MOODY'S INVESTORS SERVICE

New Issue: MOODY'S ASSIGNS A1 RATING AND NEGATIVE OUTLOOK TO CITY OF ALLENTOWN'S (PA) $16 MILLION G.O. BONDS, SERIES OF 2011

14 Feb 2011

AFFIRMATION OF RATING AND OUTLOOK REVISION TO NEGATIVE AFFECT $109.5 MILLION RATED DEBT OUTSTANDING, INCLUDING CURRENT ISSUE

Municipality
PA

Moody's Rating

ISSUE	RATING
General Obligation Bonds, Series of 2011	A1

Sale Amount	$16,400,000
Expected Sale Date	02/16/11
Rating Description	General Obligation

Opinion

NEW YORK, Feb 14, 2011 -- Moody's Investors Service has assigned an A1 rating and negative outlook to the City of Allentown's (PA) $16 million General Obligation Bonds, Series of 2011. Concurrently, Moody's has also affirmed the A1 rating and revised the outlook to negative on approximately $96.1 million of city and city-guaranteed parity rated debt.

SUMMARY RATING RATIONALE

The city's General Obligation bonds, and the city-guaranteed water, sewer, and a portion of parking bonds are ultimately secured by the city's general obligation, unlimited tax pledge. Approximately $11 million of proceeds will be used to fund various capital improvements while the balance will be used to refund portions of the city's Series 2001 general obligation debt, city-guaranteed Sewer Revenue Bonds, and city guaranteed Water Revenue Bonds. The total net present value savings is approximately $106,000 taken throughout the life of the bonds with no extension of maturity.

The A1 rating factors the sizeable and mature urban tax base with below-average socioeconomic indices; slightly above average, but manageable, debt burden with below average payout; and the anticipation of financial stability and reserve growth over the near-term.

The negative outlook reflects our belief that the city's financial position will continue to be challenged due to narrow financial flexibility given the history of structurally imbalanced operations. Over the near-term, Moody's will monitor the city's ability to stabilize the currently narrow financial position and to begin to replenish its reserves; absent these changes, the city's creditworthiness will be pressured.

STRENGTHS

- Large tax base with healthcare presence

- Recently improved budgeting assumptions

CHALLENGES

- Weak socioeconomic profile

- Currently limited financial flexibility

DETAILED CREDIT DISCUSSION

NARROW FINANCIAL POSITION, SUPPORTED WITH ONE-TIME REVENUE SOURCES; OFFICIALS PROJECT BALANCED OPERATIONS FOR FISCAL 2010

Moody's anticipates that the city will be pressured to return to structural balance given a reliance on one-time revenues to offset weak performance of economically sensitive revenues and expenditure growth. Management reports, however, that recent revenue enhancements and expenditure controls will begin to stabilize the city's finances over the next several years. Following multiple years of significant operating deficits, the city's financial position improved in fiscal years 2005 through 2007, driven by one-time revenues. Fiscal 2008 and 2009 were difficult years for the city, however, as economically sensitive revenues underperformed budget, largely reflecting the economic downturn. Management believes that fiscal 2010 (year-end December 31) will yield balanced operations and the fiscal 2011 budget is structured to slightly increase reserves.

The fiscal 2008 operating deficit of $5.9 million resulted from an original appropriation of fund balance of $642,000 and numerous revenues shortfalls, with the largest variances being in deed transfer tax ($1.56 million), current year property tax collections ($785,000), and the local service tax ($637,000). Expenditure overages related to the police department ($1.3 million) and economic development ($459,000) also contributed to the significant decline in reserves. Fiscal 2009 finances yielded a second consecutive operating deficit of $3.9 million, partially reflecting an original $1.7 million appropriation of reserves. Despite realizing approximately $1.1 million of expenditures savings in public works, the city was unable to offset the more significant revenue underperformance which partially reflected the down economy and city's vulnerability to economically sensitive revenues. The largest drivers were related to its local service tax ($1.5 million), intergovernmental revenue ($1.1 million), deed transfer tax ($713,000), license and permit activity ($411,000), and investment income ($411,000). Property taxes are the city's largest revenue source (39%), followed by Act 511 taxes (22%). Property taxes are collected at satisfactory rate of 95.8% on a current basis.

The fiscal 2010 budget did not contain an appropriation of reserves and management currently projects the year will end without an additional draw on its reserves; operations are likely to be structurally imbalanced, however, as they include a sale of city assets. The fiscal 2011 budget increased by approximately $7.4 million, or 9.1% (budget to budget) and is structured to increase reserves by $832,000. The larger than normal increase is related to an increase of the city's earned income tax authorized under PA Act 205 that is intended to address municipalities with low pension funding. The additional tax must be dedicated to funding the city's minimum municipal obligation related to its pension system. The city-managed pension systems range between 74.64% to 46.94% funded as of fiscal 2009. Net of the additional pension contribution, the city's budget would have grown by 4.7%. The budget also includes one-time revenues such as a sale of city assets ($1.1 million), but does not depend on a sale of the city's sewage capacity, as it has in past years. The city has begun to experience more consistent revenues from a casino host fee and are exploring other revenue diversification opportunities that may offset future years reliance on one-time revenues to balance the budget. Going forward, Moody's will monitor the city's ability to return to structurally balanced operations in the near-term and to increase reserves in-line with the current rating category.

