S&P Global
Ratings

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Summary:

Allegheny County, Pennsylvania Pittsburgh & Allegheny Sports & Exhibition Authority; Miscellaneous Tax

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Pittsburgh & Allegheny Sports & Exhib Auth excise tax (AGM)		
Unenhanced Rating	A-(SPUR)/Negative	Downgraded

Many issues are enhanced by bond insurance.

Rating Action

S&P Global Ratings lowered its rating two notches to 'A-' from 'A+' on the Pittsburgh & Allegheny County Sports & Exhibition Authority (SEA), Pa.'s series 2010 and 2012 hotel room excise tax revenue refunding bonds. The outlook remains negative.

The rating action and negative outlook reflect a steep drop in pledged hotel tax revenues, a direct result of the severe toll of the pandemic, to the extent that we anticipate either cash on hand or debt service reserve funds (DSRFs) may need to be tapped to meet debt service due in February 2021, unless there is further revenue growth in the coming months. The revenue outlook remains highly uncertain, both in the immediate future and the near-to-medium term, but we still expect full and timely payment due to ample liquidity.

We applied our "Priority Lien" criteria (published Oct. 22, 2018, on RatingsDirect), which factors in both the strength and stability of the pledged revenues, as well as the general credit quality of the municipality where taxes are distributed and/or collected (the obligor's creditworthiness [OC]). We link the operating risks to Allegheny County, but the rating is not limited nor constrained by the county's creditworthiness ('AA-/Stable' general obligation [GO] rating). The hotel tax is levied by the county against a base that is coterminous with the county and it receives certain residual funds after debt service and other agreements are satisfied.

Credit overview

The pledged hotel tax has historically performed very well, reflecting a deep countywide tax base and strong economic growth, but with the COVID-19 pandemic having an outsized negative effect on the travel and hospitality industries, revenues this year have declined sharply. The lower rating reflects a potential for pledged revenues to fall short of annual debt service, even if they remain flat the rest of the year, which itself could prove optimistic. November collections (from October activity) may show another increase (would be six consecutive months), but with the virus now surging and potential for increased government restrictions or behavioral changes leading to reduced travel, we feel there is a strong possibility that revenues may decline again in the very near future. We anticipate a rebound in

2021, but still expect that coverage will remain well below historical levels over the next one-to-two years. We see little to no risk in debt payments not being made in full and on time, even if coverage is below 1x, due to fully funded DSRFs. The county could also use cash on hand to satisfy the obligation, if needed.

The negative outlook reflects our view that there is at least a one-in-three chance we could lower the rating within the next several months. In our view, there is high uncertainty regarding when and at what pace revenues may begin to recover, as this will likely depend on how quickly a vaccine can be widely distributed and how quickly consumer appetite for travel returns.

Additional factors supporting the 'A-' rating reflect:

- Volatility we consider moderate, as the nature of pledged revenues is inherently more volatile, factoring in limitations in scope; sensitivity to economic fluctuations and consumer behavior trends; and reliance on tourism, business travel, and event-specific activities;
- Pledged revenues that are down 59% year-to-date, including October collections (September activity) that were 34% of 2019 levels;
- Our expectation that collections would need to slightly increase over the three-month period November to January (reflecting October-December activity), to provide 1x debt service coverage (DSC), which is highly uncertain, despite growth over recent months;
- Ample liquidity in the form of cash on hand and fully funded DSRFs, which can be used if pledged revenues do fall short of debt service requirements; and
- A very strong economy, as the tax base includes all of Pittsburgh and surrounding Allegheny County, which anchor a broad, diverse, and growing regional economy.

Environmental, social, and governance factors

In our view, the health and safety aspects of the pandemic and resulting social distancing practices, which are reflected as a social factor in our analysis of environmental, social, and governance (ESG)-related risks, have directly contributed to revenue declines and therefore the negative rating action. Absent these implications, we feel the ESG risks are mostly in line with those of the sector.

Negative Outlook

Downside scenario

We could lower the rating if pledged revenues decline further over the next few months, or if they fail to recover at levels in 2021 that we anticipate will be sufficient to provide at least weak-to-adequate levels of debt coverage.

