MOODY'S
RATINGS

Rating Action: Moody's Ratings assigns A3 to Philadelphia Gas Works' $339.69 million Gas Work's Revenue Bonds 17th Series A and $111.11 million Revenue Refunding Bonds 17th Series B; outlook stable

28 Aug 2024

New York, August 28, 2024 -- Moody's Ratings (Moody's) has assigned an A3 rating to the Philadelphia Gas Work's (PGW) $339.69 million Gas Works Revenue Bonds, Seventeenth Series A and $111.11 million Gas Works Revenue Refunding Bonds Seventeenth Series B. Concurrently, we have affirmed the A3 rating on approximately $943 million of PGW's pre-refunding 1998 Ordinance bonds outstanding. The outlook is stable.

RATINGS RATIONALE

The A3 rating reflects the historically credit supportive regulatory environment that has grown the utility's asset base, accelerated funding for both its cast iron main replacement program and to reduce its unfunded OPEB liability, and reduced borrowing needs by allowing for more cash funded capital investments. Our credit view acknowledges the utility's management that has enhanced PGW's operating efficiencies and maintained a robust and more predictable financial position, which we expect to continue going forward.

The rating remains constrained by PGW's sizeable low income and modestly growing customer base that is pressured during economic downturns, as well as the utility's position as a supplier of last resort, which yields consistently above average retail rates. Moreover, PGW's state rate regulation constrains its cost recovery framework compared to the majority of municipally owned gas utilities in the US, which benefit from local unregulated rate setting. Thus, the rating heavily factors the credit supportive relationship PGW has with the Pennsylvania Public Utility Commission (PAPUC) and the fact that the PAPUC must approve rates sufficient for PGW to satisfy its indenture required 1.5 times debt service coverage ratio (DSCR) rate covenant. The A3 rating acknowledges the 3.2% rate case increase approved by the

PAPUC in November 2023, which was significantly below the 10.3% rate increase filed by PGW. The difference was mostly driven by PAPUC revision on PGW's goal of funding incremental capital expenditures equally split using debt and internal cash flow generation and a revised number of payroll and related expenses.

RATING OUTLOOK

The stable outlook reflects our expectation that PGW's sound management and the constructive regulatory environment will continue to yield stable and relatively predictable financial and operating results.

FACTORS THAT COULD LEAD TO AN UPGRADE OF THE RATINGS

- Material reduction in outstanding debt.

- Notable expansion of the customer base.

FACTORS THAT COULD LEAD TO A DOWNGRADE OF THE RATINGS

- A less credit supportive rate regulatory environment

- Financial margins or liquidity materially declines due to higher costs and/or lower revenue collections.

- Increased leverage without sufficient cost recovery.

LEGAL SECURITY

The 1998 Ordinance bonds are secured by net revenues of the system. There is a strong rate covenant and additional bonds test requiring net revenues to be 150% of annual debt service costs and a debt service reserve fund for all bonds secured by the debt service reserve fund at maximum annual debt service. The bond ordinance requires PGW to operate and maintain the Gas Works System as long as any bonds or notes are outstanding.

USE OF PROCEEDS

Bond Proceeds from the Gas Works Revenue Bonds Seventeenth Series A will be used to fund part of PGW's ongoing Capital Improvement Program, provide up to $35 million of net proceeds to take-out existing tax-exempt Commercial Paper, and to fund the associated debt service reserve fund and issuance costs. Bond Proceeds from the Gas Works Revenue Refunding Bonds Seventeenth Series B will refund the Thirteenth Series fixed rate bonds and refund outstanding Fifth Series A-2 variable rate bonds.

PROFILE

PGW is a municipally owned regulated gas distribution utility that supplies and transports natural gas to 518,600 primarily residential customers within the City of Philadelphia (City). PGW has a distribution monopoly in the City and serves as the supplier of last resort given there is gas supplier choice in Pennsylvania. If customers use another gas supplier, PGW is paid a transportation fee for the use of its lines. PGW's gas distribution system consists of approximately 3,047 miles of gas mains, 473,702 service lines, and 197 regulator stations. PGW is owned by the City and is accounted for in the City's audited financial statements as a component unit of the City.

Approximately 38% (by length) of the gas mains are cast iron, 33% are steel, 4% are ductile iron and 25% are plastic. Of the steel lines, 53% are wrapped, coated and cathodically protected. About 22% of the service lines are steel and 78% are plastic. PGW also operates two LNG facilities for liquefaction, storage, and regasification of natural gas, which is used during the winter in addition to the utility's firm take from two interstate pipelines. The utility has laddered firm gas supply contracts and has a relatively balanced gas supply mix with half coming from the Spectra pipeline and the other half coming from the Transco-Williams pipeline.

METHODOLOGY

The principal methodology used in these ratings was US Municipal Utility Revenue Debt published in March 2024 and available at https://ratings.moodys.com/rmc-documents/416489. Alternatively, please see the Rating Methodologies page on https://ratings.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 on https://ratings.moodys.com/rating-definitions .

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