FitchRatings

RATING ACTION COMMENTARY

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

Thu 18 Feb, 2021 - 5:14 PM ET

Fitch Ratings - New York - 18 Feb 2021: Fitch Ratings has assigned a 'AA-' rating to the following Pittsburgh, PA bonds:

--$55 million GO bonds, series of 2021.

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

--$152 million unlimited GO refunding bonds, series A of 2020;

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

--$50 million GO bonds, series 2020;

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

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

--Issuer Default Rating (IDR).

The Rating Outlook is Negative.

Feedback

The series of 2021 bonds are being issued to provide funding for eligible capital projects included in the city's six-year capital improvement plan (CIP) for 2021-2026. The bonds are expected to sell on March 2, 2021.

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 'AA-' GO ratings and IDR incorporate the city's very strong operating performance as evidenced by the recent buildup of a high reserve cushion and its significant independent legal ability to increase revenues. These strengths are offset to some degree by retiree benefit and other expenditure 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's overall long-term liabilities are moderate compared to its economic resource base.

The Negative Outlook reflects Fitch's belief that the city may be challenged to rebuild reserves that are needed to offset near-term revenue declines sufficiently to maintain its high level of fundamental financial flexibility.

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 officials report that as of September 2020, over $9.1 billion worth of private investments have either been completed, in process or announced over the last decade including a record level of investment of $688 million in 2017 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 ongoing budgetary flexibility. .

RATING SENSITIVITIES

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

--Indications that economic development will continue to result in solid revenue growth once the pandemic-related disruption has subsided could result in a return to a Stable Rating Outlook.

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

--Failure to implement available policy measures that offset risks associated with a return to economic contraction consistent with Fitch's coronavirus downside scenario, resulting in an erosion of the city's superior gap-closing capacity.

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

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].

Feedback

CURRENT DEVELOPMENTS

Sector-wide Coronavirus Implications

The outbreak of coronavirus and related government containment measures worldwide has created an uncertain global environment for U.S. state and local governments and related entities. Fitch's ratings are forward-looking in nature, and Fitch will monitor the severity and duration of the budgetary impact on state and local governments and incorporate revised expectations for future performance and assessment of key risks.

While the initial phase of economic recovery has been faster than expected, GDP in the U.S. is projected to remain below its 4Q19 level until at least 3Q21. In its baseline scenario, Fitch anticipates a slower recovery in early 2021 with vaccine rollout to vulnerable, key workers and older individuals in 1H21, but limited for most of the population until late 2021. Additional details, including key assumptions and implications of the baseline scenario and a downside scenario, are described in the report "Fitch Ratings Coronavirus Scenarios: Baseline and Downside Cases - Update," published on Dec. 7, 2020, and "Fitch Ratings Updates Coronavirus Scenarios for U.S. State and Local Government," published on Dec. 16, 2020 on www.fitchratings.com.

Pittsburgh Coronavirus Impacts

As is the case with most cities, Pittsburgh has experienced significant economic and financial impacts associated with the pandemic, including sharp revenue shortfalls. In the spring after the state ordered non-life sustaining businesses and schools to close for a period of several month, the city originally projected a significant revenue shortfall of up to $127 million, more than 20% under budget. Year-end unaudited revenue estimates indicate that general fund revenues including earned income taxes, performed better than expected. Unaudited year end results indicate that the total revenue shortfall was $56.6 million, or 10% of budget. Management attributes the less severe earned income tax collections to the city's institutional presence -- including healthcare and higher education -- which did not report significant employee reductions. The city also made spending adjustments, which resulted in positive expenditures results that were roughly 4% under budget. The savings were primarily derived from a hiring freeze, a ban on employee travel, deferring or canceling various projects, and a bond refunding. The city estimates that 2020 will end with a $44.6 million use of general fund balance.

Feedback

The city's real estate and deed transfer taxes saw growth of 3.97% and 25%, respectively, based on 2020 unaudited results, reflecting the strength of the local tax base. However, parking taxes had an estimated 43% budget shortfall, followed by amusement taxes that came in at just 21% of budgeted projections. 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 given the large numbers of people working remotely. Under Act 44, state legislation mandating that the city improve pension funding levels, the city adopted a funding plan. The plan includes a requirement to make a $26.7 million pension contribution from an irrevocably dedicated stream of parking tax revenues. In in the event parking revenues are insufficient, the city is required to pay from other available sources. The city collected sufficient parking revenue to make the dedicated pension payment in 2020.

The 2021 budget assumes a 3.35% overall budget increase from 2020 estimated actual spending, reflecting a modest recovery and elimination of all vacant positions. The city also held all non-union salaries flat and cut 10% from the non-essential or non-contractual spending in each year through 2025. The city passed an ordinance to temporarily decrease its minimum general fund balance requirement of at least 10% of budgeted expenditures on a budgetary basis, established when Pittsburgh regained fiscal independence after exiting the Commonwealth's Act 47 oversight in 2018. The city's five-year budget through 2025 assumes general fund surpluses from 2022 through 2024 to replenish reserves to the formal policy level.

The city improved its financial resilience during the recent economic recovery with available general fund balance of $146.6 million on a GAAP basis, 25.7% of general fund spending at the end of 2019. 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.

