FitchRatings

Fitch Affirms Pittsburgh, PA's GOs and IDR at 'AA-'; Outlook Stable

Fitch Ratings-New York-05 April 2018: Fitch Ratings has affirmed the following Pittsburgh, PA (the city) ratings at 'AA-':

--$104 million general obligation (GO) series 2012 A&B;
--$174 million GO pension bonds, series 1998C;
--Issuer Default Rating (IDR).

The Rating Outlook is Stable.

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 improved operating performance, including its exceptionally strong ability to manage through downturns given a solid reserve cushion and significant independent legal ability to increase revenues. These strengths are offset to some degree by retiree benefit and other spending pressures that leave the city with just adequate ability to control spending and a pace of spending growth that is likely to be above that of slow-growing revenues, requiring ongoing budget management. The city recently exited the Commonwealth's Fiscal Recovery Act (Act 47), which provided strong state oversight and significant control over expenditures. Despite the absence of state oversight, Fitch believes that Pittsburgh is well positioned to manage its budget in line with the current rating level. The city's overall long-term liability burden is 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, with a population of 303,625 in 2016, has below-average wealth levels;

however, the city has seen an increase in educational attainment levels over the past decade. 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 reports a record level of private investment in 2017 including investments made by Google, Uber ATC, Amazon, and Apple.

KEY RATING DRIVERS

Revenue Framework: 'aa'
Fitch expects natural revenue growth to remain in line with the rate of inflation based on modest growth within the local economy. The city has significant independent legal ability to increase revenues.

Expenditure Framework: 'a'
The natural pace of expenditure growth is expected to be above revenue growth prospects. The city maintains adequate ability to control spending, although carrying costs for debt service, pension and OPEB are high.

Long-Term Liability Burden: 'aa'
Fitch expects that the long-term liability burden 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: 'aaa'
The city has exceptionally strong 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
Expenditure Growth: The city is vulnerable to expenditure increases given the high carrying costs for debt and pensions and other operating expenditure pressures. The rating is sensitive to the city's ability to maintain expenditure growth in line with modest natural revenue growth through budget management.

Net Pension Liability: Fitch expects the city to continue diverting dedicated parking tax revenue to make extra payments and improve the pension systems' net assets to liabilities ratios pursuant to the city's pension funding plan. The rating is sensitive to the city's ability to minimize future growth in the net pension liability.

CREDIT PROFILE

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. The TAV increased by 48% in 2013 after a reassessment reflecting significant economic development activity within the local economy, then fell by 8% in 2014. More recently, TAV grew by more than 3% in 2016. Wealth levels have improved in recent years but still remain below state and national averages. Unemployment rates are generally in line with the state rates; however, educational attainment exceeds the state and national averages.

Revenue Framework
Almost 80% of general fund revenue is derived from multiple sources of local taxes including property, earned income, parking, payroll and local service taxes. Other sources of revenue include fines, fees and charge for services, which account for 10%. Intergovernmental revenue accounts for 10%, including $10 million in guaranteed gaming revenues from the state.

Fitch expects revenue growth to remain in line with the rate of inflation as it has over the past decade. Property tax growth is expected to track inflation based on estimated average annual growth in TAV over the next four years. Earned income and deed transfer taxes exceeded the rate of inflation in fiscals 2015 and 2016 driven by job growth and improvements in the city's real estate market.

The city has the independent legal ability to levy taxes up to 40 mills on assessed values for general operating purposes. The 2016 operating tax rate is 8.06 mills, which leaves significant margin to raise general fund revenue as necessary. The city has no plans to increase the property tax rate at this time.

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 over 17%.

Fitch believes the natural pace of spending growth will remain above the expected revenue growth prospects absent offsetting policy action. Management believes that future salary increases will remain in line with 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 are above average; however, Fitch believes the costs will remain relatively stable given the sharp decline in the debt service schedule. Debt service costs have historically been high but are expected to decline below 10% by 2019. The five-year plan maintains debt service spending at 10% of expenditures through 2022. Pension contributions are expected to increase in the near term as the city increases its contributions from parking tax revenues.

Under Act 47, management was granted strong expenditure controls including commonwealth oversight 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 and reducing annual cash-funded capital spending in the event of a revenue shortfall. The 2018 budget appropriates $26 million for capital projects, which accounted for 5% of budgeted expenditures.

Long-Term Liability Burden
The long-term liability burden, including overall debt and net pension liability, is moderate at approximately 14% of personal income. The largest components are the net pension liability and overlapping debt, which account for 51% and 29%, respectively. The city's direct debt (20% of the liability) is expected to decrease given limited future borrowing plans and a rapid rate of amortization with 87% of principal paid within 10 years.

The city maintains three single-employer defined benefit pension plans for non-uniformed employees, police, and fire, respectively. The net pension asset to liability ratio for all three plans combined was a very low 28% at a Fitch-adjusted 6% rate of return as of Dec. 31, 2016. 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 financial statements; however, the state did consider the revenues an actuarial asset for the purpose of meeting the required funding levels and 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 payments. Currently, the city's pension funding plan requires a $26.8 million contribution from 2018 through 2041. The city is considering extending the plan beyond fiscal 2041 to support long-term fiscal stability.

Operating Performance
Fitch believes the city would maintain exceptionally strong financial resilience throughout economic cycles given its solid available reserves and significant independent legal ability to increase revenues. The Fitch Analytical Sensitivity Tool indicates that the city's general fund revenues demonstrated very little revenue volatility throughout economic downturns based on historical results. Available general fund reserve levels were $101 million at the end of 2016, over 19% of general fund expenditures. Estimated 2017 results indicate the unrestricted general fund reserves will be approximately $102 million, equivalent to almost 20% of general fund expenditures.

On Feb. 16, 2018, Pittsburgh regained fiscal independence after exiting the Commonwealth's Act 47 oversight. The city had operated as a 'distressed municipality' under Act 47 for 14 years beginning in 2003. Under the Act, the Commonwealth established a fiscal oversight authority, the Intergovernmental Cooperation Authority (ICA) in 2004 to oversee and approve the city's budget and multi-year financial planning, which is expected to be disbanded later this year. In preparation for the exit from Act 47, the city formalized many of the practices used through the recovery period including maintaining available general fund reserves of at least 10% of general fund spending within the five-year plan, with a target of between 12.5% and 16.7%. Other formalized policies include minimizing annual debt service costs to 12% of operating expenditures and fully funding actuarially calculated required pension contributions.

The 2018-2022 Five-Year Plan assumes modest revenue growth and fully funds the annual actuarially calculated required pension contributions. The plan also assumes additional supplemental pension contributions up to $5 million and increased funding for cash-funded capital projects. Fitch believes the city will maintain stable financial operations if management continues to adhere to its multi-year financial forecast including minimizing its future long-term liability burden and reducing total carrying costs through the rapid amortization of existing debt and improving the pension funding.

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

Applicable Criteria
U.S. Public Finance Tax-Supported Rating Criteria (pub. 03 Apr 2018) (https://www.fitchratings.com/site/re/10024656)

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