MOODY'S
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CREDIT OPINION
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Philadelphia School District, PA

Update following revision of outlook to positive

Summary

Philadelphia School District's (Baa3 positive) financial position will largely stabilize at its improved level, though a structural operating imbalance will persist over the longer term. Specifically, the district spends about 40% of its budget on tuition to outside charter and cyber schools, which materially impacts its operating flexibility. Further, overall enrollment continues to decline, due both to charter pressure and changing demographics. The district's moderate leverage profile will grow in the near term, though federal aid will offset some of the district's sizable capital needs.

The district continues to benefit from a strong relationship with the City of Philadelphia (A1 stable), along with its large and dynamic economic base. The city acts as tax collector for certain of the district's pledged revenue, and remits it daily to the School District's Fiscal Agents, a financial institution with trust powers through a lockbox structure.

On June 28, 2023, we affirmed the district's Baa3 issuer, general obligation unlimited tax (GOULT) and non-contingent lease backed by GOULT ratings and revised the outlook to positive from stable.

Credit strengths

» Materially improved reserves and liquidity due to an influx of federal coronavirus aid

» City's willingness to support the district with dedicated tax revenues and an established governance link between the city and school district provide material strength to the credit profile

» GO debt is secured by a lockbox agreement that has never been tripped (since inception in 1982) with debt service coverage of 3.7 times as of fiscal 2022 year end

Credit challenges

» Marked competition from outside charter and cyber schools

» Return to structural imbalance currently projected after fiscal 2025

This report was republished on 29 June 2023 with a correction to the number of years covered by the capital improvement plan in the Leverage section.

» No ability to raise revenues independently; reliance on the state and city for revenue generation is a substantial limiting factor to the district's overall credit profile

Rating outlook

The positive outlook reflects our expectation that the district's financial position will continue to improve and then stabilize at a considerably stronger level, due largely to extraordinary support from the federal government. Future reviews will consider whether the district can maintain strong reserves in the absence of one-time aid, while grappling with continued enrollment pressures and increasing leverage.

Factors that could lead to an upgrade

» Maintenance of budget balance and strong reserves once federal funding rolls off

» Improved funding environment

» Ability to manage enrollment pressure due to charter competition

Factors that could lead to a downgrade

» Sustained draws on reserves and liquidity

» Acceleration of declining enrollment trend

» Significant borrowing beyond current expectations

Key indicators

Exhibit 1

Philadelphia School District, PA

	2019	2020	2021	2022	Baa Medians
Economy					
Resident income	70.5%	74.0%	76.9%	N/A	86.0%
Full value ($000)	$82,141,330	$91,741,956	$99,268,222	$100,781,161	$971,081
Population	1,579,075	1,581,531	1,596,865	N/A	12,995
Full value per capita	$52,019	$58,008	$62,164	N/A	$78,968
Enrollment	132,520	130,617	124,111	118,207	1,707
Enrollment trend	-0.6%	-0.9%	-1.8%	-3.7%	-1.5%
Financial performance					
Operating revenue ($000)	$3,051,796	$3,124,381	$3,123,633	$3,145,328	$25,791
Available fund balance ($000)	$301,821	$110,396	$307,350	$517,991	$2,637
Net cash ($000)	$364,986	$382,569	$497,296	$801,767	$3,224
Available fund balance ratio	9.9%	3.5%	9.8%	16.5%	10.6%
Net cash ratio	12.0%	12.2%	15.9%	25.5%	12.4%
Leverage					
Debt ($000)	$2,957,370	$3,547,870	$3,337,448	$3,518,731	$20,047
ANPL ($000)	$2,842,158	$3,684,811	$4,380,739	$4,176,018	$55,909
OPEB ($000)	$153,061	$164,090	$294,072	$189,460	$6,554
Long-term liabilities ratio	195.1%	236.7%	256.5%	250.7%	373.0%
Implied debt service ($000)	$228,816	$215,621	$254,072	$234,088	$1,426
Pension tread water ($000)	$140,085	$163,108	$171,387	$141,291	$1,760
OPEB contributions ($000)	$9,177	$9,491	$9,593	$9,885	$240
Fixed-costs ratio	12.4%	12.4%	13.9%	12.2%	15.8%

For definitions of the metrics in the table above please refer to the US K-12 Public School Districts Methodology or see the Glossary in the Appendix below. Metrics represented as N/A indicate the data were not available at the time of publication. The medians come from our most recently published K12 Median Report.
Sources: US Census Bureau, Philadelphia School District, PA's financial statements and Moody's Investors Service

Profile

Philadelphia School District is coterminous with the City of Philadelphia (A1 stable) and the largest public school district in Pennsylvania (Aa3 stable). The district operates more than 200 schools with enrollment of 118,207 as of the 2021-2022 school year.

