

Investment Insights

State of the State: Pennsylvania

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Overview

Pennsylvania's revenues are tracking in line with its budget. Conservative budgeting and ample reserves should mitigate any deficit that may arise.

The commonwealth's creditworthiness is tied to the ability to pass timely, balanced budgets while maintaining healthy reserve levels, and continued progress on pension funding.

We highlight the Pennsylvania Housing Financing Agency's revenue bonds, which enjoy strong credit fundamentals and align with Pennsylvania's housing mission.

State overview

Thanks to recent revenue outperformance, conservative budgeting, and a focused effort to build reserves, we believe the Commonwealth of Pennsylvania is in a strong financial position. Pennsylvania benefits from a large and diverse economy that has experienced consistent growth over the past several years,¹ as well as access to liquidity through the state treasury or issuance of tax-anticipation bonds,² and near-record reserve levels.¹

However, credit challenges include underfunded pensions and the commonwealth's history of budget impasses. Despite contributing over 100% of the tread water rate* for the past seven years,³ Pennsylvania's pensions remain funded below the 80% threshold that the US Government Accountability Office considers sound for government pensions.⁴ The commonwealth also has a pattern of passing budgets late, as underscored by the latest budget impasse, which was more than four months overdue.⁵ We view these delays as a sign of governance weakness, although the impasse did not affect debt payments.⁶

Maintaining credit quality will depend on the Pennsylvania's ability to pass structurally balanced, timely budgets, sustain reserve levels that provide financial flexibility, and continue making progress on pension funding.

Fiscal year 2025 in review

At the start of fiscal 2025, Pennsylvania was in a strong financial position, thanks to several years of higher-than-expected revenue and subsequent allocations to reserve funds. The commonwealth entered the fiscal year with combined general fund and rainy day fund balances of \$18.7 billion, or roughly 38% of its revenues from the prior fiscal year.⁷ This is a big improvement from a pre-pandemic figure of just \$835 million in fiscal 2019.⁸

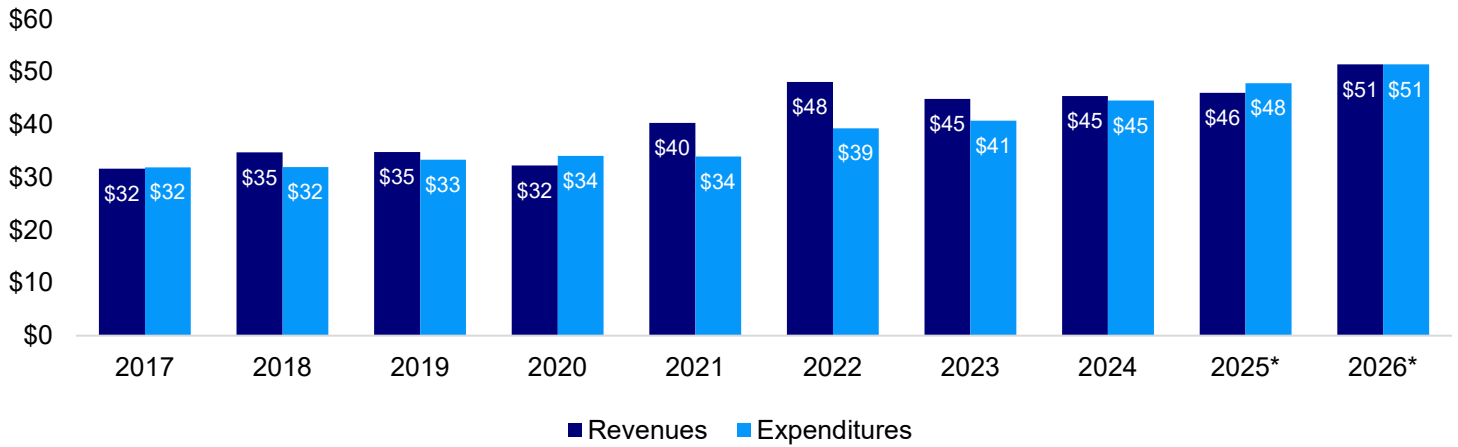
The fiscal 2025 budget was enacted on July 11, 2025, which was nearly two weeks into the fiscal year and illustrates Pennsylvania's history of delayed budgets. General fund revenues reached \$46.3 billion, 2.2% above the Independent Fiscal Office's estimates.⁹ This was mainly due to stronger than expected sales and use tax collections. In fiscal 2025, sales and use tax revenue totals grew 3.1% to \$14.7 billion, while the other major revenue source, personal income tax revenue, increased 6% to \$19 billion.⁹ Historically, these revenue streams have made up approximately 30% and 40% of total general fund revenue, respectively.¹⁰

