S&P Global
Ratings

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Summary:
Pittsburgh; General Obligation

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Summary:

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Credit Profile		
US$118.88 mil GO bnds, rfdg (federally taxable) ser 2020B due 09/01/2032		
Long Term Rating	AA-/Stable	New
US$30.915 mil GO bnds, rfdg ser 2020A due 09/01/2033		
Long Term Rating	AA-/Stable	New
Pittsburgh GO (FGIC) (MBIA) (National)		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed

Rating Action

S&P Global Ratings assigned its 'AA-' rating to Pittsburgh's $30.9 million series 2020A $119 series 2020B federal taxable general obligation (GO) bonds. At the same time, S&P Global Ratings affirmed its 'AA-' rating on the city's GO debt outstanding. The outlook is stable.

Pittsburgh's full faith and credit pledge and its agreement to levy ad valorem property taxes without limitation as to rate or amount secure the bonds. The series 2020A is expected to be used to refund the outstanding series 2018 GO bonds. The proceeds from the series 2020B are expected to be used to refund the series 2012B and a portion of the series 2012A and 2014 GO bonds.

Credit overview

Although Pittsburgh is seeing significant declines in some of its revenue streams due to the COVID-19 pandemic, we believe that, given its very strong reserves that stood at $146 million or 27% of expenditures in 2019, it is well positioned to absorb the near-term effects. Given the very strong management and fiscal oversight, the city will likely make the necessary budgetary adjustments to avoid material deterioration of is financial profile. Its fund balance policy calls for a minimum target of 10% of expenditures which it anticipates it may not fall below. However, should this occur, it could pressure the rating downward.

Real estate taxes, its major revenues source remains stable and while there could be some delays as a result of acceleration in unemployment stemming from the sudden stop in the economy, officials report that the city has received 90% of the levy already billed for fiscal 2020. S&P Global Economics indicates that the COVID-19 pandemic has caused the national economy to fall into a recession and the economic recovery will be slow (see "U.S. Faces A Longer And Slower Climb From The Bottom," published June 25, 2020, on RatingsDirect), which we expect will cause severely limited growth at the local level. While we expect the economic effects of the pandemic will result in delayed revenue collections and lower overall collections, we believe the city's reserves and available cash balances will allow officials to fund ongoing operations and debt service. Furthermore, the city has secured authority to access a line of credit to provide additional liquidity, if needed. Therefore, we do not anticipate any immediate credit pressure as a result of the COVID-19 pandemic.

Located within 500 miles of half the population of the U.S., Pittsburgh remains the economic center of western Pennsylvania. Following more than a decade of state oversight, the city exited financial monitoring stronger than ever. Officials enacted policies and practices in 2017 to ensure that progress continued and financial discipline established under state oversight would be maintained. As a result, Pittsburgh has continued to improve its financial position despite pressures from long-term liabilities.

With debt-reduction goals met in 2019, the city continues to focus on improving its pension funding. However, we anticipate these liabilities will remain a credit pressure in the near term.

The stable outlook reflects S&P Global Ratings' opinion that management will likely continue to proactively manage financial and operational performance and maintain strong reserves and very strong liquidity. We believe ongoing economic expansion will further support finances. Pittsburgh's high unfunded pension liability still constrains the rating, which could be a concern if the city deviated from its plans to fund at least the actuarially determined contribution (ADC) annually. Although our outlook is generally for two years, we see significant downside risks due to the pandemic and developing recession over the next six-to-12 months.

The rating reflects our opinion of the city's:

- Very strong management, with strong financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Adequate budgetary performance, with operating surpluses in the general fund and at the total governmental fund level in fiscal 2019;
- Strong budgetary flexibility, with an available fund balance that we expect will decrease in the near term from its fiscal 2019 level of 27% of operating expenditures;
- Very strong liquidity, with total government available cash at 15.2% of total governmental fund expenditures and 1.7x of governmental debt service, and access to external liquidity we consider strong;
- Very weak debt and contingent liability profile, with over $460 million of net direct debt and a large pension and other postemployment benefit (OPEB) obligation, with an evolving plan to address the liability that, in our view, has not yet made sufficient progress toward funding. The city's debt service carrying charges are at 9.2% of expenditures and net direct debt is 72.6% of total governmental fund revenue, but amortization is rapid, with 72.8% of debt scheduled to be retired in 10 years;
- Growing economy, anchoring a broad and diverse metropolitan statistical area (MSA), with overall economic factors we view as adequate; and
- Strong institutional framework score.