SIZEABLE AND MATURE TAX BASE; HEALTHY GROWTH DRIVEN BY MARKET APPRECIATION

Moody's believes city's mature and sizeable $5.9 billion tax base will remain relatively stable given ongoing economic diversification in the region. Allentown is the county seat of Lehigh County (G.O. rated Aa1) and as such, has a significant portion of the tax base that is tax-exempt (20% in 2010), which is reflected, in part, by the below average full value per capita of $47,258. Income levels are also below average, with per capita and median family incomes at 78% and 76% of the state, respectively, but approximating national medians. The tax base, while mature (only about 0.5% of the land is vacant), is also diverse, with residential property accounting for two-thirds of assessed values (67.1%) and commercial and industrial properties, together, representing nearly all of the balance (26.1% and 6.3%, respectively). The city experienced significant full value growth between 2004 and 2007 but as the economy has slowed, so has the city's tax base growth. The five-year annual average of 1.9% reflects significant increases from 2006 through 2008 and declines in 2009 and 2010 (6.8% and 9.2%, respectively); the full value activity is largely driven by increase in the value of residential properties. Assessed valuation, on the other hand, remained essentially flat over the same period, reflecting the mature character of the city.

Located approximately 60 miles north of Philadelphia (G.O. rated A2/stable outlook) and 90 miles west of New York City (G.O. rated Aa2/stable outlook), the city is the third largest in Pennsylvania. Although the city was one of Pennsylvania's fastest growing areas since 2003, there are some signs of weakness to its economy as layoffs in the manufacturing, professional/business services and retail sectors persist. On balance, the city's education and healthcare sectors is the strongest it's been in the last six years. Allentown's economy is also driven by the transportation, warehousing and distribution industries given its proximity to major transportation routes, particularly with Interstate-78 running east-west to the south of the city and Interstate-476 running north-south to the west. Common to many mature communities, the city is engaging in significant redevelopment efforts, presently focusing on its downtown area. In the future, the city anticipates redevelopment along the riverfront after a new bridge across the Lehigh River is completed. The city's Keystone Opportunity Zone has also attracted many businesses from diverse industries. Some companies with the corporate headquarters or a major presence in Allentown are Mack Trucks, Air Products and Chemicals (senior unsecured rated A3/on review for possible downgrade), LSI Logic Corporations (formerly Agere Systems), and Lehigh Portland Cement.

ABOVE-AVERAGE DEBT BURDEN EXPECTED TO REMAIN MANAGEABLE GIVEN SELF-SUPPORTING OBLIGATIONS AND NO IMMEDIATE DEBT PLANS

The city's 2.1% direct debt burden is slightly above average compared to the 0.5% state median, but is expected to remain manageable given no immediate debt plans. Excluded from the direct debt burden are significant self-supporting water, sewer and parking authority debt obligations, which comprise approximately 25% of the city's general obligation debt and are supported by user fees. Inclusive of these obligations, the city's direct debt burden would increase to 2.9% of full valuation. Overlapping county and school district debt increases the debt burden to 7.3%, exclusive of self-supporting city debt. Debt service represented a manageable 8.2% of operating expenditures in fiscal 2009 and is expected to remain at similar levels over the medium-term. All of the city's debt is fixed rate and the city is not party to any derivative agreements.

WHAT COULD CHANGE THE RATING - UP (or removal of negative outlook)

- Decreased reliance on one-time revenues to balance the budget

- Trend of increasing GAAP basis fund balance as a percent of revenues

WHAT COULD CHANGE THE RATING - DOWN

- Fiscal 2010 ends worse than currently projected

- Trend of decreasing GAAP basis fund balance as percent of revenues

- Increasing reliance on one-time revenue sources to fund ongoing operations

- Tax base deterioration resulting in negative operational impact

KEY STATISTICS:

2006 Population (estimated): 107,294 (+0.6% since 2000)

2006 Full Valuation: $5.76 billion

2006 Full Value Per Capita: $53,837

1999 Per Capita Income (as % of PA and US): $16,282 (78.0% and 75.4%)

1999 Median Family Income (as % of PA and US): $37,356 (76.0% and 74.6%)

Direct Debt Burden: 1.2%

Overall Debt Burden: 2.4%

Payout of Principal (10 years): 57.8%

FY06 General Fund balance: $9.1 million (12.6% of General Fund revenues)

FY05 General Fund balance: - $2.7 million (- 3.9% of General Fund revenues)

Post sale G.O. and G.O.-Guaranteed Debt Outstanding: $120.6 million

Post-sale parity rated debt outstanding: $109.5 million

The principal methodology used in this rating was General Obligation Bonds Issued by U.S. Local

Governments published in October 2009.

REGULATORY DISCLOSURES

Information sources used to prepare the credit rating are the following: parties involved in the ratings, public information, confidential and proprietary Moody's Investors Service information, and confidential and proprietary Moody's Analytics information.

Moody's Investors Service considers the quality of information available on the credit satisfactory for the purposes of assigning a credit rating.

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