FitchRatings

RATING ACTION COMMENTARY

Fitch Rates Pittsburgh, PA's GOs 'AA-'; Outlook Revised to Negative

Wed 29 Jul, 2020 - 11:25 AM ET

Fitch Ratings - New York - 29 Jul 2020: Fitch Ratings has assigned an 'AA-' rating to the following Pittsburgh, PA bonds:

--152 million unlimited tax general obligation (GO) refunding bonds, series A of 2020;

--$80.5 million in GO refunding bonds, series B of 2020.

Fitch has affirmed the following Pittsburgh ratings at 'AA-':

--$50 million GO bonds, series 2020;

--$104 million GO bonds, series 2012 A&B;

--$174 million GO pension bonds, series 1998C;

--Issuer Default Rating (IDR).

The Rating Outlook has been revised to Negative from Positive.

The series A bonds are being issued to refinance all or a portion of outstanding principal on series of 2018 bonds; the series B bond will refinance series of 2012A, series of 2012B and series of 2014. The bonds are expected to sell on Aug. 5, 2020.

SECURITY

The GO bonds are general obligations of the city to which the full faith, credit and taxing power of the city are pledged.

ANALYTICAL CONCLUSION

The revision of the Outlook to Negative from Positive reflects the uncertainty associated with the pandemic-related economic downturn. The city is anticipating significant revenue declines that Fitch believes might reduce the city's financial resilience and capacity to manage the current downturn and other fiscal pressures over time. The prior Positive Outlook reflected the improved economic conditions and financial resilience prior to the pandemic, which are now uncertain.

The 'AA-' GO ratings and IDR incorporate the city's very strong operating performance given its recent buildup of a high reserve cushion and significant independent legal ability to increase revenues. These strengths are offset to some degree by retiree benefit and other pressures that leave the city with just adequate ability to control spending and a pace of spending growth that will likely require ongoing budget management.

The city exited the Commonwealth's Fiscal Recovery Act (Act 47) in 2018 after 14 years, which had provided strong oversight and gave the city authority to significantly control expenditures. The city has since formalized many of the fiscal policies that were in place during the oversight period, and Fitch expects the city to continue its current strong financial management. The city is expected to utilize some of its reserves to address the current economic pressure; however Fitch believes that the city has the ability to rebuild reserves and continue to reduce its net pension obligations with supplemental contributions over time. The city's overall long-term liabilities are moderate compared to its economic resource base.

ECONOMIC RESOURCE BASE

The city of Pittsburgh is located in southwestern Pennsylvania where the Ohio, Monongahela and Allegheny rivers meet and serves as the Allegheny county seat. The city had a population of 300,296 in 2019, down close to 2% from the 2010 Census, and has below average wealth levels. Resident income and poverty measures remain weak; however, the city's median household income has increased at a rate that is roughly double the growth experienced within the state and the U.S. since the 2010 Census. The city has also seen an increase in educational attainment levels over the past decade, which has helped spur personal income growth and employment.

The city's tax base had historically been driven by manufacturing but has seen growth in healthcare, education, financial services and technology in recent years. The city is home to the University of Pittsburgh and Carnegie Mellon University, which are among the largest regional employers. Over the past 15 years, the presence of technology firms has more than doubled, resulting in approximately 2,400 firms that employ over 90,000 people according to the city. The city continues to experience significant growth in the technology sector and the city reports $550 million in private investment in 2018 primarily for autonomous vehicles and robotics firms. This comes after a reported record level of private investment for the city in 2017 ($688 million) including investments made by Google, Uber ATC, Amazon and Apple.

KEY RATING DRIVERS

REVENUE FRAMEWORK:

Ongoing diversification and growth of the economy is expected to support natural revenue growth above the rate of inflation. The city has significant independent legal ability to increase revenues within statutory limits.