Detailed credit considerations

Economy: strong economic base; below average resident wealth and income with declining enrollment and marked competition from charter schools

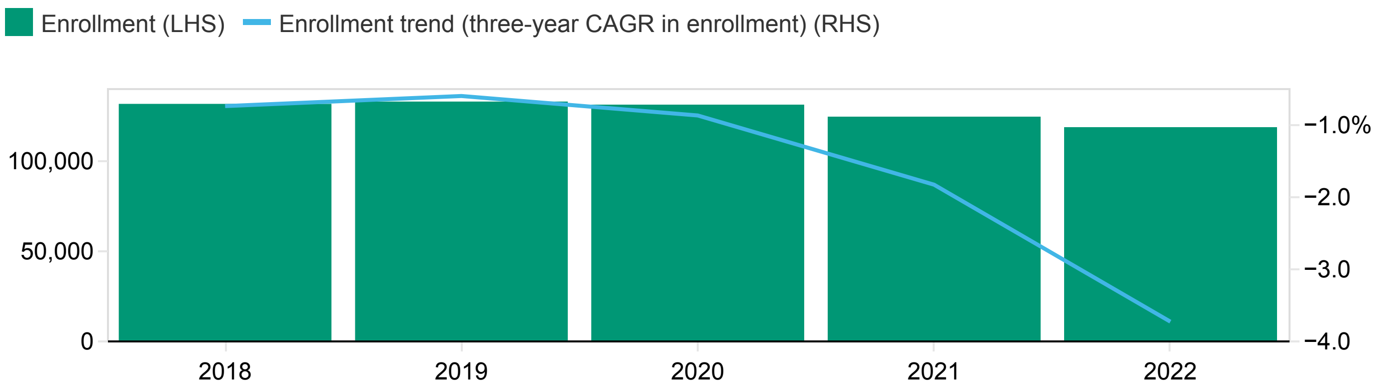
Philadelphia's economy continues to be anchored by some of the top higher education and healthcare institutions in the nation, and these institutions will continue to be the cornerstone of the city's longer term recovery. Of the 15 biggest employers in Philadelphia, nine are either higher education or healthcare entities - most prominently the University of Pennsylvania (Aa1 stable) and the University of Pennsylvania Health System (Aa3 stable). The city is home to about 30 hospitals, including Thomas Jefferson University Hospital and the Children's Hospital of Philadelphia ("CHOP") (Aa2 stable). The nature of Philadelphia's largest institutions, including their already established brand equity and regional market share, will continue to provide stability for the sector.

Favorably, Philadelphia's largest institutions continue to expand and invest in the city. In 2021, Penn Medicine completed construction on a new 1.5 million square foot Patient Pavilion; one of the largest hospital projects underway in the nation and the largest capital project in Penn's history, and in late 2022, CHOP opened a new Center for Advanced Behavioral Healthcare in West Philadelphia, with 47,000 square feet dedicated to patient care. The city has also realized new ancillary growth from its eds & meds anchors – according to the city, Philadelphia research firms received $1.2 billion in NIH funding in 2022, particularly for cell therapy, gene therapy, and gene editing research. The city's large, $116 billion tax base (as of 2023) has grown by a robust compound 16% on average, annually, over the last five years, and the city reports an additional $9 billion of full value development expected to come online through 2026. Resident wealth (as measured by full value per capita) is a below average $73,000.

Despite the city's sizable and resilient economy, resident income levels are below average at approximately 77% of the national level. Moreover, the school district's enrollment has declined by a compound average 3.7% annually over the last three years - a trend that will continue for at least the next five years (albeit at a slower pace). Current enrollment is 112,606, indicating a 4.7% decline from the 2021-2022 school year.

While management attributes the ongoing decline to out-migration to suburban communities, the district has historically and continues to face marked competition from charter schools, a challenge that has only compounded since the onset of the coronavirus pandemic. Currently, 64,225 students attend outside brick and mortar charter schools and an additional 15,151 attend outside cyber schools - a combined equivalent of 71% of in-house enrollment. Outside cyber school enrollment increased by 88% since the start of the pandemic, and while the school board has not recently approved any additional charter schools, management expects ongoing competition with 200 students departing the district for charter or cyber schools annually.