Environmental, social, and governance factors

Pittsburgh is actively working to address challenges presented by environmental, social, and governance (ESG) factors, including those presented by climate change, and social, racial, and economic inequities within the city. To that end, the city signed the U.S. Mayors Climate Protection Agreement in 2007, committing to implement a climate change mitigation plan. Pittsburgh continues to update its climate action plan, most recently in 2017, which focuses on how it can reduce greenhouse gas emissions. The plan works in tandem with the city's resilience strategy--One PGH. This is the city's holistic approach to identifying root causes of systemic social challenges, including affordable housing and income inequality, to find solutions for all of its residents. From a governance perspective, we believe the management team has a close working relationship with the mayor and city council, which we believe is important to maintain financial stability. Finally, Pittsburgh is taking steps to mitigate risks associated with cyberattacks. Overall, we view its actions on these ESG items as a positive indicator that management is working to address evolving risks.

Stable Outlook

Downside scenario

Holding all other factors equal, if pension, any unforeseen pressure, or revenue declines associated with COVID-pandemic were to weaken budgetary performance, resulting in a deterioration of reserves or liquidity with no plans to correct it, we could lower the rating.

Upside scenario

Should the city make significant progress toward funding its pension obligations, while maintaining its strong financial profile and continuing to experience economic expansion, we could raise the rating.

Credit Opinion

Very strong management

We view the city's management as very strong, with strong financial policies and practices under our FMA methodology, indicating financial practices are strong, well embedded, and likely sustainable.

Practices include:

- Conservative revenue and expenditure assumptions that consider historical and projected trends and tie to multiyear financial and capital forecasts, with actual results typically outperforming the budget;
- As required by policy, management monitors financial performance and makes quarterly detailed revenue and expenditure reports to city officials comparing year-to-date actual results with the budget, with amendments made if needed;
- Investments adhere to a formal policy with, at least, quarterly reports on holdings and performance to officials;
- Annually updated five-year financial forecasts and capital planning that identifies funding sources for projects, providing greater discipline when budgeting;
- A formal reserve policy to maintain available general fund balance at no lower than 10% of expenditures to ensure sufficient cash flow to fund operations; and
- A comprehensive debt policy with affordability metrics and limitations on variable-rate debt issuance, which management reviews every three years.

Adequate budgetary performance

Pittsburgh's budgetary performance is adequate, in our opinion, with four consecutive surpluses, over the past four years. The city had operating surpluses of 3.8% of expenditures in the general fund and 5.6% across all governmental funds in fiscal 2019. Our assessment accounts for our expectation that fiscal year 2020 could experience some budgetary challenges and some deterioration relative to fiscal 2019 results, primarily because of risks associated with the COVID-19 pandemic and the national recession. Given these risks, we revised the city's budgetary performance to adequate from strong.

Officials balanced the fiscal 2020 budget without using reserves and with no rate increases for major tax revenues. Based on its most recent year-end estimates, the general fund could end the year with an operating shortfall of $43 million, due to significant declines in revenues caused by the COVID-19 pandemic. The city reported major declines in the amusement, facility usage, parking, and telecommunication license taxes of, 82%, 65%, 41%, and 30%, respectively. These declines are as reported in the first quarter and the city indicated that the reductions could be greater for second quarter and the estimated general fund shortfall could increase. If the city is unable to make the necessary, timely, and sufficient budgetary adjustments, it could see its budgetary performance weaken further. As a result of revenue losses, Pittsburgh implemented a hiring freeze, delayed or cancelled some programs and continues to look at other areas. The city may also consider deferring OPEB contributions. The city was unable to provide any current updates on its fiscal 2020 year-end operations. To the extent that the disruption from the pandemic is prolonged, the city's 2021 budget could also be negatively affected and its available fund balance could fall. However, the city's policy states that a budget cannot pass if it reflects that the fund balance will fall below 10% of expenditures. Pittsburgh demonstrated a track record of making significant adjustments to the budget to achieve structural balance and generate savings. In addition to the implemented budgetary adjustments, about $6.2 million in funds from CARES Act may be received and alleviate some of the budgetary pressures.

Real estate taxes generated 30% of fiscal 2019 general fund revenue, earned income taxes accounted for 23%, payroll preparation taxes 14%, and parking taxes 13%. Both real estate and earned income taxes have not seen significant disruptions. The city dedicated parking revenues to fund a portion of its significantly underfunded pension system. These dedicated parking revenues are contributed based on prior-year collections and are not expected to affect 2020.

The city plans to continue transferring surplus results to fund pay-as-you-go capital needs. In addition, the 2020 budget calls for pension funding to exceed the ADC, which is in excess of the minimum municipal obligation. While the city has managed to make these increases in funding without pressuring its budget, funding ratios and underlying assumptions and methodologies could lead to contribution volatility.

