S&P Global Ratings

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Summary:

Pennsylvania Intergovernmental Cooperation Authority; Miscellaneous Tax

Primary Credit Analyst:
Lisa R Schroeer, Charlottesville (434) 529-2862; lisa.schroeer@spglobal.com

Secondary Contact:
Carol H Spain, Chicago (1) 312-233-7095; carol.spain@spglobal.com

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Summary:

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Long Term Rating	AAA/Stable	Affirmed

Rationale

S&P Global Ratings affirmed its 'AAA' rating on Pennsylvania Intergovernmental Cooperation Authority's (PICA) series 2009 and 2010 special tax revenue bonds (City of Philadelphia Funding Program) under the application of its Priority-Lien Tax Revenue Debt criteria, published Oct. 22, 2018. The outlook is stable.

The rating factors in our view of PICA's ownership of the pledged revenue, which is never comingled with either state or city revenue, and the revenue's strength and stability. In addition, we view the unique structure and purpose of the organization of PICA as an autonomous oversight board created by the state of Pennsylvania for the city of Philadelphia as a key credit factor.

The rating applies to PICA's series 2009 and 2010 special tax revenue bonds (City of Philadelphia Funding Program); $100 million is outstanding for the 2009 series and $68.5 million is outstanding for the 2010 series. All bonds will mature by 2023.

Pursuant to our priority-lien criteria, we link the rating to the state as the relevant operating entity because of its role in setting up PICA by statue, the board's composition of state appointees, and PICA's oversight responsibilities as detailed in state statute. These responsibilities include approving budgets and five-year financial plans. PICA's strong oversight and control functions, established at the state level by statute, limit both the likelihood of severe fiscal distress for the city as well as potential risks to the pledged revenue in a distress scenario.

A first lien on a 1.5% wage tax levied for PICA on city residents and on the net profits earned in business, professions, and other activities conducted by Philadelphia residents is pledged by PICA to secure the bond. PICA was created in June 1991 to provide a financing vehicle to assist in resolving Philadelphia's fiscal crisis and oversee the city's finances. State legislation created the ability to raise the PICA revenue through the imposition of the PICA tax, which is owned by PICA. Once the bonds are paid off, the PICA tax expires and PICA will dissolve. The city collects the revenues as a designated agent of the state and places them into the PICA tax fund. The state treasurer is required to transfer all amounts in the fund to the revenue fund for bond payments. After debt service, the flow of funds is: to the debt service reserve (DSR) fund; payment of interest rate exchange, cap, or floor agreements; and to PICA for minimal operating expenses. PICA provides excess funds to the city as a grant. The DSR is funded at maximum annual debt service (MADS) on the bonds. No additional bonds, other than refunding bonds, are permitted under the authorizing legislation.

We believe the relationship between the revenue and the operating entity is remote. We believe the pledged revenue is neither legally nor practically available to finance operations and is unlikely to be affected by operating distress. We believe this is supported by the intent of the creation of PICA, the unique ownership of the revenue stream, and the flow of funds that prevents the revenue from comingling with either city or state revenues. In addition to PICA owning the revenue stream, the revenue collection is placed into a specific PICA tax fund. It is never part of either the city's or state's treasury and is kept segregated.

Key credit considerations include:

- Strong underlying economic base with access to a broad and diverse economy that supports Philadelphia's economic activity, which has led to stable pledged revenues;
- Fiscal 2018 collections that provide more than 8x coverage of MADS, which we expect will improve through maturity in 2023 as a result of annually declining debt service requirements and statutory limitations on the issuance of additional bonds for refunding purposes only;
- Our view that wage and net profits in business taxes demonstrate historically very low volatility through various economic cycles, with no history of significant volatility at the local level; and
- The state's creation of PICA and its governance as identified in state statute, as well as the legal and mechanical structure outlined in the bond documents, supports our view that operating risks are less likely to affect pledged revenue.

