S&P Global Ratings

RatingsDirect®

Summary:

Pittsburgh; General Obligation

Primary Credit Analyst:
Tiffany Tribbitt, New York + 1 (212) 438 8218; Tiffany.Tribbitt@spglobal.com

Secondary Contact:
Moreen T Skyers-Gibbs, New York + 1 (212) 438 1734; moreen.skyers-gibbs@spglobal.com

Table Of Contents

Summary:

Pittsburgh; General Obligation

Credit Profile		
US$55.0 mil GO bnds ser 2021 due 09/01/2041		
Long Term Rating	AA-/Stable	New
Pittsburgh GO (FGIC) (MBIA) (National)		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed
Pittsburgh GO		
Long Term Rating	AA-/Stable	Affirmed
Pittsburgh GO (BAM)		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.

Rating Action

S&P Global Ratings assigned its 'AA-' long-term rating to Pittsburgh's $55 million series 2021 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, which will fund various planned capital needs.

Credit overview

Overall, we believe the financial progress made by Pittsburgh prior to the recent recession positioned the city well to absorb the negative effects of the pandemic while maintaining operations. Pittsburgh used reserves in 2020 to cover revenue losses and increased expenses without major service disruptions. City council passed an ordinance allowing reserves to fall below the 10% minimum target, with a restoration plan in place to return reserves to previous levels by 2024. The 2021 budget reflects revenues in line with 2020 levels, which overall were about 7% lower than 2019. Pittsburgh's 2021 budget used revenue projections based on 2020 estimated revenues and reduced general fund expenditures by 6.3%, with further savings identified to close any budget gap generated by falling revenues or insufficient federal aid. Given an improving revenue environment and current federal aid proposals, combined with the city's commitment to make expenditure reductions if needed, we do not expect the city's finances will weaken significantly in 2021, and we believe reserves could even improve by year end. Notably, the city maintained its commitment to overfunding its required pension contributions despite the budget challenges presented by the pandemic, which we view positively given the low funded ratios in the plans that remain a credit weakness.

Located within 500 miles of half the population of the U.S., Pittsburgh remains the economic center of western Pennsylvania. Throughout the pandemic, its major revenue sources remained strong. Economic development projects continue, and we expect the city's robust financial management policies and practices will continue to support balanced operations during this credit event. For these reasons, we expect the rating will remain stable in the near term.

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, but weaker 2020 results expected;
- 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 that we consider strong;
- Very weak debt and contingent liability profile, with about $482 million of net direct debt and a large pension and other postemployment benefits (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 74.0% of total governmental fund revenue, but amortization is rapid, with 71.9% of debt scheduled to be retired in 10 years;
- Adequate 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. The city maintains a climate action plan, focused on how it can reduce greenhouse gas emissions. It is on track to complete related capital investments by 2025 and already generates significant energy savings because of investments and cooperative agreements. The plan works in tandem with the city's resilience strategy--One PGH--that is the city's holistic approach to identifying the root causes of systemic social challenges, including affordable housing and income inequality, to find solutions for all its residents. From a governance perspective, the city's actions in 2020 demonstrate its ability to proactively update policies to meet emerging challenges. 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

Should budgetary pressures cause a deterioration of reserves or liquidity without what we view as sufficient measures to restore reserves, we could take a negative rating action. Furthermore, if the city deviates from its plans to improve the long-term sustainability of its pension plans, resulting in possible plan liquidity risk, it could pressure 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 7% 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, given our expectation that 2020 results will weaken compared with 2019, and that the pandemic will continue to be a source of budgetary pressure in the near term. The expected 2020 deficit follows four-consecutive surpluses, most recently in 2019, which ended with operating surpluses of 3.8% of expenditures in the general fund and 5.6% across all governmental funds.

2020 will end with a reserve draw of about $16.8 million based on preliminary numbers or about 3% of unadjusted expenditures, given significant revenue losses. The city did offset some of these losses with expenditure reductions and federal aid including about $6.2 million in COVID-19 relief.

The city passed a balanced budget for 2021 that includes 10% non-essential or non-contractual spending cuts in all departments, elimination of vacant positions, and holding non-union wages flat. Furthermore, officials have identified additional reductions to close any emerging budget gaps including layoffs scheduled for July 1, 2021, if federal funds fall short of budgeted needs. Given this, and the city's commitment to restoring its reserve levels, we expect performance will improve in the near-term.

Pittsburgh benefits from a diverse and largely stable revenue mix. Major sources in 2019 include:

- Real estate taxes (30%);
- Earned income taxes (23%);
- Payroll preparation taxes (14%);
- Parking taxes (13%); and
- Amusement and facility usage taxes (4%).

