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Ratings

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Summary:

Pittsburgh; General Obligation

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Credit Profile		
US$50.0 mil GO bnds ser 2020 due 02/01/2039		
Long Term Rating	AA-/Stable	New
Pittsburgh GO (FGIC) (MBIA) (National)		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed

Rationale

S&P Global Ratings assigned its 'AA-' rating to Pittsburgh's series 2020 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.

Security and use of proceeds

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 approximately $50 million in proceeds will fund various capital projects, in accordance with the city's capital improvement plan.

Credit overview

Located within 500 miles of half the population of the United States, Pittsburgh continues to be 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 during state oversight would be maintained. As a result, Pittsburgh's financial position is strong, 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 rating reflects our opinion of the city's:

- Very strong management, with strong financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Strong budgetary performance, with slight operating surpluses in the general fund and at the total governmental fund level in fiscal 2018;
- Strong budgetary flexibility, with an available fund balance that we expect will decrease in the near term from its fiscal 2018 level of 23% of operating expenditures;
- Very strong liquidity, with total government available cash at 15.7% of total governmental fund expenditures and 122.1% of governmental debt service, and access to external liquidity we consider strong;
- Very weak debt and contingent liability profile, with about $466 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 12.8% of expenditures and net direct debt is 73.3% of total governmental fund revenue, but amortization is rapid, with 72.9%

of debt scheduled to be retired in 10 years;

- A growing economy, anchoring a broad and diverse metropolitan statistical area (MSA), with overall economic factors we view as adequate ; and
- Strong institutional framework score.

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.

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 the city 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, in order to find solutions for all of its residents. From a governance perspective, we believe the city's 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 Pittsburgh's actions on these ESG items as a positive indicator that management is working to address evolving risks.

Strong budgetary performance

Pittsburgh's budgetary performance is strong, in our opinion, with three consecutive surpluses, and another expected for fiscal 2019. Officials balanced the fiscal 2020 budget without using reserves and with no rate increases for major tax revenues. The 2020 budget anticipates revenue increases of 2.6%, a conservative estimate given the 4% increase experienced in fiscal 2019. The budget is largely in line with fiscal 2019 while continuing to support city initiatives;

however, the budgeted surplus is smaller, mainly due to an extra pay period occurring this year. The 2020 budget includes funding for a new tax revenue collection system, which officials anticipate will improve collection rates.

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 actuarially determined contribution (ADC), which is in excess of the minimum municipal obligation (MMO).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.

The city had slight operating surpluses of 0.6% of expenditures in the general fund and of 0.8% across all governmental funds in fiscal 2018 after adjustments to account for recurring transfers. Officials made significant adjustments to the budget to achieve structural balance, and continue to find savings to promote budgetary balance. Pittsburgh's comprehensive debt and capital planning focuses on meeting the city's 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 2018 to fiscal 2019, a savings of about $25 million.

Real estate taxes generated 25.7% of fiscal 2018 general fund revenue, earned income taxes accounted for 17.4%, payroll preparation taxes accounted for 11.5%, and parking taxes accounted for 9.4%. The city received about $13.5 million in annual gaming revenue from the commonwealth for its share of the 2% local slots revenue. While federal and commonwealth grants collectively account for less than 1% of revenue, the city and its agencies receive significant support from commonwealth and federal governments.

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 pay-as-you go capital transfers. Pittsburgh's available reserves were 23% of operating expenditures, or $124.0 million, at the end of fiscal 2018. Given the city's strong performance, its reserves continue to grow. However, the city's five-year financial forecast reflects a fund balance more in line with the 10% reserve policy after transferring for capital spending. 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. Given our expectation the city will continue to maintain balanced operations and remain in compliance with its reserve policy, we do not foresee any material changes to our view of Pittsburgh's budgetary flexibility.

Very strong liquidity

In our opinion, Pittsburgh's liquidity is very strong, with total government available cash at 15.7% of total governmental fund expenditures and 122.1% of governmental debt service in 2018. 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.. 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.

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 12.8% of total governmental fund expenditures in fiscal 2018, and net direct debt is 73.3% of total governmental fund revenue. Approximately 72.9% 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, with 2019 debt service expected to be about 9.17% of unadjusted expenditures. This will bring Pittsburgh 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. 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 offset 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.

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.

Although the city paid in excess of its ADC in fiscal years 2018 and 2019, the fiscal 2018 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.

The city offers the following pension and OPEB benefits:

- A single-employer defined benefit pension plan: 31.82% funded with a total net pension liability of $918.45 million
- A single-employer defined benefit plan used to provide OPEB: 4.85% funded with a net OPEB obligation of $408.1 million.

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, the city 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, on RatingsDirect).

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 to 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 174% of its annual required pension contribution in 2018.

Pittsburgh largely funds postretirement medical benefits for eligible employees on a pay-as-you-go basis, which given medical claims trends, will likely contribute to contribution volatility. However, the city eliminated OPEB for new hires, with only police and firefighters hired before 2005 eligible, which should mitigate liability growth, helping to reduce these risks. Pittsburgh's combined required pension and actual OPEB contributions totaled 12.1% of total governmental fund expenditures in 2018. Of that amount, 7.9% represented required contributions to pension obligations, and 4.3% represented OPEB payments.

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, Pittsburgh has an estimated population of 305,122. 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 expansion of startups and technology firms, including robotics, artificial intelligence, and autonomous vehicles. Apple, Facebook, and Google continue to expand their footprints in the city. 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 $64,695.Pittsburgh is in Allegheny County, which had an unemployment rate of 4.0% in 2018.

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, located 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 grow, we expect Pittsburgh will continue to demonstrate resiliency given positive trends in its economic base.

Strong institutional framework

The institutional framework score for Pennsylvania cities is strong.

Outlook

The stable outlook reflects S&P Global Ratings' opinion management will likely continue to proactively manage financial and operational performance during the two-year outlook period 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 ADC annually. Therefore, we do not expect to change the rating during the outlook period.

Downside scenario

Holding all other factors equal, if pension or other pressure 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.

Related Research

- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Alternative Financing: Disclosure Is Critical To Credit Analysis In Public Finance, Feb. 18, 2014
- 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
- 2019 Update Of Institutional Framework For U.S. Local Governments

Ratings Detail (As Of February 21, 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.		