Exhibit 2
Enrollment



Source: Moody's Investors Service

Financial operations: reserves buoyed by extraordinary federal coronavirus aid; concealing structural imbalance

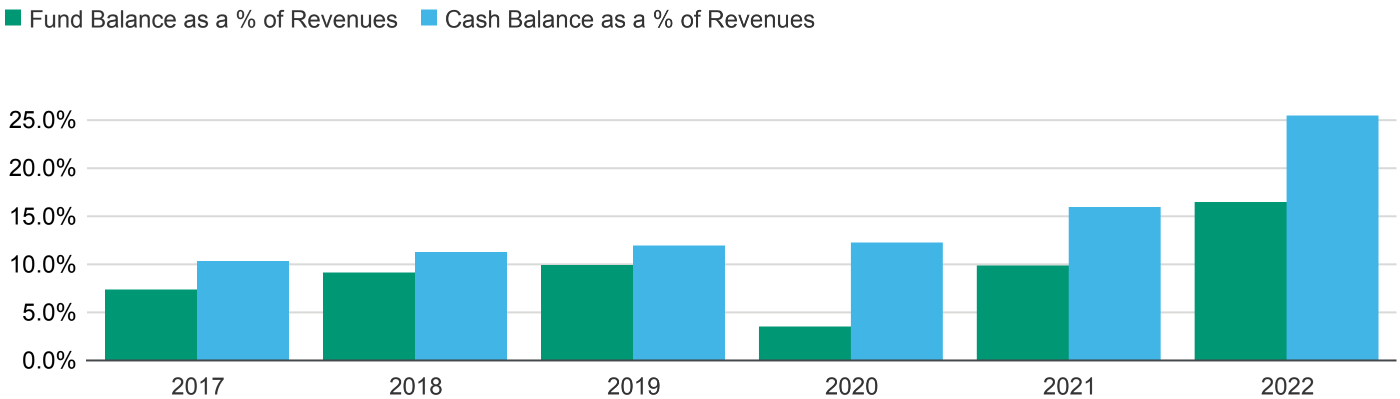
The district's financial position will continue to benefit from federal coronavirus aid in the current (2023) fiscal year, which concludes at the end of the month. Management currently projects that the district's available General Fund reserves will grow by $248 million. The district will recognize $369 million of federal coronavirus aid and a $92 million increase in state aid. Charter school tuition expenditures declined modestly to $1.2 billion, while special education expenditures grew to $862 million.

Fiscal 2022 resulted in a sizable $213 million operating surplus (combined General Fund and Debt Service Fund), which brought available reserves to $518 million or 17% of operating revenue - a five year high. The district recognized $736 million in federal coronavirus aid in its Categorical Funds, which it used to offset $217 million in recurring expenses and eligible capital needs.

Management reports a true structural imbalance of around $100 million annually due in large part to sizable charter school tuition costs (40% of 2022 revenue) and special education expenses (25% of 2022 operating revenue). Beyond fiscal 2023, the district has $550 million in remaining federal aid that it can draw upon. Of this amount, $210 million is earmarked for school construction and $75 million is earmarked for one-time core instruction material. Accordingly, the district's financial position will benefit from federal support through 2025.

The district is reliant on both state aid, which accounts for 48% of operating revenue, and local sources, which account for just over half of operating revenue. The recent Pennsylvania Supreme Court ruling that declared the commonwealth's funding formula unconstitutional may result in significant additional revenue for the district, which may compensate for its aforementioned structural deficit. Absent ongoing support beyond the horizon of federal coronavirus aid, however, the district's long-term financial trajectory will continue to suffer.

Exhibit 3
Financial Trends



Source: Moody's Investors Service

Liquidity

Liquidity will improve in fiscal 2023 due to the above-mentioned projected operating surplus. At the end of fiscal 2022, the district had net cash of $802 million, which equated to 26% of operating revenue.

The district continues to use tax revenue anticipation notes (TRANs), including $500 million in fiscal 2023. Management expects a slightly smaller borrowing in fiscal 2024.

Leverage: moderate leverage; significant borrowing plans

The district's leverage will grow in the near term, as the district's capital plan calls for $2.8 billion (89% of 2022 revenue) in borrowing over the next six years. Management currently expects to borrow $250 million in fiscal 2024, which equates to about 8% of 2022 revenue. At the end of fiscal 2022, the district had $3.5 billion in net direct debt outstanding, which equated to a moderate 112% of operating revenue.

