FitchRatings

FITCH UPGRADES PENNSYLVANIA INTERGOV COOP AUTH'S SPECIAL TAX REVS TO 'AAA' ON CRITERIA CHANGE

Fitch Ratings-New York-28 February 2017: Fitch Ratings has upgraded the following Pennsylvania Intergovernmental Cooperation Authority (PICA) special tax revenue refunding bonds (City of Philadelphia Funding Program) to 'AAA' from 'AA+':

--$158.635 million, series 2009;
--$107.46 million, series 2010.

The Rating Outlook is Stable.

SECURITY
The outstanding bonds are limited obligations of the authority payable from pledged revenues, consisting of a 1.5% tax on wages and other compensation earned by city residents, as well as the net profits earned in business, professions, and other activities conducted by residents. Payment of the pledged revenues to PICA is not subject to city or state appropriation.

KEY RATING DRIVERS

The 'AAA' rating reflects solid economic underpinnings supporting pledged revenues, robust coverage through economic cycles and a strong legal framework that explicitly separates pledged revenues from the city and commonwealth.

PLEDGED REVENUE GROWTH PROSPECTS: Fitch anticipates growth in the pledged wage, earnings, and net profits tax revenues will be solid and between the pace of national economic growth and inflation. Historical trends indicate a relatively resilient stream with limited declines and recent acceleration in growth. Fitch links the performance and outlook for pledged revenues to the city of Philadelphia's overall economy.

ECONOMIC SENSITIVITY AND RESILIENCE OF SECURITY: Coverage for the PICA special tax revenue bonds from pledged revenues should be extremely resilient through a moderate downturn given the ample current coverage and resilience of the pledged revenue stream.

EXPOSURE TO ISSUER: Fitch considers the ratings distinct from the both the city of Philadelphia (Issuer Default Rating [IDR] 'A-'/Outlook Stable) and the commonwealth of Pennsylvania (IDR 'AA-'/Outlook Stable). Pledged revenues remain the property of PICA until paid to the trustee and are not subject to commonwealth or city appropriation. Fitch does not consider PICA's own operating risks to be a material credit consideration given its limited function as a fiscal oversight entity without direct service responsibilities.

RATING SENSITIVITIES
Sound Coverage Cushion: The ratings on the Pennsylvania Intergovernmental Cooperation Authority special tax revenue bonds are sensitive to Fitch's expectations for the maintenance of a robust coverage cushion from the pledged revenues, consistent with the current rating level.

No Further Leveraging: Fitch does not anticipate the authority will issue additional new money bonds, which requires commonwealth legislative authorization.

CREDIT PROFILE

PICA was created by state legislation in 1991 (Pennsylvania Intergovernmental Cooperation Authority Act for Cities of the First Class, or the Act) to assist the city in its financial recovery. The authority has broad powers to review and approve city budgets and multi-year financial plans. If PICA certifies the city's noncompliance to the state, Pennsylvania withholds certain state aid due to the city. PICA was given statutory authority to issue wage tax-secured bonds to fund the operating deficits and capital expenditures of the city. At this time PICA has exhausted its borrowing authorization. Any additional issuance not for refunding purposes would require board consent and legislative approval by the Commonwealth. PICA reports that it has no plans to seek additional authorization.

The special tax revenue bonds are secured by a 1.5% tax on the salaries, wages, commissions and other compensation earned by residents of the city and on net profits earned in business, professions and other activities conducted by residents of the city (collectively, the PICA Tax). The 1.5% tax is exclusively the property of PICA, and the city and state have covenanted not to reduce the tax as long as PICA bonds are outstanding.

STRONG COVERAGE
Coverage of annual debt service by pledged revenues has strengthened due to steady revenue growth and a declining debt service schedule. Receipts grew by an annual average of 3.7% between fiscals 2006-2016, including a robust 9.1% increase year-over-year (yoy) in fiscal 2016 to $447 million. Collections for the first seven months of fiscal 2017 were up nearly 7% yoy.

Growth in pledged revenues is tied to the city's economic trajectory. Fitch's current IDR for the city is 'A-' with a Stable Outlook. For more information on the city's economy, see Fitch's press release 'Fitch Rates Philadelphia, PA's $283MM GOs 'A'; Outlook Stable', dated Nov. 7, 2016 and available at 'www.fitchratings.com'.

ROBUST RESILIENCE

The security provided by the pledged revenues is extremely resilient to economic volatility. Fitch's analysis focuses on current maximum leverage rather than the 3x ABT. While the lien remains open under the indenture, it requires unlikely state legislative action to be utilized. PICA has no plans to pursue additional authorization, and the city relies on residual revenues for its operating needs.

To evaluate the sensitivity of the dedicated revenue stream to cyclical decline, Fitch considers both revenue sensitivity results (using a 1% decline in national GDP scenario) and the largest decline in revenues over the period covered by the revenue sensitivity analysis. Based on the authority's pledged revenue history, the Fitch Analytical Sensitivity Tool (FAST) generates a 1.1% scenario decline in pledged wage, earnings, and net profits tax revenues. The largest actual decline was a 2% decline in fiscal 2010.

Fiscal 2016 pledged revenues of approximately $450 million provided seven times (x) coverage of MADS and can withstand an 85% decline while still maintaining sum sufficient MADS coverage. This is equivalent to 77x the scenario result, and 50x the worst actual decline in revenues, warranting a 'aaa' assessment for this rating factor.

SOLID GROWTH PROSPECTS

Growth prospects for the pledged wage, earnings and net profits tax revenues are solid and in line with Fitch's expectations regarding the city's economic trajectory. Pledged revenues are derived from a broad citywide economic base, benefiting from Philadelphia's role as a regional center for healthcare and higher education. Jobs expansion since the recession has been steady, but low wealth levels and weak population growth persist and limit growth prospects somewhat. The population is estimated at 1.5 million.

Historical revenue growth has been generally consistent, through the last two national recessions. Pledged revenues declined only twice since fiscal 1999, never more than 2%, and never for consecutive years. Particularly robust growth in fiscal 2015 and 2016 of 7.5% and 9.1% respectively, primarily reflects economic growth in the city. Fitch does not anticipate that pace will continue, but continued growth between the pace of national economic growth and inflation is likely.

EXPOSURE TO ISSUING ENTITY

Fitch does not cap the rating on the bonds at the commonwealth or city's IDR. The city acts as collector of the PICA tax in an agency capacity under an intergovernmental agreement with the state revenue department. Statutory provisions in the act make clear that at all times, the tax revenues remain the property of PICA. After payment of debt service and fulfillment of indenture requirements, residual revenues flow to the city. Payment of the pledged revenues to PICA is not subject to city or commonwealth appropriation

PICA's operational risks are minimal as it functions largely as a fiscal oversight body without material operating demands. Fitch does not evaluate PICA's operational profile and does not limit the rating on the bonds to the authority's underlying credit quality.

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In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis and InvestorTools.

Applicable Criteria
U.S. Tax-Supported Rating Criteria (pub. 18 Apr 2016)
https://www.fitchratings.com/site/re/879478