Pittsburgh's comprehensive debt and capital planning focuses on meeting its capital needs while reducing its debt burden and planning for the future, with energy initiatives in its capital planning generating operational savings. Of note, the city decreased its debt service expenditures from fiscal years 2018 to 2019, a savings of about $25 million.

We believe that the city's ability to continue lowering its fixed costs lessens the burden from revenue loss.

Although the city could see added expenditures due to some damages caused by the civil unrest protests, it may receive funding from the state, adjust its budget, or use its reserves.

Strong budgetary flexibility

Pittsburgh's budgetary flexibility is strong, in our view, with an available fund balance that we expect could decrease in the near term given its current year-end estimates and pay-as-you-go capital transfers. Pittsburgh's available reserves were 27% of operating expenditures, or $146.6 million, at the end of fiscal 2019 and increased by 18% over 2018. Given the loss of revenues due to the COVID-19 pandemic, in our opinion, we believe that the city's fund balance provides cushion to absorb the declines.

Given the city's strong performance, its reserves continue to grow. However, its five-year financial forecast reflects a fund balance more in line with the 10% reserve policy after transferring for capital spending. The added pressure from revenue loss could result in a reduction in the city's available fund balance. Should its available fund falls below its 10% policy with no plans to rebuild, its budgetary flexibility could weaken and pressure the rating.

Although Pittsburgh's fixed costs are somewhat high, the city has been working to reduce its carrying costs while taking steps to increase pension funding. It recently settled or will settle the majority of its labor contracts, with most contracts including modest increases.

Very strong liquidity

In our opinion, Pittsburgh's liquidity is very strong, with total government available cash at 15.2% of total governmental fund expenditures and 165.7% of governmental debt service in 2019. Given Our analysis excludes funds in accounts we view as restricted.

In our view, the city has strong access to external liquidity if necessary, as demonstrated by GO debt issuances in the past 20 years.

The city entered into a fixed-rate, $40 million loan agreement with Key Government Finance Inc. in September 2018 to fund the purchase and rehabilitation of a building that Pittsburgh, Pittsburgh Urban Redevelopment Authority, and Pittsburgh Housing Authority will share. Due to the timing of the purchase, the city entered into this loan agreement; the three participants, however, will share the liability. Although an event of default could result in principal acceleration, we believe the events of default, including cross-default or credit deterioration to speculative grade, are remote given the city's credit profile. The city expects to take out this issue with the issuance of the series 2020A bonds. In addition, we believe Pittsburgh maintains sufficient liquidity to cover an acceleration if an event of default were to occur. The city does not have any exposure to other contingent liquidity risks or variable-rate debt or swaps, and we do not consider its investments aggressive. While there are outstanding swaps, they are associated with the Pittsburgh Water and Sewer Authority and not the city.

Given the potential shortfall due to revenue loss, the city's cash is likely to decline but we understand that it has a line of credit already authorized.

Very weak debt and contingent liability profile

In our view, Pittsburgh's debt and contingent liability profile is very weak. After these issues, its debt will total $463.1 million. Total governmental fund debt service was 9.2% of total governmental fund expenditures in fiscal 2019, now in line with its debt management policy affordability metrics, which limit debt to 12% of expenditures. The policy also requires tax-supported debt to remain below 3.5% of full taxable assessed value. Net direct debt is 72.6% of total governmental fund revenue. Approximately 72.8% of the direct debt will be repaid within 10 years, which is, in our view, a positive credit factor.

The city continues to work to lower its debt burden, and its 2019 total governmental debt service is down from 12.8%.

New issuances must be amortized at a rate of 60% within 10 years. Given these limitations, despite the city's planned new-money issuances of about $50 million a year in the near term, we do not expect material changes to Pittsburgh's improving debt profile. However, continued pressure from the city's pension obligations offsets these gains somewhat.

Pension and other postemployment benefits

- In our opinion, a credit weakness is Pittsburgh's large pension and OPEB obligation, with a funding plan that continues to evolve, but may not be sufficient to make what we view as significant funding progress in the near term.
- Although the city paid in excess of its ADC for the past three years, the fiscal 2019 contribution fell short of our minimum funding progress metric, although it did exceed static funding, indicating the city continues to make slow funding progress toward its liabilities.
- Furthermore, Pittsburgh largely funds postretirement medical benefits for eligible employees on a pay-as-you-go basis, which, given medical claims trends, will likely help cause contribution volatility. However, the city eliminated OPEBs for new hires, with only police and firefighters hired before 2005 eligible, which should mitigate liability growth, helping reduce these risks.