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. 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. More recently, taxable assessed value (TAV) grew by a very strong 7.6% from 2020 to 2021 reflecting growth and resilience in the local economy.

REVENUE FRAMEWORK

Approximately 54% of budgeted general fund revenue is derived from multiple sources of local taxes including property, earned income, parking, and payroll taxes in 2020 (on total budgeted revenue of approximately $608.2 million). Other sources of revenue include fines, fees and charge for services, which account for 11%. Intergovernmental revenue accounts for 7%, including $10 million in guaranteed gaming revenues from the state.

Fitch expected revenue growth to exceed the rate of inflation as it has over the decade ending 2019. Property tax growth is expected to exceed inflation based on recent economic development activities. Prior to the pandemic, the city had seen earned income taxes rise at a pace that exceeded inflation, driven by income growth and the job diversification. This trend is expected to continue as the economy recovers given the continued investment in the local economy.

The city has the independent legal ability to levy taxes up to 40 mills on AVs for general operating purposes. The 2021 operating tax rate is 8.06 mills, which leaves significant margin to raise general fund revenue as necessary.

City Council passed a resolution in December 2020 to create a Parks Trust Fund, funded with a voter approved 0.50 mills tax levy, which is expected to yield $10 million annually.

EXPENDITURE FRAMEWORK

The largest general fund expenditure items include public safety, which accounts for over 65% of spending, followed by general government, which account for 18% in 2019.

Fitch believes the natural pace of spending growth will remain above expected revenue growth absent offsetting policy action. Management believes that future salary increases will approximate the rate of inflation, although employee benefit costs, including pension and OPEB costs, are expected to increase at a faster rate.

Carrying costs for debt service, required pension contributions and OPEB costs have moderated in recent years given the sharp decline in the debt service schedule. Debt service costs declined below 10% of governmental spending in 2019. The city will maintain annual debt service costs below 12% of annual operating expenditures through 2024, which is in line with its formal debt policy of 12%.

Under Act 47, the city was under state oversight which provided management strong control over allowable cost increases for all labor contracts, requiring salary increases to remain under certain financial caps. Despite losing the protections of Act 47, Fitch believes that the city maintains adequate ability to manage operating costs by controlling the size of its workforce. In the event of budgetary shortfalls, the city has the capacity to make staffing adjustments while maintaining most city services and reduce the amount of cash funded capital. The city budgeted $5.5 million in pay go capital in 2021, approximately 1% of budgeted general fund expenditures.

LONG-TERM LIABILITY BURDEN

The long-term liability burden, including the current bond offering, overall outstanding debt and NPL, is moderate at approximately 13% of personal income. The largest component of the metric is the NPL, which account for 52% of the total long-term liability burden. The city's direct debt (20.6% of the liability) is expected to decline slightly based on the city's future borrowing plans and rapid amortization of outstanding principal (82.3% paid within 10 years), Debt plans include issuing between $35 million to $60 million in general obligation debt annually through 2025.

The city maintains single-employer defined benefit pension plans for non-uniformed employees, police, and fire. The net pension asset to liability ratio for all three plans combined was a very low 32.4% based on Fitch's standard 6.0% rate of return assumption as of Dec. 31, 2019. The city was required by the state to reach at least a 50% funding level by Dec. 31, 2010 to avoid having the city's plans merged into the state's pension system, the Pennsylvania Municipal Retirement System. The city was able to comply with this requirement by transferring $45 million into the pension trust and dedicating future parking tax revenues for future pension contributions through council legislation. The future parking revenues do not meet the criteria for the recognition as an asset on the city's audited financial statements; however, the state recognized the future revenues as an actuarial asset in its calculation of the required funding levels and the city avoiding a state take over.

The dedication of the parking tax is irrevocable, and should revenue be insufficient, the city is still obligated to make the supplemental payments from other legally available resources. Currently, the city's pension funding plan requires a $26.8 million supplemental contribution (5.6% of governmental spending) from parking taxes in 2021 through 2041, in addition to its statutorily required contribution. The city is considering extending the plan beyond 2041 to boost the pensions actuarial assets over the long term.

OPERATING PERFORMANCE

Fitch believes the city will maintain superior financial resilience throughout moderate economic cycles given its solid available reserves and significant independent legal ability to increase revenues. The strength of the city's inherent budget flexibility and financial reserves are considered in relation to expected revenue volatility during an economic downturn. and Fitch believes management will take significant action to comply with its fund balance policy including using its legal ability to increase revenues.

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

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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

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

RATING ACTIONS

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

VIEW ADDITIONAL RATING DETAILS

FITCH RATINGS ANALYSTS

Shannon McCue
Director
Primary Rating Analyst
+1 212 908 0593
Fitch Ratings, Inc.
Hearst Tower 300 W. 57th Street New York, NY 10019

Michael Rinaldi
Senior Director
Secondary Rating Analyst
+1 212 908 0833

Amy Laskey
Managing Director

Feedback

Committee Chairperson
+1 212 908 0568

MEDIA CONTACTS

Sandro Scenga
New York
+1 212 908 0278
sandro.scenga@thefitchgroup.com

Additional information is available on www.fitchratings.com

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

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US Public Finance   Infrastructure and Project Finance   North America   United States

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