EXPENDITURE FRAMEWORK:

Fitch expects continuing pressure from pension and other post-employment benefits (OPEB) to elevate the natural pace of revenue growth above increases in revenue. The city maintains adequate ability to control spending, primarily through its ability to control the size of its workforce, although carrying costs for debt service, pension and OPEB are elevated.

LONG-TERM LIABILITY BURDEN:

Fitch expects that long-term liabilities will remain moderate in relation to the city's economic resource base given rapid amortization of principal and an ongoing plan to improve pension funding.

OPERATING PERFORMANCE:

The city has superior gap closing capacity including strong available reserve balances in relation to historical revenue volatility, significant legal ability to increase revenues and adequate expenditure flexibility. Management has implemented a number of financial policies including multi-year budgeting and debt and fund balance policies to support long-term fiscal stability.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--A resumption of the expansion of the local economy driven in part by private investment;

--A reduction in fixed costs relative to governmental spending.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--The inability to regain the highest level of gap-closing capacity once the current economic downturn has subsided;

--An ongoing reversal in the trend of economic expansion of the local tax base that limits the city revenue growth prospects over time;

--A decrease in the city's expenditure flexibility over time, given management's needs to utilize spending cuts to mitigate the anticipated revenue shortfalls and other pandemic related spending pressures.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit [https://www.fitchratings.com/site/re/10111579].

CURRENT DEVELOPMENTS

Sector-wide Coronavirus Implications

The ongoing outbreak of coronavirus and related government containment measures worldwide creates an uncertain global environment for U.S. state and local governments and related entities in the near term. While the city's most recently available fiscal and economic data may not fully reflect impairment, material changes in revenues and expenditures are occurring across the country and likely to worsen in the coming weeks and months as economic activity suffers and public health spending increases. Fitch's ratings are forward-looking in nature, and Fitch will monitor developments in state and local governments as a result of the virus outbreak as it relates to severity and duration and incorporate revised expectations for future performance and assessment of key risks.

In its baseline scenario, Fitch assumes sharp economic contractions to hit major economies in 1H20 at a speed and depth that is unprecedented since World War II. Sequential recovery is projected to begin from 3Q20 onward as the health crisis subsides after a short but severe global recession. GDP is projected to remain below its 4Q19 level until mid-2022. Additional details, including key assumptions and implications of the baseline scenario and a downside scenario, are described in the report entitled, "Fitch Ratings Coronavirus Scenarios: Baseline and Downside Cases - Update" (https://www.fitchratings.com/site/re/10120570), published April 29, 2020 on www.fitchratings.com.

As is the case with most cities, Pittsburgh has experienced significant economic and financial impacts associated with the pandemic including sharp revenue shortfalls. Pennsylvania's governor proclaimed a public health emergency on March 6 and subsequently ordered all non-life sustaining businesses and schools in seven counties including Allegheny County to close on March 19. The state also extended the deadline for personal income tax payments to July 15 from the original due date of April 15 and more recently extended unemployment benefits for 13 weeks starting July 4. On April 20, Mayor Peduto disclosed that the city of Pittsburgh could suffer more than a 20% or $127 million shortfall in projected revenues for fiscal 2020. More recently, management reports that revenue shortfalls may be less severe than the original projection based on more current estimates but continues to use a 20% revenue decline as the worst case scenario. Fitch believes that the city will adjust spending in response to the estimated revenue shortfall but also believes that reductions in the current fiscal year will be more difficult as the year goes on.

Budget Impacts of the Pandemic

Management continues to monitor revenue collections and is in the process of compiling second quarter results, which are expected to provide more clarity on estimated year-end results. Based on first quarter collections (through March 31), the city estimates the largest revenue declines will be in parking taxes, with a variance from budget of $24 million or -40.8%, followed by a $15 million shortfall (-82.3%) in amusement taxes, and $5.4 million (-3.6%) in property taxes. The city anticipates that income tax collections will likely track budgeted estimates for the year despite the state approved payment delays. Fitch believes this assumption may be optimistic given the significant increases in unemployment rates.