Fiscal 2026 enacted budget

The enacted budget for fiscal 2026 is balanced and allocates \$50 billion in general fund expenditures, reflecting a 4.7% increase compared to the previous fiscal year. Historically, education and health and human services have made up the largest portions of the general fund budget, and this trend continues in fiscal 2026, with each category accounting for 41% of the total. Education spending is projected to rise by 4.7% year over year, while health and human services funding is expected to grow by 7% relative to fiscal 2025 levels.¹¹ In addition, the budget keeps the rainy day fund relatively stable, maintaining a balance of approximately \$7 billion.⁵

*Tread water rate refers to the minimum annual contribution necessary to keep the pension system's unfunded liabilities from growing

Figure 1: Fiscal year general fund operations (billions)



Source: Pennsylvania Governor’s Executive Budget 2025-2026, dated February 4, 2025

*Estimates based on the fiscal 2026 Executive Budget

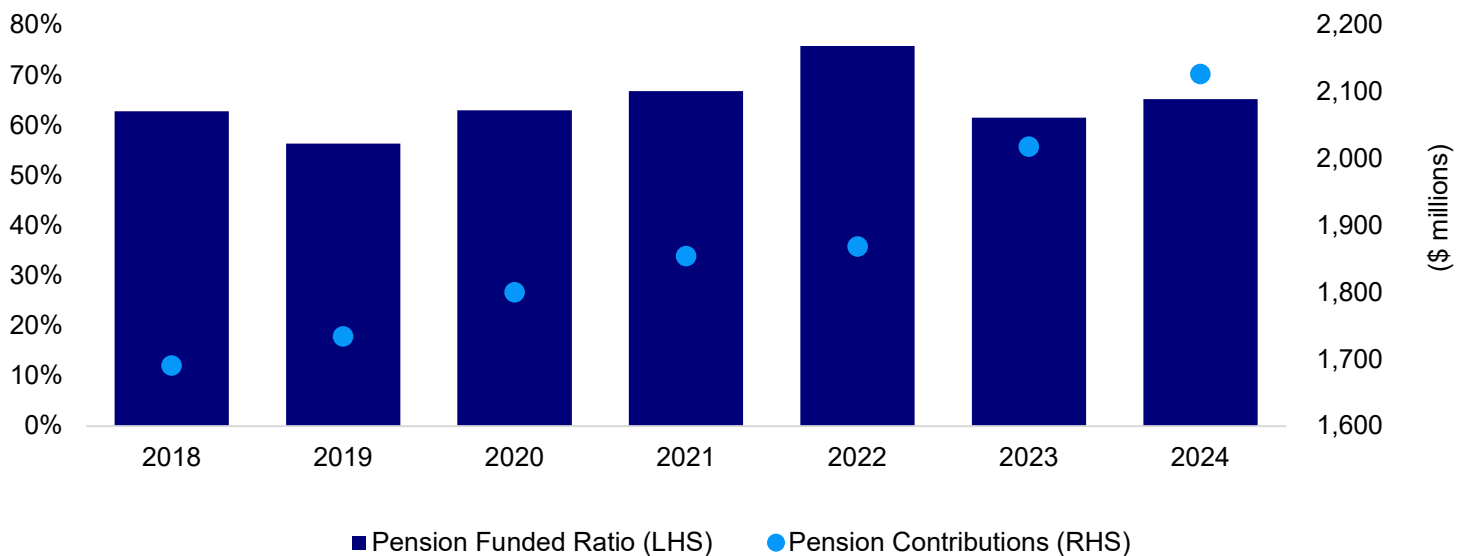
Liquidity

Pennsylvania enjoys robust access to liquidity, which supports its fiscal stability. Although the general fund cash position decreased from \$15 billion in fiscal 2024 to \$11.3 billion in fiscal 2025, it remains substantially stronger than pre-COVID levels, when the general fund cash totaled just \$2.8 billion.¹² According to available data for fiscal 2025, the budget stabilization fund amounted to 16% of general fund revenues.¹³ When this is combined with the unassigned general fund balance (or the portion of revenues that are not assigned to specific expenses), the total reserve rises to 33% of general fund revenues, further supporting the commonwealth’s solid financial footing.¹⁴

