

NEW YORK--( [BUSINESS WIRE](#) )--Fitch Ratings affirms the following capital fund program (CFP) revenue bonds at 'AA-':

--\$85 million Philadelphia Housing Authority CFP revenue bonds, series 2002 A;

--\$65 million Redevelopment Authority of the City of Philadelphia CFP revenue bonds, series 2002 B and series 2003 C & D.

The Rating Outlook is revised to Stable from Negative.

## SECURITY

The bonds are secured by the public housing capital fund annual appropriation assigned through the Department of Housing and Urban Development's (HUD) budget, as well as debt service reserve fund sureties to cover any timing delays in appropriations.

## KEY RATING DRIVERS

**STABILIZED APPROPRIATION LEVELS:** Philadelphia Housing Authority's appropriation amounts are projected to stay constant for FY 2014 and FY 2015. The primary reason for the outlook change to stable is based on the latest U. S. budget agreement reached in January of 2014, whereby the aggregate HUD capital fund appropriation is expected to remain at the funding amount appropriated prior to FY 2013 sequestration level.

**STABLE DEBT SERVICE COVERAGE:** Utilizing the appropriation amounts projected, debt service coverage (DSC) levels are expected to stabilize. When Fitch's stress scenarios are applied to current appropriation amounts the DSC increases slightly to 3.33x

from prior the year stressed level estimate of 3.31x. Based on these levels, the annual appropriation would have to be cut by 26% to warrant a potential downgrade.

**BOND STRUCTURE:** The structure allows payments to flow directly to the trustee to pay debt service on a first priority basis.

**MANAGEMENT OVERSIGHT:** Philadelphia Housing Authority's management has consistently submitted capital plans to HUD in a timely manner.

## RATING SENSITIVITIES

**DECLINES IN FUTURE APPROPRIATIONS:** Further declines in the annual capital fund public housing appropriations may reduce debt service coverage to levels that would negatively impact the current rating. Fitch estimates that if the 2015 appropriation were reduced from 2013 levels after sequestration, in an amount of 26% or more than the FY 2013 appropriation, then debt service coverage would be on the cusp of the minimum threshold ratio appropriate for its current 'AA-' rating.

## RATING CRITERIA

Fitch's approach for public housing authority (PHA) bonds secured by U. S. Housing and Urban Development (HUD) capital fund annual appropriations involves: a quantitative analysis of annual appropriation amounts and the corresponding debt service coverage levels, review of the legal structure of the agreement, and a qualitative analysis of management oversight.

Fitch takes a conservative approach to analyzing appropriation amounts and debt service coverage levels by evaluating the appropriation risk (i.e. the Fitch stressed appropriation amount). Fitch recognizes that bonds with longer maturities are exposed to a higher degree of appropriation risk i.e. budget cuts. Therefore, the agency recalculates the debt service coverage level to account for the potential volatility in annual appropriation amounts.

Fitch accounts for this by considering the base appropriation level to be the lower of either the lowest amount received over the past five years or 95% of the previous year's funding. This base amount is then adjusted further depending on the remaining years to maturity, with a 10% decrease for bonds five years to maturity, a 15% decrease for 10 years to maturity, a 20% decrease for 15 years to maturity, and a 25% decrease for 20 years to maturity.

The final Fitch stressed appropriation amount is then used to calculate the adjusted debt service coverage level. A minimum stressed DSC of 4.0x is typical for a 'AA' rating, 3.0x is typical for a 'AA-' rating, 2.0x is typical for a 'A+' rating, and 1.5x is typical for a 'A' rating.

In addition to quantitative measures, Fitch also reviews the legal structure of the bonds. We review the annual contributions contract (ACC) between the PHA and HUD for any items that would help mitigate the risks associated with the PHA's ability to pay bondholders. Fitch specifically looks for the following items in an ACC: debt service payments going directly from HUD to the trustee on a predetermined schedule usually three days in advance of the debt service payment date and administrative sanctions not being able to delay payments of the debt service or recapture funds approved for debt service payments.

The final component Fitch reviews is management's performance and their ability to meet HUD's deadlines and requirements to receive annual appropriations. Each year HUD requires public housing authorities to submit one-year and five-year capital fund plans and funds are only allocated after HUD's approval of the plans. Since the start of the capital fund program, agencies have been successful in submitting plans in a timely manner since appropriations are predicated upon an agency's ability to submit plans on time. Fitch confirms with individual public housing authorities that plans were submitted to HUD. Fitch also discusses the current progress of modernization projects and the authority's ability to finish the work to completion. Fitch monitors the authority's current number of housing units since that is a prime component in the capital fund appropriation formula because if the number of housing units decline the portion of funds appropriated to a public housing authority could also decline if there is no replacement housing plan in place.

## CREDIT PROFILE

According to the H.R. 3547 Consolidated Appropriations Act passed by both the House and Senate and signed by the President on Jan. 17, 2014 the aggregate increase to the Public Housing Capital Fund Appropriation is \$1.875 billion or 5% greater than the FY 2013 \$1.78 billion amount after sequestration. However, the actual year over year increase in capital allocations to housing authorities may vary depending on how the increase is applied. Our conservative estimate for the Philadelphia Housing Authority would be a return to the FY 2012 appropriation. This Fitch stressed appropriation amount moves the DSC farther away from the 'AA-' minimum DSC of 3.0x by about 26%, meaning that the annual appropriation of future capital fund appropriations would have to be reduced by 26% to warrant a potential rating change. More importantly the current increase in the amount changes the trend of three straight years of declines.

Given that the individual public housing authority's 2014 capital fund appropriation is not yet available, Fitch's review is restricted to the aggregate HUD Capital Fund appropriation amount and expects that the PHAs will receive approximately the same proportion of the total appropriation. The affirmation recommendation is based on the current debt service coverage level, which utilizes the estimated 2014 appropriation amount. Fitch will review this credit again when the individual capital fund appropriation for Philadelphia is finalized in the next six to eight months.

Credit concerns revolve around the volatility of appropriation amounts. Prior to sequestration, appropriation amounts had drastically decreased which quickly eroded debt service coverage levels. Philadelphia Housing Authority has seen debt service coverage levels drop to 4.10x from 6.30x from FY 2010 to FY 2013. However, the prior trend of declines combined with the forecasted stabilization in future appropriations for the next two years (FY 2014 and FY 2015) set the stage for a return to a Stable Outlook.

The appropriation amounts, under HUD's budget, are part of the U.S. government's general fund and are reliant upon the federal budget process. In January of 2014, the budget was agreed to at the same spending level for the next two years, another sign of stabilization. Most of these concerns are somewhat mitigated by the legal structure of the bonds, the fact that the federal government provided Public Housing Authorities funds every year since 1937, and the debt service reserves.

Fitch recognizes that Philadelphia Housing Authority is one of the moving to work (MTW) agencies, which allows them flexibility in spending. Although the potential security is

there, these funds are not pledged to the bondholders, and therefore Fitch awards no credit to Philadelphia Housing Authority for being a MTW agency and subsequently does not include any funds other than the annual capital fund appropriations into the calculation of debt service coverage levels.

Additional information is available at '[www.fitchratings.com](http://www.fitchratings.com)'.

Applicable Criteria and Related Research:

--'Revenue-Supported Rating Criteria', June 3, 2013.

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Additional Disclosure

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