ASSET PRESERVATION ADVISORS

"Pittsburgh, PA: A Cautionary Tale of Revival" JUNE 2018

THE STEEL CITY

An unlikely poster child for the American steel industry, President Donald Trump campaigned on a promise to defend the American manufacturing base and rebuild those communities most affected by the forces of globalization. For many living in former "steel cities," memories of the American steel industry depression and the job losses that ensued, are still fresh. The primary cause: a ten-year economic downturn, sparked by the OPEC oil embargo and the Iranian revolution, which caused consumer markets to contract and demand for steel to weaken significantly. Between 1976 and 1986, an estimated 300,000 American steelworker jobs were lost and small towns like Youngstown and Gary, Indiana, were left devastated by plant closures.

Once considered to be an economic powerhouse and a leading producer of steel and manufactured goods, Pittsburgh, Pennsylvania suffered a similar fate to Youngstown and Gary, but on a grander scale.

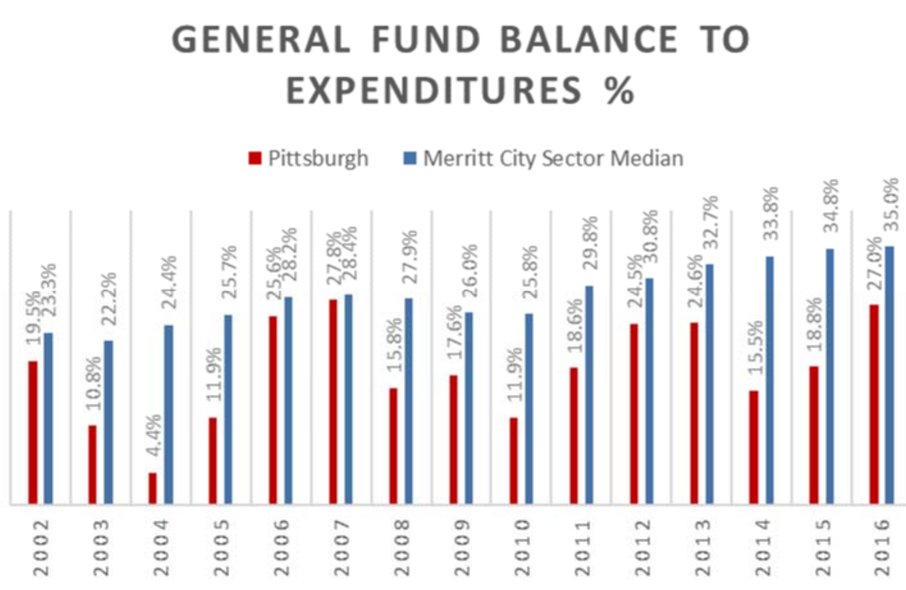
Shedding an estimated 46,000 of its 90,000 steelworker jobs in just four years, the city struggled both financially and economically for years to come as unemployment rates soared, from 5.8% in 1979 to 9.6% in 1983[1]. By the early 2000s, population decline, and rising unemployment forced city leaders to find ways to re-tool the local economy. They transformed the city from a manufacturing center into an economy driven by services, technology, robotics, healthcare, finance, education and high-tech industries, along with riverfront development and regional tourism.

Pittsburgh's turnaround is a testament to a municipality's ability to reform and significantly improve financial conditions as compared to their corporate counterparts. Municipalities have a natural monopoly on the residents they serve. As long as residents exist, a municipality can tax in perpetuity and employ austerity measures to improve its economic outlook. While Pittsburgh's story is one of significant financial improvement, APA warns that this is a cautionary tale for investors: even after 14 years of state oversight and economic improvement, significant hurdles remain. In our opinion, if Pittsburgh is to be a model for all former steel city revivals, it has several major obstacles to overcome.

THE REVIVAL

After twenty years of economic challenges and financial pressures, the city's general fund saw a significant decrease of $27 million in 2003, leaving only $35 million in the fund; a meager 11% of expenses. The fund declined further in 2004 by $20.6 million, resulting in a $14.5 million general fund balance, only 4% of expenses[2]. Increasing debt levels and $86 million in annual debt service, an estimated 25% of the city's budget, forced the city to be designated as a "distressed municipality" under State Act 47. In December 2003, Pittsburgh was placed under state control with a state-appointed coordinator and a five-member oversight board; where it would remain for the next 14 years.

During that time, the state provided technical assistance and taxing authority to aid in the delivery of services, created a more business-friendly environment to bring businesses back, and kept access to financial markets open for borrowing. Pittsburgh leaders implemented various financial changes, established various debt issuance policies, and set goals for its General Fund, in an attempt to improve the city's financials. Despite setbacks along the way, the city was ultimately successful in establishing general fund surpluses from 2012 through 2016, with a 2016 ending balance of $114 million, or 27% of expenses[3]. For comparison, Merritt Research's median for A-rated cities is lower, at approximately 20% of expenses. As a result, after 14 years of state oversight, Pittsburgh was released from state control in February of this year.