Return to stable scenario

If revenues remain steady enough to provide at or near sufficient coverage in February, and they demonstrate at least modest recovery next year that we feel can be sustained, we could revise the outlook to stable.

Credit Opinion

Security and pledge overview

SEA's series 2010 and 2012 hotel tax revenue bonds are payable from the Allegheny County hotel room excise tax, which consists of a basic 5% tax and an added 2% tax, levied against each transaction of renting a room or rooms to accommodate persons requiring temporary occupancy. The tax is levied against all transactions within county boundaries.

The county levies the tax and collects it monthly. By state statute, from the basic 5% levy, one-third of the amount of collected within a municipality (other than Pittsburgh) that has its own convention center must first be paid by the county to that municipality. This currently includes one municipality (Monroeville), which effectively has the first claim on hotel tax revenues generated in Monroeville. This allocation typically accounts for less than 2% of gross collections. After this allocation, revenues are used for debt service and to pay a 5% administration fee, both on a parity basis. Next, two-fifths of receipts are to be made available to the Greater Pittsburgh Convention and Visitors Bureau (an independent, tourism promotion agency), and lastly, remaining revenues flow to the county. By statute, the county is to make these residual revenues available for use in supporting the convention center and tourism promotion activities. For the added 2% levy, there is the same requirement to first distribute one-third of receipts collected from a municipality with a convention center to that municipality. However, after this distribution, 100% of remaining receipts are directed to debt service.

The county, via cooperation and support agreements, has assigned hotel tax revenues equal to debt service to SEA, which in return, pledges the revenue to the bonds. After distributing shares to Monroeville, the county makes monthly transfers of revenues to the trustee in the amount of 1/12 annual debt service. Bond documents stipulate that the entirety of the added 2% tax is used to make the bond deposits, with remaining requirements coming from the basic 5% levy. There is no other debt with a parity pledge of the hotel tax.

Moderate hotel tax volatility

We consider volatility moderate, factoring in a more narrowly taxed service that can fluctuate more based on economic trends, discretionary travel, and spending habits.

Our macro volatility assessment begins with an assessment of the historical volatility of the economic activity being taxed, and includes an analysis of societal, demographic, political, and other factors that could affect these activities. Based on the variance of national economic activity that we believe most closely represents the taxing base over multiple economic cycles, it is used to inform our opinion on expectations of future volatility. We also consider local factors on a micro basis, to determine if local volatility is similar or different from national levels.

Tax revenues averaged 5.5% annual growth over the last 10 years and 3.7% over the last five. They saw a one-year dip during the Great Recession, falling 9% in 2009. Growth in 2010, however, exceeded the decline in 2009.

The county collected $12.87 million in January through October, which is only 41% of collections for the same period last year. May was the low point, at only $257,000 (8% of 2019 levels), but revenues have rebounded each month since, reaching $1.26 million in October (though still only 34% of 2019 levels).

There is modest concentration in the hotel tax base, given the more limited nature of the taxed service. Based on data provided in 2019, combined revenues from the ten-largest revenue-generating hotels account for 31% of total revenues. These ten hotels accounted for 22% of room volume. As of 2019, the county had 142 hotels, with 19,204 rooms, compared to 119 hotels with 16,376 rooms five years prior. Occupancy rates dipped to 11.9% this past March, but were above 40% at the end of August.

Weak-to-adequate coverage and liquidity

The weak-to-adequate assessment reflects the potential for coverage to dip below 1x this year, but a likelihood that revenues will recover next year, though remain well below historical levels.

