

NEW ISSUE - PHILADELPHIA (CITY OF) PA
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Moody's Rating

Issue Rating

General Obligation Fixed Rate Refunding Bonds, Series 2007A Baa1
Sale Amount \$218,470,000
Expected Sale Date 12/06/07
Rating Description General Obligation, Unlimited Tax

General Obligation Multi-Modal Refunding Bonds, Series
2007B Baa1
Sale Amount \$317,430,000
Expected Sale Date 12/19/07
Rating Description General Obligation, Unlimited Tax

MOODY'S ASSIGNS Baa1 TO PHILADELPHIA'S (PA) \$535.9 MILLION G.O.
REFUNDING BONDS

AFFIRMATION OF Baa1 RATING AND STABLE OUTLOOK APPLIES TO APPROXIMATELY
\$4 BILLION OF PARITY DEBT OUTSTANDING

Opinion

Moody's Investors Service has assigned a Baa1 rating and stable outlook to the City of Philadelphia's \$218.47 General Obligation Fixed Rate Refunding Bonds, Series 2007A and \$317.43 million General Obligation Multi-Modal Refunding Bonds, Series 2007B. At this time, Moody's has affirmed the Baa1 rating and stable outlook on \$667.04 million in parity debt previously issued by the city as well as the Baa1 rating and stable outlook on \$2.78 billion in other unconditional General Fund obligations. The bonds are secured by the city's general obligation, unlimited tax pledge and proceeds will be used to refund various series of bonds for an expected net present value savings of 3.5% of refunded principal.

Affirmation of the Baa1 rating and stable outlook reflects the city's improving, although still weak, demographic and economic trends, modest property value growth, and a heavy burden of tax-supported debt. Mitigating these weaknesses, city finances are subject to oversight by a state body, with well-established five-year planning and quarterly monitoring procedures in place. The city's budgetary management has been effective, which contributed to maintenance of a positive unreserved General Fund balance for over a decade; three years of large operating deficits, however, depleted reserves and created a negative unreserved fund balance as of the end of fiscal 2004.

The city returned to surplus operations in fiscal 2005, 2006 and 2007.

Moody's stable outlook reflects the expectation that financial operations will remain stable going forward, as reflected in the city's Five Year Plan which currently demonstrates narrow, but adequate reserves for the next few years.

STRENGTHENING FINANCIAL OPERATIONS REPLENISH RESERVES TO ADEQUATE LEVELS

Prudent financial processes, cautious revenue forecasting, and growth in tax receipts have resulted in three years of surplus operations that increased reserves since substantial operating deficits in 2002 through 2004 reduced unreserved General Fund balance to -\$148 million, or a negative 4.8% of 2004 General Fund revenues. Prior to 2004, the city had maintained a positive unreserved General Fund balance for 11 years, even with gradual reductions in the city's wage tax rate since 1996, intended to enhance the city's competitive position relative to the MSA. Through the 2008 budget year, the rate has been reduced by approximately 15%, with an additional reductions included through 2012. Facing somewhat unfavorable results from employee negotiations three years ago, the city expanded its efforts to reduce the city workforce, including 200 layoffs.

Philadelphia's responsibility for both city and county government services, a trend of loss of middle-class residents, already high tax rates and sluggish tax base growth have combined to present significant challenges to the maintenance of balanced financial operations. The city's finances are subject to oversight by a state body, the Pennsylvania Intergovernmental Cooperation Authority (PICA), with well-established five-year planning and quarterly monitoring procedures in place. State oversight is to continue until long-term bonds sold by PICA to finance the city's early 1990's accumulated operating and capital deficits are fully retired (scheduled final maturity is in 2022). In response to these challenges, the city's financial management processes have been prudent, with cautious revenue forecasts, moderate contingency reserves, and other smaller layers of cushion included in recent years' annual budgets.