Economic fundamentals: Strong

While Philadelphia is not the linked operating entity under our priority-lien criteria, we consider the city's economic activity to be a key factor in evaluating the revenue pledge, which is generated by the economic activity of Philadelphia residents. We consider the city's economy strong after several years of increases in assessed value and market value growth, which have raised its market value per capita. In addition, most of the city's major revenues increased over the past year. For 2018, year-end revenue came in higher than anticipated, with strong growth in the transfer tax (34% growth over the previous year). In addition, the business income and receipts tax increased 8.8% over the previous year. Other revenues, such as the wage and earnings tax, increased 6.4% over the previous year, and property tax revenue increased 10.8%, in part due to a reassessment. These revenue trends support our view of the overall economic activity, which underlies the PICA pledged revenues as well. The PICA revenues, the wage tax levied on city residents and on the net profits earned in business, professions, and other activities conducted by Philadelphia residents, have almost doubled since 2000.

Philadelphia, with an estimated population of 1.6 million, is coterminous with Philadelphia County in southeastern Pennsylvania. It is the sixth-largest city in the U.S. in terms of population. It is in the Philadelphia-Camden-Wilmington metropolitan statistical area, which we consider to be broad and diverse. The city has a projected per capita effective buying income of 79.8% of the national level and per capita market value of $104,404. It underwent two revaluations of its tax base for 2017 and 2018, resulting in $165.0 billion in tax year 2019. The county unemployment rate was 6.2% in 2017. Leading city employers include Albert Einstein Medical Center, Children's Hospital of Philadelphia, Southeastern Pennsylvania Transit Authority, and Comcast Corp.

Philadelphia's economy is comparatively diverse, with strong health care and higher education industries, with historically more moderate employment growth, and a higher unemployment rate when compared with state and national levels. The city has realized good levels of employment growth over the past two years, mitigating some of the economic concerns about five years of slower-than-U.S. employment growth through 2015. The economy shows signs of stability, despite the projections that suggest slower-than-U.S. levels of employment and growth.

Coverage and liquidity: Very strong

Pledged revenue collections have increased consistently over the past 18 years, with minor declines in 2010 and 2012. Since 2000, the revenue has doubled, providing very strong coverage over the years, and in fiscal 2018 it increased by 6%. PICA projections show 3.8% growth in the upcoming year. Given the strong economic fundamentals and recent trends, we believe this forecast is likely attainable, although not necessary to retain very strong coverage levels.

In fiscal 2018, total pledged tax revenue increased to almost $497 million, providing over 8x coverage of MADS, which is in the current year. With declining annual debt service requirements through maturity in 2023 and the state statutes prohibiting new-money issuance after 1996, we believe coverage will remain very strong.

The DSR is required to be funded at MADs, although we believe that, given the high level of coverage, the need for the reserve is minimal. In combination with our very low volatility assessment and based on our view of very strong coverage coupled with a closed lien, there is no downward adjustment to the coverage score that would indicate potential liquidity pressures.

Volatility: Very low

We assess the volatility of revenue to determine the likelihood of the availability of revenue during different economic cycles. We have two levels of volatility assessment: macro and micro.

Our macro volatility assessment begins with an assessment of the historical volatility of the economic activity being taxed, and includes an analysis of societal, demographic, political, and other factors that could affect these activities. To inform our opinion on expectations of future volatility, we use the variance of national economic activity that we believe most closely represents the taxing base over multiple economic cycles. For the pledged revenue, we determined our macro view of volatility based on personal income tax data from the Bureau of Economic Analysis for the period 1993-2014.

On a micro level, with stable collections coupled with a broad base, we see no internal or external influences that we believe worsen the macro assessment of volatility as very low. While fluctuations could occur relative to economic cycles and potentially the financial services industry bonus season, we believe historical trends inform our view of future tax collections that we believe will remain stable.

Linkage to the State of Pennsylvania as a related entity: Remote

We link the rating to the state as the relevant operating entity because of PICA's oversight responsibilities as detailed in state statute, and the purpose of PICA and its limited operations. These responsibilities include approving budgets and five-year financial plans. PICA's strong oversight and control functions, established at the state level, limit both the likelihood of severe fiscal distress for the city as well as potential risks to the pledged revenue in a distress scenario.