Pledged revenues totaled $37.8 million in calendar year 2019, covering effective maximum annual debt service (MADS) of $15.7 million by 2.4x. We include the Monroeville share of revenues (paid first) and administration fees (equal claim) in our effective MADS. Over the last five years, these two items combined to average 5.2% of total revenues. The bonds have interest-only payments in August (the 2020 payment of $3.3 million was made in full), and pay principal and interest in February (the next payment is $10.5 million). On a bond year basis, revenues from February through October totaled $9.96 million. If collections in the three-month period November through January remain flat at October levels ($1.26 million per month), we project they would fall just short of 1x coverage of total 2020/2021 effective debt service. If using revenue net of an estimated Monroeville portion, and prior to paying the administrative fee, we'd estimate revenue still falling just short of debt service. In practice, debt service transfers are made prior to the administrative fees being paid.

In our view, November collections would need to grow faster than they did in October (8.5% monthly increase) to meet 1x debt coverage, especially considering potential for retraction over the holidays. Revenues have grown in each of the past five months, but as the weather turns and virus cases mount, there is potential for hotel stays to decline again, especially if governing bodies enact further stay-at-home orders. Any declines in monthly revenues from now until January would likely result in coverage below 1x. As noted, both bonds have a DSRF sized at actual MADS. These are secured by a combination of cash and surety bonds backed by Assured.

Debt service is level through 2026, before dropping in 2027. This corresponds with the expiration of the added 2% levy at the end of 2026. Collections from the basic 5% levy in 2019 would cover the estimated post-2027 MADS (including Monroeville and administration fees) by more than 1.5x. There is no expiration of the basic 5% levy.

The additional bonds test (ABT) in the bond documents is set at 1.25x MADS and is based on historical collections. However, according to state statute, if additional debt was issued, the portion of revenue available for debt service on the additional debt would fall under a different waterfall. More specifically, only the 2010 and 2012 bond debt service would be given priority before the Bureau and convention center support allocations, and any additional debt would be payable after satisfying the series 2010 and 2012 debt service and the Bureau requirements. Effectively, this makes any additional debt subordinate, thereby closing the lien on additional parity debt. We still recognize, though it is a remote risk, that state legislation could be revised, allowing effective parity debt. The 1.25x ABT would still remain in place in the event of a change in state law.

Very strong economy supporting the hotel tax

We consider the economic fundamentals very strong, reflecting a broad and diverse countywide tax base.

Located in southwest Pennsylvania, the county is home to Pittsburgh, the second-largest city in the state and making up about one-quarter of county population. The county has an estimated population of 1.2 million and projected per capita effective buying income of 113% of the national level. The metropolitan statistical area (MSA) supports more than 1.19 million jobs, and though slightly below national levels, saw 3% employment growth in the last five years. The population for the MSA is over 2.3 million.

Despite a history of stable growth and development, rapidly evolving economic conditions as a result of COVID-19 have already affected the labor market. County unemployment averaged 4.1% in 2019, before jumping to 15.7% in April, which closely mirrored statewide levels. It has since fallen to 11% in August and (preliminary) 7.9% in September. (For more information on our view of the U.S. economy, see "U.S. Economic Update: The U.S. Economy Reboots, With Obstacles Ahead," Sept. 24, 2020).

For further information on our view of the county's economy, see our summary analysis on Allegheny County, published July 14, 2020.

Obligor linkage

Under our criteria, the legal structure can distance the linkage between the priority-lien pledge and the OC, lessening the degree of exposure of the pledged revenue stream to operating risks of the OC. However, we view the linkage for hotel tax bonds as "close," reflecting the bond structure that directs revenues to the county, prior to transfer to the trustee. Therefore, we consider the flow of pledged revenue to be more within the county's direct control, leaving some degree of exposure to operating risk.

Rating linkage to Allegheny County

We assess Allegheny County's general operations because we view overall creditworthiness as a key determinant of an obligor's ability to pay all of its obligations, including bonds secured by special taxes.

In addition to the broad and diverse tax and employment base with strong incomes, Allegheny County's creditworthiness is strengthened by it strong management conditions, mostly balanced year-to-year budget results, strong reserves ($87.5 million available fund balance, equal to 11% of operating expenditures), and strong liquidity. Limiting credit conditions include a debt profile containing variable-rate debt and contingent liabilities, and an underfunded pension system that has the potential to pressure operations. The unfunded pension liability is more than $1.2 billion and is only 43% funded.

Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020

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