The fiscal 2004 deficit fund balance was exacerbated by a late payment from the state of \$90 million, received in September, 2004. That state payment was booked in the fiscal 2005 year, which contributed to a GAAP surplus of \$150 million, increasing total General Fund balance to \$154 million (7.5% of General Fund revenues), although the unreserved GAAP General Fund balance was still negative at -\$36 million. On a budgetary basis, however, the fiscal 2005 surplus increased General Fund reserves from -\$47 million (-1.4% of General Fund revenues) to \$96 million (2.8% of General Fund revenues). The city experienced another surplus of \$150 million in fiscal 2006, increasing total General Fund balance to \$305 million (8.5% of General Fund revenues), with the unreserved portion at \$111 (3.1% of General Fund revenues), on a GAAP basis. General Fund reserves on a budgetary basis grew to \$254 million (7.4% of General Fund revenues). The surpluses have been driven by strict expenditure controls and strong tax revenues, most notably in the business privilege, wage and real estate transfer taxes. We note that the city's ending balances on a budgetary basis have been higher than the unreserved GAAP balance, due to changes in some tax payment dates that were positive on a cash basis but not on a GAAP basis.

Unaudited results for fiscal 2007, which ended on June 30, show an additional surplus of \$188 million (on a GAAP basis), increasing total General Fund balance to \$493 million (12.7% of General Fund revenues) and unreserved General Fund balance to \$153 million (3.9% of General Fund revenues) on a GAAP basis; on a budgetary basis, General Fund balance grew to \$297 million (8.0% of General Fund revenues). While real estate transfer taxes were lower than the previous year, they were still ahead of budget, and business privilege and wage taxes remained strong in fiscal 2007.

The city's original budget was passed and approved by PICA in conjunction with the 2008-2012 Five Year Plan. The adopted budget anticipated growth in local tax collections, including an increase in revenues from the wage tax (2.9%) which accounts for about 1/3 of total revenue and where a program of gradual reductions in the tax rate is ongoing. The estimate for intergovernmental revenues assumed 1.2% growth over fiscal 2007. Overall, the fiscal 2008 budget assumed a 2.2% increase in General Fund revenues over 2007 projections and a 2.3% increase in General Fund expenditures, leading to a budgeted \$87 million use of reserves. Since the passage and approval of the budget earlier this year, the city has made some adjustments in its estimates, including a reduction in state aid for child welfare and corresponding reductions in contracts for service delivery, as well as upward adjustments to tax revenue given healthy wage tax collections, which has resulted in an estimated reduction of fund balance by only \$49 million.

In addition to this use of reserves in fiscal 2008, the city's Five Year Plan currently calls for additional General Fund balance appropriations of approximately \$121 million from fiscal 2009 through fiscal 2012, although Moody's believes that this incorporates conservative revenue estimates.

Moody's notes, however, that the fiscal 2012 ending fund balance would represent the low point at \$128 million and, unlike the past several five-year plans, there is no year where reserves will dip to very narrow levels (i.e. below \$100 million). Despite the relative improvement, the city still faces financial challenges, including negotiations with police and fire personnel in the coming year. The Five Year Plan takes into account post-employment benefits for all existing retirees for the full five years, even though many will begin to drop off in 2009 and 2010 due to a five year cap on such benefits.

WEAK LONG-TERM DEMOGRAPHIC AND ECONOMIC TRENDS, ALTHOUGH SOME IMPROVEMENT INDICATED

Philadelphia has experienced a long trend of industry and population loss since 1950, with a particularly sharp economic retreat hitting in the late 1980's and early 1990's. The late 1990's saw a resumption of growth, with employment up 5.7% between 1998 and 2001, and then down about 1.6% between 2001 and 2003, reflecting the slowdown in the national economy. The decline flattened in fiscal 2004 and then grew by about 1.1% in 2005 and 0.8% in 2006.

Results for the first ten months of 2007 demonstrate continued growth, with each month showing an increase over the same month of the prior year.

Manufacturing has continued to decline in importance, and diversified

services now account for 54% of total employment (or more than 60% including the finance/insurance/real estate sector). Population loss during the 1990's was just over 4%, although this was only about half the loss that had been estimated prior to the 2000 census count. With an estimated 1.45 million residents, the city remains the nation's fifth most populous.