Although most of these revenues remained stable despite recessionary pressures, Pittsburgh experienced major declines compared with the budget in its amusement, facility usage, and parking taxes of, 79%, 39%, and 43%, respectively. Despite the shortfall in parking revenues, which are partially dedicated to pension funding, the city made its full funding contribution as planned in 2020 and it expects to continue doing so even if parking revenues fall short of expectations.

Increased overtime, particularly in public safety, drove the largest increase in 2020 expenditures. This was due both to COVID-19-related absences, and additional staffing needs for civil unrest and protests. However, we expect most of these costs will be offset by increased federal aid. Given our expectations that the city will continue to make necessary adjustments to maintain balanced operations, we do not expect performance will deteriorate significantly in the near term.

Strong budgetary flexibility

Pittsburgh's budgetary flexibility is strong, in our view, with an available fund balance that we expect will 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. The city preliminary expects reserves will end at about 8% of expenditures on a budgetary basis for 2020.

City officials chose to use reserves to offset the one-time budgetary challenges created by the pandemic. Given this would cause the city to fall below its 10% reserve target, officials revised Pittsburgh's reserve policy, allowing the city to temporarily reduce reserves to no less than 7% of the budget, with a requirement to increase reserves by at least 1% annually until the city returns to its 10% policy level. Given the city's proactive budget management, we expect it will adhere to these plans, however, should the city fail to do so we could alter our view of Pittsburgh's flexibility and management policies.

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. Our analysis excludes funds in accounts we view as restricted. The city hasn't experienced significant delays or issues with its cash flows despite the challenges of the pandemic. Pittsburgh has strong access to external liquidity if necessary, as demonstrated by GO debt issuances in the past 20 years. The city does not have variable-rate or swap exposure, and no longer has any privately placed debt.

Very weak debt and contingent liability profile

In our view, Pittsburgh's debt and contingent liability profile is very weak. 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.

As part of its financial recovery, the city committed to lowering its fixed costs and implemented debt policies to maintain lower fixed costs. Given these limitations, despite the city's planned new-money issuances of about $50 million a year in the near term. However, continued pressure from the city's pension obligations offsets these gains somewhat.

Pension and other postemployment benefits (OPEB)

- In our opinion, a credit weakness is Pittsburgh's large pension and OPEB obligation, with a funding plan that continues to evolve, but might not be sufficient to make what we view as significant funding progress in the near term.
- Pittsburgh continues to make slow funding progress toward its liabilities, as demonstrated by the fiscal 2019 contribution exceeding static funding but falling short of our minimum funding progress metric.
- Furthermore, Pittsburgh largely funds postretirement medical benefits for eligible employees on a pay-as-you-go basis, which, given medical claims trends, will likely 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, although the plan did not experience any liquidity pressures in 2020. (For more, see "Pension Brief: Liquidity Is A Rising Concern for U.S. Public Pensions in Down Markets," published March 24, 2020, on RatingsDirect.)

Pittsburgh's funding discipline should result in improvement in funded ratios over the next five years, partially due to the plan's level-dollar closed amortization schedules, but also because of the city's intention to continue overfunding its actuarially determined contribution (ADC) in the near term. The city made 187% of its annual required pension contribution in 2019, funded above the ADC in 2020, and plans to do so in 2021 despite budgetary pressures caused by revenue reductions. Furthermore, the city makes its contributions quarterly, allowing it to spread risk and realize additional investment gains. The city dedicates its parking revenues to pension funding; however, officials will provide general fund support to cover any shortfalls.

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, Pittsburgh 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 city has a projected per capita effective buying income of 98.8% of the national level and per capita market value of $64,978. The second-largest city in Pennsylvania, it has a population of 303,796. 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. This helps to stabilize employment; the city's unemployment rate is 6.5%, significantly lower than its April 2020 peak of 15.2%. County unemployment averaged 9.1% in 2020.

Overall, Pittsburgh's market value grew by 2.1% over the past year to $19.7 billion in 2020. Officials report projects continue despite the financial and physical challenges presented by the pandemic. Furthermore, while some commercial space in the city's downtown region is not being released, some spaces are already being converted into residential properties, demonstrating a potential resiliency to changing demands. However, we still anticipate slow growth in 2021 and continued pressure from elevated unemployment levels through 2023 (for more, see "Staying Home for the Holidays," published Dec. 2, 2020).

Strong institutional framework

The institutional framework score for Pennsylvania cities is strong.

Related Research

- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- 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
- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020
- 2020 Update Of Institutional Framework For U.S. Local Governments