Management attributes a major portion of the amusement and parking revenue shortfall to the cancellation of profession sports events, concerts and other large events including the cancellation of the scheduled National Hockey League games, a limited schedule of Major League Baseball games and reduced demand for parking services given the large numbers of people working remotely. Under Act 44, the city is required to make a $26.7 million pension contribution from an irrevocably dedicated stream of parking tax revenues, but in the event parking revenues are insufficient, the city is required to pay from other available sources. The city collected $11.6 million in parking taxes from Jan. 1 through March 31.

The city has taken steps to mitigate the revenue shortfalls by reducing expenditures through a general hiring freeze and with other savings associated with the stay at home orders including facilities savings. The city's year-end spending estimates based on first quarter results reflected a $21 million reduction with a large portion from employee salary and benefits associated with a hiring freeze. The city has also proposed a 10% reduction to all departmental discretionary spending and is looking at the potential of reducing or eliminating non-essential programs and delaying up to $9 million in cash funded capital projects budgeted for 2021. The current debt offering is a refunding of outstanding debt that is expected to provide over $10 million in debt service savings in the current year, with no extension in maturity. The city anticipates a total of $7.63 million in CARES Act funding from Allegheny County to offset a portion of pandemic related expenditures.

FAST Analysis and Financial Resilience

Fitch's baseline and downside scenarios reflect potential revenue declines in year 1 of 8% and 15.6%, respectively, although declines could be significantly higher based on actual results since the shut-down began. The Fitch Analytical Stress Test (FAST) scenario analysis tool, which relates historical tax revenue volatility to GDP to support the assessment of operating performance under Fitch's criteria, has been adjusted to reflect GDP parameters consistent with Fitch's global coronavirus forecast assumptions. FAST is not a forecast, but it represents Fitch's estimate of possible revenue behavior in a downturn, based on historical revenue performance.

The city improved its financial resilience during the recent economic recovery with available general fund balance of $146.6 million, 25.7% of general fund spending at the end of 2019, reflecting a $20.7 million operating surplus. The total government-wide cash on hand covers over five month of city spending; although, the city has the authority to issue tax anticipation notes and a line of credit in the event it needs to bolster cash balances throughout the fiscal year. Management is working to minimize the use of reserves to stay within it fund balance policy. When Pittsburgh regained fiscal independence after exiting the Commonwealth's Act 47 oversight in 2018, it formalized financial policies including a policy to maintain available general fund reserves of at least 10% of general fund spending within the five-year plan. Fitch believes that the city will be challenged in the medium term to maintain the

10% available fund balance policy in the absence of significant spending reductions or tax rate increases. The city does maintain significant independent legal ability to increase property taxes.

CREDIT PROFILE

Pittsburgh's largest employers are dominated by healthcare including University of Pittsburgh Medical center, which employees 53,000 and Highmark Health with 21,251 employees and city is also home to the University of Pittsburgh. The city continues to face challenges associated with modest population decline and comparatively weak income measures. Unemployment rates are generally in line with the state; however, educational attainment exceeds the state and national averages. The city's tax base remained relatively stable during the prior economic downturn evidenced by slow and steady growth in taxable assessed values (TAV) prior to 2012. More recently, the average annual increase in TAV was 2% from fiscal 2015 through fiscal 2019 (Dec. 31 year-end).

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

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

The highest level of ESG credit relevance, if present, is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity(ies), either due to their nature or to the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY/DEBT	RATING			
Pittsburgh (PA)	LT IDR	AA- Rating Outlook Negative	Affirmed	
• Pittsburgh (PA) /General Obligation - Unlimited Tax/1 LT	LT	AA- Rating Outlook Negative	Affirmed	

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

U.S. Public Finance Tax-Supported Rating Criteria (pub. 27 Mar 2020) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

FAST States & Locals - Fitch Analytical Stress Test Model, v2.4.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Pittsburgh (PA)	EU Endorsed

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