Pension funding

The state’s pension has been consistently underfunded, although Pennsylvania has been making steady progress to combat weakness, increasing their funded ratio from 56% in fiscal 2019 to 65% in fiscal 2024 (Figure 2).¹⁴ We are positive on management’s demonstrated commitment to improving its pension funding practices, including contributing the full amount of its actuarially required contribution since fiscal 2019.³

Figure 2: Pension overview



Source: CreditScope, as of June 2024, latest data available.

Economic Update

Pennsylvania is the nation's 5th most populous state, with a population of 13 million as of 2024.¹⁵ However, the commonwealth has experienced no population growth over the last decade,³ and is expected to remain flat through 2030.¹⁶

Pennsylvania is highly urbanized with two major metropolitan areas, Philadelphia and Pittsburgh. While the commonwealth is still the second largest natural gas producer in the nation, the growth of this industry has plateaued due to pipeline capacity and infrastructure limitations.¹³ Pennsylvania's post-pandemic economic recovery lagged that of the nation,¹⁷ but its unemployment rate has trended roughly in line with to slightly lower than that of the nation.¹⁸

Per estimates from the Independent Fiscal Office, economic activity is expected to continue to grow, albeit at a slower pace than in previous years. Real Gross Domestic Product (GDP)* growth in 2025 is expected to be 1.4% compared to 2.1% and 2.5% in fiscal 2024 and 2023, respectively.¹⁹ Real GDP growth is estimated to average of 1.3% through 2028.¹⁹ Wealth indicators for the commonwealth are slightly below those of the country.²⁰

Pennsylvania general obligation credit ratings

Moody's: Aa2 / Stable, as of May 21, 2025

S&P: A+ / Stable, as of November 14, 2025

Fitch: AA / Stable, as of May 28, 2025

Moody's has maintained a Aa2 rating with a stable outlook since October of 2024. The rationale for the rating and outlook cited the large size and diversity of the commonwealth's economy. The rating also incorporates a healthy financial position and average long-term liabilities.

S&P has maintained an A+ rating for the state since 2017. The basis for the rating is the commonwealth's diverse economy, moderate debt and recent improvements in its financial position. S&P changed their outlook from Positive to Stable in November 2025, citing Pennsylvania's most recent 5-month budget delay that hindered state agencies' abilities to fully carry out service, although debt service was not impacted.

Fitch's rating hinges on Pennsylvania's solid operating performance and low long-term liabilities. These positives are somewhat hindered by modest revenue growth and a history of budget impasses.

Revenue bond spotlight: Pennsylvania Housing Finance Agency, Single-Family Mortgage Revenue Bonds

Moody's: Aa1 / Stable, as of November 10, 2025

S&P: AA+ / Stable, as of February 25, 2025

The Pennsylvania Housing Finance Agency (PHFA), established in 1972, is a state-affiliated entity dedicated to providing safe, affordable housing for older adults, low- and moderate-income families, and individuals with special housing needs. PHFA fulfills this mission by financing single-family home purchases, multifamily rental developments, and community revitalization projects. Since inception, PHFA has generated over \$20 billion in funding, supported more than 206,000 home loans, and financed 110,000 rental units.²¹

We are highlighting the PHFA's Single-Family Mortgage Revenue Bonds, which are secured under the 1982 indenture. This indenture was created for the purpose of making funds available for the purchase of mortgage loans for single family residences for persons and families of low and moderate income.²² The bonds are secured by a pledge of homeowner mortgage loans and supported by a capital reserve fund equal to 3% of outstanding principal plus \$1 million. In addition, the Commonwealth of Pennsylvania is legally authorized to provide an appropriation sufficient to make up any deficiency in debt service to avoid a default. However, the state is not obligated to do so.²²