The city offers the following pension and OPEB benefits:

- A single-employer defined-benefit pension plan: 38.59% funded with a total net pension liability of $827.6 million
- A single-employer defined-benefit plan used to provide OPEBs: 5.87% funded with a net OPEB obligation of $437.8 million
- A single-employer defined-benefit plan used to provide OPEBs for firefighters: 0% funded with a net OPEB obligation of $24.4 million

Pittsburgh's combined required pension and actual OPEB contributions totaled 12.7% of total governmental fund expenditures in 2019. Of that amount, 8.3% represented required contributions to pension obligations, and 4.4% represented OPEB payments.

Given the plan's low funded ratio, we see additional risk of contribution volatility due to the 7.25% discount rate, which makes the plan's assets more vulnerable to market shock events. However, Pittsburgh's funding discipline should result in improvement in funded ratios over the next five years, helping mitigate this vulnerability, in part due to the plan's level-dollar closed amortization schedules, but also because of the city's intention to continue overfunding its ADC in the near term. The city made 187% of its annual required pension contribution in 2019.

The city's dedication of parking tax revenues ensures a continuous stream of funding for its pension obligations; however, they are insufficient to meet the plan's ADC, requiring additional payments from the city's general revenues that could vary depending on actual parking revenues realized. Dedicated parking revenues that fund a portion of the ADC are contributed based on prior-year collections; therefore, any reduction in parking revenues as a result of stay-at-home directives or social distancing to flatten the COVID-19 infection rate will not affect 2020 contributions. For more on pension plan liquidity pressures, see "Pension Brief: Liquidity Is A Rising Concern for U.S. Public Pensions in Down Markets," published March 24, 2020.

Although Pittsburgh splits its pension plan into three components for valuation and funding purposes, assets can pay benefits and expenses of any of the three plans without limitations; therefore, in accordance with generally accepted accounting principles (GAAP), the city is considered to be administering a single plan. In addition, for its valuations, it includes future parking tax revenues, which is not recognized as an asset under GAAP. While this improves actuarial funded ratios, we believe it could lead to underfunding of contributions. (For more on how we view asset transfers, see "Pension Brief: Are Asset Transfers A Gimmick Or A Sound Fiscal Strategy?" published Feb. 19, 2019.)

Adequate economy

We consider Pittsburgh's economy adequate, given our view of its underlying economic metrics and its role as the anchor of a broad and diverse MSA. The second-largest city in Pennsylvania, it has a population of 300,286. After decades of population declines, officials anticipate the first year-over-year increase in the coming year. The city benefits from the strong presence of medical and educational institutions. These include the University of Pittsburgh, University of Pittsburgh Medical Center, Carnegie Mellon University, Highmark Health, and Allegheny Health Network.

The city is experiencing expansions of startups and technology firms, including those involved in robotics, artificial intelligence, and autonomous vehicles. Apple, Facebook, and Google continue to expand their footprints there. These economic developments help offset the historically weaker demographics and contribute to improving economic indicators. The city has a projected per capita effective buying income of 99.9% of the national level and per capita market value of $65,737. Pittsburgh is in Allegheny County, which had an unemployment rate of 4.1% in 2019.

Overall, Pittsburgh's market value grew by 2.1% over the past year to $19.7 billion in 2020. Commercial growth continues throughout the city, with a 24.7% increase in building permits issued between 2014-2019. Major projects, including various market-rate and affordable housing projects, continue to add value to the city's tax base. Notable developments include redevelopment of the historic Smallman Street produce terminal and completion of redevelopment of Hazelwood Green, on Pittsburgh's last brownfield site. The city is creating bus rapid transit to connect downtown Pittsburgh with Oakland, expanding access to employment opportunities. Although our regional forecasts anticipate slow growth, we expect Pittsburgh will continue to demonstrate resilience given positive trends in its economic base.

Despite a history of stable growth and development, rapidly evolving economic conditions as a result of COVID-19 have already affected the labor market. We note the county unemployment rate of 13.1% as of May 2020 already far surpasses the peak during the last recession, when it approached 7.6% in 2010. Furthermore, the effects of social distancing and other decisions made to safeguard the community from the spread of COVID-19 support our view of an economic contraction in 2020. As a result, we will monitor the longer-term effects of the current downturn on the labor market and the economy overall.

Strong institutional framework

The institutional framework score for Pennsylvania cities is strong.

Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020

- Criteria Guidance: Assessing U.S. Public Finance Pension And Other Postemployment Obligations For GO Debt, Local Government GO Ratings, And State Ratings, Oct. 7, 2019
- Alternative Financing: Disclosure Is Critical To Credit Analysis In Public Finance, Feb. 18, 2014

Ratings Detail (As Of July 28, 2020)		
Pittsburgh GO		
Long Term Rating	AA-/Stable	Affirmed
Pittsburgh GO (BAM)		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed
Many issues are enhanced by bond insurance.		