Resident wealth indicators are low, with per capita and median family incomes only about 77% and 74% of the national median, respectively, and 23% of residents below the poverty level. A relatively large portion of the city's job base is in low-paying sectors, with healthcare, social services, and state and local government accounting for about 30% of total jobs (a large share of which are likely held by city residents, as opposed to commuters).

Although city unemployment rates have averaged approximately 7.6% in recent years, it appears to be improving, and was 6.2% in August of 2007, although still above the state (4.5%) and nation (4.6%).

The city's property tax base has grown modestly over the past decade, averaging 2.7% growth annually since 2002. The \$46.5 billion tax base does benefit from significant diversity, with the 10 largest tax payers comprising less than 5% of total valuation.

OVER \$7.0 BILLION OF TAX SUPPORTED DEBT NOW OUTSTANDING, INCLUDING OVERLAPPING OBLIGATIONS; CITY'S ANNUAL SERVICING BURDEN IS HIGH BUT MANAGEABLE

Including this issue, Philadelphia's total tax-supported debt is just over \$7.0 billion, inclusive of overlapping school debt. The ratio of debt to full property value is high at 15.5%, one of the highest ratios among the nation's 10 largest cities. The city's high debt burden reflects its dual city and county responsibilities, special efforts to promote economic development (e.g. convention center, stadiums, and blight remediation), the PICA deficit-funding bonds sold in the early 1990's, and a \$1.3 billion pension bond issued several years ago. In addition, the school district has faced significant capital needs associated with its aging facilities. With city G.O. bond issuance tightly constrained by a debt cap in the Pennsylvania Constitution, there will likely be continued use of non-G.O. debt structures going forward.

In conjunction with the variable rate Series 2007B bonds, the city will enter into an interest rate swap with Royal Bank of Canada (RBC - Issuer Rating of

Aaa) for a notional amount equal to the Series B issuance amount. The city will make semi-annual payments based on a fixed rate (to be determined) and RBC will make monthly payments based on the SIFMA (formerly BMA) Municipal Swap Index. Regularly scheduled payments will be parity with the general obligation debt of the city. Early termination is optional for the city only.

Termination events include deterioration of either the city or RBC's rating falling below Baa3 and the downgraded party has not transferred the agreement to an acceptable party or provided for a Credit Support Provider.

Potential termination payment requirements are remote given the city's and the counterparty's current ratings. A termination payment by the city would be subordinate to the general obligation debt service payments.

Outlook

Moody's rating outlook for Philadelphia is stable, reflecting the city's return to surplus operations and the expectation of satisfactory reserves going forward. Moody's believes the city will continue to benefit from the five-year planning and quarterly monitoring procedures required by the state oversight board, as well as the conservative budgeting provided by the financial management team.

What could make the GO rating go UP:

- Continued strengthening of financial operations resulting in substantial fund balance improvement
- Improvement in economic/demographic trends

What could make the GO rating go DOWN:

- Financial deterioration in fiscal 2008 and beyond

KEY STATISTICS

2006 estimated population: 1.45 million

2007 full value: \$46.5 billion

Full value per capita: \$32,077

1999 Per capita income as % of state: 79.1%

1999 Median family income as % of state: 75.3%

Direct debt burden: 9.9%

Total debt burden: 15.5%

Payout of principal (10 years): 49.9%

FY2006 General Fund balance: \$304.5 million (8.5% of General Fund revenues)

FY2006 Unreserved General Fund balance: \$111.2 million (3.1% of General Fund revenues)

FY2006 General Fund balance (budget basis): \$254 million (7.4% of General Fund revenues)

FY2007 General Fund balance (unaudited): \$492.6 million (12.7% of General Fund revenues)

revenues)

FY2007 Unreserved General Fund balance (unaudited): \$152.7 million
(3.9%
of General Fund revenues)

FY2007 General Fund balance (budget basis): \$297 million (8.0% of
General Fund
revenues)