We favor these bonds for their high credit quality, stable cash flows, and long history of strong fiscal management. They carry strong credit ratings from both Moody's and S&P. Cash flow is healthy and more than sufficient to manage short-term disruptions. The indenture has a multi-year history of strong overcollateralization, which provides solid loss protection in the event of elevated mortgage delinquencies. Based on the value of mortgages outstanding, delinquency rates for loans up to 90 days delinquent are 3%, which is a better position than the 5.1% level in 2018.²³ As of March 31, 2025, 55% of mortgage loans are guaranteed to the United States government, which is viewed favorably.²³

The Single-Family Mortgage Revenue bond indenture is a stable and well-managed program, with the bonds offering competitive yields, strong credit fundamentals, and alignment with Pennsylvania's housing mission. These investments directly support affordable housing initiatives, promote economic development, and enhance community stability.

*GDP measures the monetary value of final goods and services produced in the state annually.

Sources:

1. Pennsylvania Executive Budget, dated February 4, 2025.
2. Annual Comprehensive Financial Report, dated December 20, 2024.
3. CreditScope, as of June 30, 2024.
4. U.S. Government Accountability Office, dated July 10, 2008.
5. City & State Pennsylvania 2025-26 Pennsylvania state budget tracker, dated November 12, 2025.
6. Pennsylvania Annual Financial Report, as of June 30, 2024.
7. Pennsylvania Annual Financial Report, as of June 30, 2019.
8. Pennsylvania Independent Fiscal Office Monthly Revenue Update, as of June 30, 2025.
9. Commonwealth of Pennsylvania Office of the Budget, for fiscal years 2017-2026.
10. 2025-26 Enacted Budget – General Fund State Appropriations, dated November 12, 2025
11. Enacted General Fund Tracking Run, dated July 12, 2024.
12. Pennsylvania Treasury, OpenBookPA, as of June 30, 2025.
13. Pennsylvania Governor's Executive Budget 2025-2026, dated February 4, 2025.
14. CreditScope, as of June 30, 2025.
15. US Census Bureau, as of December 31, 2024.
16. Pennsylvania Independent Fiscal Office Demographic Outlook, dated October 23, 2024.
17. Bureau of Economic Analysis, as of December 31, 2024.
18. Bureau of Labor Statistics, as of September 30, 2025.
19. Pennsylvania Independent Fiscal Office Economic and Budget Update, dated November 22, 2024.
20. CreditScope, as of December 31, 2024.
21. Pennsylvania Housing Finance Agency, dated December 15, 2024.
22. PHFA Single Family Mortgage Revenue Bonds Series 2016-199 Offering Statement, dated March 23, 2016.
23. Pennsylvania Housing Finance Agency Quarterly Disclosure Report, dated April 7, 2025.

About risk

Municipal securities are subject to the risk that legislative or economic conditions could affect an issuer's ability to make payments of principal and/or interest.

Junk bonds involve greater risk of default or price changes due to changes in the issuer's credit quality.

The value of investments and any income will fluctuate (this may partly be the result of exchange rate fluctuations) and investors may not get back the full amount invested. The values of junk bonds fluctuate more than those of high-quality bonds and can decline significantly over short time periods.

All fixed income securities are subject to two types of risk: credit risk and interest rate risk. Credit risk refers to the possibility that the issuer of a security will be unable to make interest payments and/or repay the principal on its debt. Interest rate risk refers to the risk that bond prices generally fall as interest rates rise and vice versa.

Municipal bonds are issued by state and local government agencies to finance public projects and services. They typically pay interest that is tax-free in their state of issuance. Because of their tax benefits, municipal bonds usually offer lower pre-tax yields than similar taxable bonds. The value of investments and any income will fluctuate (this may partly be the result of exchange rate fluctuations) and investors may not get back the full amount invested.

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For more information on Standard and Poor's rating methodology, please visit www.standardandpoors.com and select 'Understanding Credit Ratings' under 'About Ratings' on the homepage.

For more information on Moody's rating methodology, please visit <https://ratings.moodys.io/ratings> and select 'Rating Methodologies' on the homepage.

For more information on Fitch Ratings rating methodology, please visit www.fitchratings.com and select 'Criteria' under 'Resources' on the homepage. Then select 'Rating Definitions' under 'Resources' on the 'Contents' menu.

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