Source: Merritt Research

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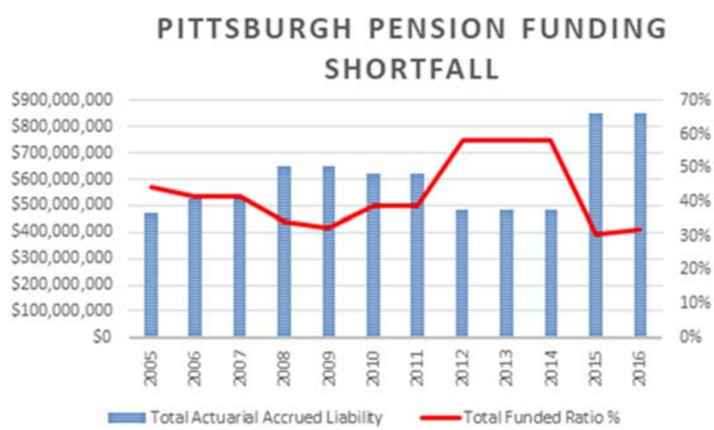
Pittsburgh is now home to seven Fortune 500 companies including Kraft (dual headquarters with Chicago) and PNC Financial. Health care has become a prominent driver of its economy, with the University of Pittsburgh Medical Center, its largest employer, providing over 48,000 jobs.

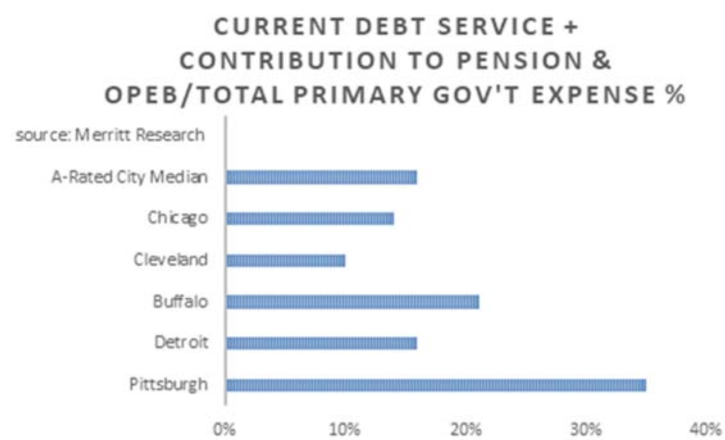
CHALLENGES REMAIN

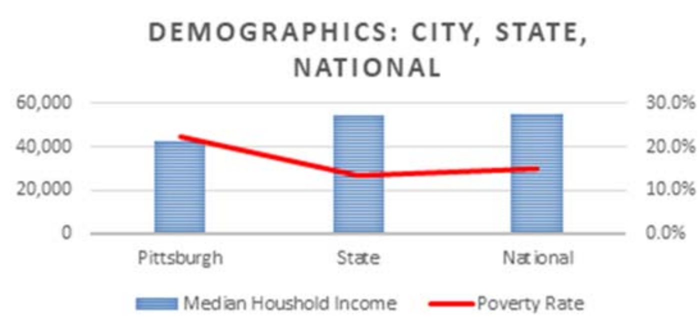
While economic growth and improved financial operations have been good for Pittsburgh, some difficulties will likely continue to challenge city leaders. The city's wealth levels trail state averages and poverty rates remain elevated. In 2016, per capita income for city residents was 97% of state levels and 98% of national levels with median family incomes at 85% of state and 87% of national medians. The 2016 poverty rate of 22.3% was high as compared to the state rate of 13.3% and 15.1% for the nation[4].

Pittsburgh's pension system has been underfunded for decades. Over the past ten years, its funding ratio has averaged only 42% per year, which APA considers well below average when compared to other cities of comparable size and rating. The city's total net pension liability increased from $523 million in 2006 to a staggering $851 million in 2016. This, in addition to comparably high debt levels from a per capita debt standpoint, has not gone unnoticed by the rating agencies. In May of 2005, S&P rated the City of Pittsburgh BBB-, upgraded it to BBB in 2008, A in 2013, and most recently to A+ in August 2014. Similarly, Moody's placed a Baa1 rating on the city in July of 2008, upgraded the rating to A1 in April 2010, and affirmed once more in March of 2013[5]. In their June 2013 review, S&P stated, "Pittsburgh will continue to face pressures stemming from their high fixed costs and sizable long-term liabilities," a view with which APA agrees.

In our view, Pittsburgh has made tremendous progress in improving their economy and financial operations, but we continue to be cautiously optimistic with expectations for a full recovery. APA believes the city must address its legacy liabilities in the form of underfunded pensions and high-debt levels before it can be considered fully recovered. Similar to other former steel cities, legacy costs continue to be an issue and are likely to be for some time.







Data

Source, All Charts: Merritt Research

For more information on this topic or for more about Asset Preservation Advisors customized portfolio management, please contact us: ContactUs@AssetPreservationAdvisors.com, (404) 261-1333

[1] City-Data.com: Pittsburgh History: 2018, http://www.city-data.com/us-cities/The-Northeast/Pittsburgh-History.html (accessed 6/18/2018)

[2] PEW, With State Help, Pittsburgh Got Its Finances Under Control: March 26, 2018; http://www.pewtrusts.org/en/research-and-analysis/articles/2018/03/26/with-state-help-pittsburgh-got-its-finances-under-control (accessed 6/18/18)

[3] Merritt Research, Credit Scope (accessed 6/15/18)

[4] Merritt Research (accessed 6/15/18)

[5] Bloomberg LP, Moody's (accessed 6/15/18)

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