We believe the relationship between the revenue and the operating entity is remote. We believe the pledged revenue is neither legally nor practically available to finance operations and is unlikely to be affected by operating distress. We believe this is supported by the intent of PICA, the unique ownership of the revenue stream, and the flow of funds that prevents the revenue from comingling with either city or state revenues. In addition to PICA owning the revenue stream, the revenue collection is placed into a specific PICA tax fund. It is never part of either the city's or state's treasury and is kept segregated.

PICA was created in June 1991 to provide a financing vehicle to assist in resolving Philadelphia's fiscal crisis. The authority provides oversight to the city's finances, which includes reviewing its budgets and long-term financial plans. The authority may ultimately withhold state funding if it does not approve of the budget or longer-term plans. To date, PICA has not had to use this mechanism, but it does show the strength of the oversight body to ensure its fiscal stewardship. This oversight is incorporated into the city's overall operating profile as well.

The authority exists for as long as the bonds remain outstanding, with a small phase-out period.

By legislation, the pledged tax revenue was created for PICA and is owned by PICA. The city collects the revenues as a designated agent of the state and places them into the PICA tax fund. The state treasurer is required to transfer all amounts in the fund to the revenue fund for bond payments. After debt service, the flow of funds is: to the DSR fund; payment of interest rate exchange, cap, or floor agreements; and to PICA for minimal operating expenses. PICA provides excess funds to the city as a grant. The DSR is funded at MADS on the bonds. No additional bonds, other than refunding bonds, are permitted under the authorizing legislation.

Ratings linkage to Pennsylvania

Though we believe a remote relationship exist, we do factor in Pennsylvania's general operating (GO) profile. As part of the priority-lien criteria, we view overall creditworthiness as a key determinant in our analysis.

For more information on the commonwealth's creditworthiness, please refer to our GO analysis on Pennsylvania , published April 24, 2018, on Ratings Direct.

Highlights regarding the state's credit profile include an on-time $32.7 billion budget for fiscal 2019 that significantly narrows the commonwealth's structural gap to about 1% compared with 7% the previous year. Projected 4.2% tax revenue growth and stronger liquidity ease Pennsylvania's 2018-2019 budget pressures; however, fiscal relief could be short-lived. Given the almost structurally aligned budget, the slowdown in economic growth that we forecast--and the ensuing deceleration of revenue growth that would likely accompany it--is a greater credit consideration. Pennsylvania's ongoing budget pressures largely reflect slow revenue growth, coupled with rising human services costs, particularly Medicaid. Altogether, debt service, pension, other postemployment benefits, and Medicaid account for a significant 43% of the state's fiscal 2019 general fund spending. Pennsylvania's minimal reserves and narrow margins limit its flexibility in the event of a revenue shortfall. Despite what we anticipate to be continuing thin cash balances, the modest size of ongoing structural gaps suggests that Pennsylvania's financial position will not likely deteriorate significantly further over the two-year outlook horizon. We also expect that the commonwealth will continue to fully fund pension actuarially determined contributions (ADCs), which we view as a strength relative to lower-rated states. In our view, the state's narrow margins and lack of reserves will continue to weigh on its prospects for a higher rating.

Outlook

The stable outlook reflects our view of the strong MADS coverage based on audited fiscal 2018 pledged revenue collections, supported by our view of the very low volatility in the pledged revenue. The city's economic activity and overall strong economy lend stability to the view of the revenue pledge. In addition, under our criteria, there is a link between the attributes of the priority-lien pledge and the State of Pennsylvania as a related entity. This reflects our expectation that Pennsylvania's budgetary pressures will not significantly worsen over the two-year outlook horizon given its recent measures close its budget gap, improved liquidity position, and full ADC funding.

Downside scenario

If S&P Global Ratings lowered its rating on Pennsylvania, it would likely lower its rating on PICA. Should Pennsylvania's structural imbalance worsen in such a way that we believe weakens the state's credit, we could lower the rating on the bonds. We do not anticipate coverage metrics would be a driver of downward rating pressure.

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.