philadelphia's demographic and economic level indicators (unemployment rate, educational attainment, median household income [MHI]) in 2023 are assessed as 'Weak' on a composite basis, performing at the 34th percentile of Fitch's local government rating portfolio. This is due to very low median-issuer indexed adjusted MHI and elevated unemployment rate offsetting midrange education attainment levels.

-- Percent of population with a bachelor's degree or higher: 33.6% (2022) (60th percentile)

-- MHI as a percent of the portfolio median: 75.3% (2022) (13th percentile)

### **Economic Concentration and Population Size - 'Strongest'**

Philadelphia's population in 2022 was of sufficient size and the economy was sufficiently diversified to qualify for Fitch's highest overall size/diversification category.

The composite metric acts asymmetrically, with most issuers (above the 15th percentile for each metric) sufficiently diversified to minimize risks associated with small population and economic concentration. Downward effects of the metric on the MP are most pronounced for the least economically diverse issuers (in the 5th percentile for the metric or lower). The economic concentration percentage shown below is defined as the sum of the absolute deviation of the percentage of personal income by major economic sectors relative to the U.S. distribution.

-- Population size: 1,566,836 (2022) (above the 15th percentile)

-- Economic concentration: 39.9% (2023) (above the 15th percentile)

Demographic and Economic Strength Additional Analytical Factors and Notching: +1.0 notch (for Economic and Institutional Strength)

### **Analyst Inputs to the Model**

Philadelphia is the largest component of the Philadelphia-Camden-Wilmington Metropolitan Statistical Area, which contributes 2.3% to U.S. GDP as of 2022. The city is also very important to the Commonwealth of Pennsylvania's economy because it is the largest city in Pennsylvania and the sixth-largest in the United States.

The city's economy is anchored by higher education including the University of Pennsylvania, Temple University, Drexel University, and St. Joseph's University and there are more than 30 hospitals including the Children's Hospital of Philadelphia and the Hospital of the University of Pennsylvania. Other large employers include Comcast Corp.,

Philadelphia's carrying costs to governmental expenditures and liabilities to governmental revenue remain strong while liabilities to personal income remain weak. The long-term liability composite metric in 2023 is at the 55th percentile, roughly in line with Fitch local government rating portfolio.

-- Liabilities to personal income: 11.1% Analyst Input (15th percentile) (vs. 11.4% 2023 Actual)

-- Liabilities to governmental revenue: 108.5% Analyst Input (82nd percentile) (vs. 110.9% 2023 Actual)

-- Carrying costs to governmental expenditures: 11.5% Analyst Input (74th percentile) (vs. 10.6% 2023 Actual)

### **Analyst Inputs to the Model**

The long-term liability metrics were adjusted to incorporate new debt and to subtract recently amortized debt.

The long-term liability metrics were adjusted to reflect the city's current bond offering and debt amortized in fiscal 2024. The net pension liability was adjusted to deduct the portion of the liability attributable to the city's self-supporting enterprise funds.

### **PROFILE**

Philadelphia is the sixth largest city in the U.S. based on population, with a stable employment base weighted toward higher education, healthcare and professional and business services. The 2022 estimated Census population was roughly 1.6 million, up 2.7% since 2010. The city reported significant growth in assessed values in 2023 increasing more than 19% as a result of the city revaluation.

### **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.

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any, did not participate in the rating process, or provide additional information, beyond the issuer's available public disclosure.

## **APPLICABLE CRITERIA**

[U.S. Public Finance Local Government Rating Criteria \(pub. 02 Apr 2024\) \(including rating assumption sensitivity\)](#)

## **APPLICABLE MODELS**

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

U.S. Local Government Rating Model, v1.2.0 (1)

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