When incorporating the district's other long term liabilities - Moody's adjusted net pension liability (ANPL) and adjusted other post-employment benefit (OPEB) liability - total leverage amounted to 251% of operating revenue. The district's fixed-costs ratio was manageable, however, at 12% of operating revenue.

Legal security

The district's general obligation unlimited tax (GOULT) bonds are backed by its full faith, credit and taxing power, and benefit from a lock-box structure, originally established in 1982. Through various credit cycles over the past 39 years, the lock box mechanism has never been tripped, and a sinking fund payment never been missed. The district reports that this remained the case during the coronavirus pandemic.

The City of Philadelphia, as tax collector for certain of the district's local taxes (property, business use and occupancy, liquor, and non-business income taxes), remits the district's revenues on a daily basis directly to the fiscal agent. If a given day's revenues are insufficient to meet the daily deposit requirement, the shortfall is added to the subsequent day's requirement until current. Only once the daily deposit requirement has been met do remaining local tax revenues flow to the district's operating account. These four dedicated local taxes provided debt service coverage of 3.7 times in fiscal 2022, unchanged from fiscal 2021.

Favorably, the General Obligation bonds are also secured by the state intercept, governed by Section 633 of the PA School Code and stipulated in the district's fiscal agent agreements, that would be triggered 15 days prior to the debt service or sinking fund payment due date if the sinking fund was not fully funded. The state intercept mechanics only require 10 days for payment, which would ensure debt service would be paid prior to a default. Furthermore, with implementation of Act 85 in 2016, the state has ensured that intercept payments, for the benefit of bond debt service, will be made even in the absence of an appropriation budget of the state.

At fiscal 2022 year end, state aid substantially exceeded sum sufficient coverage of debt service.

Debt service for the district's State Public School Building Authority (SPSBA) bonds is paid directly from the State Treasurer to the Bond Trustee from state appropriations to the district on specified dates scheduled at least 35 days prior to each debt service payment date under a direct-pay agreement. The district has extended its full faith and credit taxing power as security for these bonds, and Act 85 applies to these bonds as well.

Debt structure

All of the district's debt is fixed rate and amortizes over the long term.

Debt-related derivatives

The district is not exposed to any swaps or other derivatives.

Pensions and OPEB

The district's pension liabilities are expected to grow but remain moderate. The district contributes to the Public School Employee Retirement System (PSERS), a multi-employer cost-sharing plan administered by the Commonwealth of Pennsylvania. Pennsylvania reimburses local school districts for at least 50% of their pension contributions, although some districts receive higher levels of reimbursement aid. If the state were to end its support, local school districts' ANPLs would roughly double, in most cases.

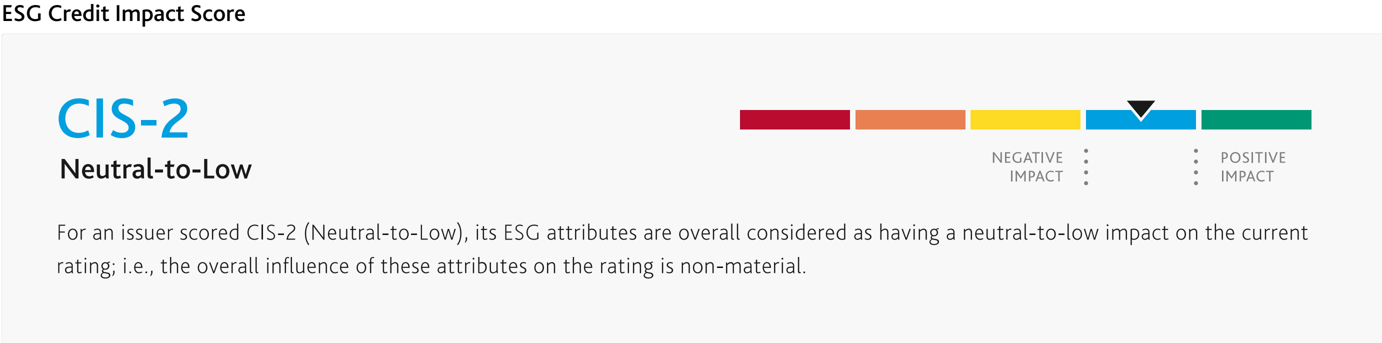
Pennsylvania school districts typically report their pension liabilities, attributable to their shares of the Pennsylvania Public School Employees' Retirement System (PSERS), with a one-year lag. During fiscal 2022, the district contributed $199 million, which was matched in full by the state's reimbursement for half the annual cost. The fiscal 2022 Moody's ANPL, under Moody's methodology for adjusting reported pension data, was $4.2 billion, or a moderate 133% of annual operating revenues. The district's adjusted net OPEB liability amounted to a manageable $189 million or 6% of revenue.

ESG considerations

Philadelphia School District, PA's ESG Credit Impact Score is Neutral-to-Low CIS-2

Exhibit 4

ESG Credit Impact Score

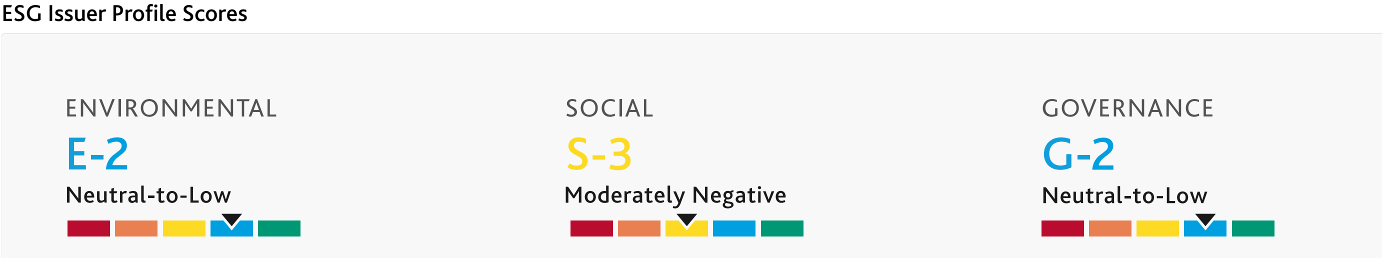


Source: Moody's Investors Service

Philadelphia School District's ESG Credit Impact Score is neutral-to-low (**CIS-2**), reflecting neutral-to-low exposure to environmental and governance risks, and moderately negative exposure to social risks.

Exhibit 5

ESG Issuer Profile Scores



Source: Moody's Investors Service

Environmental
Philadelphia School District's E Issuer Profile Score is neutral-to-low (**E-2**), reflecting relatively low exposure to environmental risks across all categories, including physical climate risks, carbon transition, water management, natural capital and waste and pollution.

Social
Philadelphia School District's S Issuer Profile Score is moderately negative (**S-3**), reflecting moderately negative exposure to social risks across categories including labor and income, education, and health and safety. Exposure to social risks related to demographics, housing, and access to basic services is neutral-to-low. Population has grown over the last decade, though the percentage of school-aged children in the district is slightly below the median of school districts we rate. The percent of school-aged children in poverty in the district is well above the national median. Additionally, while educational attainment is above average for district residents, the graduation rate for the district is well below the national median, likely due to a significant charter school presence in Philadelphia. The city's housing affordability index is above the national index, though life expectancy is below the rest of the nation, and its violent crime rate is markedly above the national median. The district's exposure to access to basic services risk is neutral-to-low.

Governance
Philadelphia School District's G Issuer Profile Score is neutral-to-low (**G-2**). The district's transparency and disclosure is excellent with frequent and regular financial disclosures, and the district has exhibited satisfactory budget management. The district's capture rate (the percentage of school-aged children within the district's boundaries who attend the district) is materially below that of other school districts across the commonwealth and nation, again due to notable competition from outside cyber and charter schools. This is reflected in the district's moderately negative policy credibility and effectiveness score. While the district has limited revenue raising ability on its own, its strengthened governance relationship with the city helps to mitigate this risk, and is reflected in the district's neutral score for institutional structure, in line with all Pennsylvania school districts.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click here to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

Rating methodology and scorecard factors

The US K-12 Public School Districts Methodology includes a scorecard, a tool providing a composite score of a school district's credit profile based on the weighted factors we consider most important, universal and measurable, as well as possible notching factors dependent on individual credit strengths and weaknesses. Its purpose is not to determine the final rating, but rather to provide a standard platform from which to analyze and compare school district credits.

The distinction between the assigned rating of Baa3 and the scorecard-indicated outcome of A1 reflects the structural challenges that the district continues to face, including significant competition from outside charter and cyber schools, which will continue to challenge its enrollment and operating flexibility.

Exhibit 6

Philadelphia School District, PA

	Measure	Weight	Score
Economy			
Resident Income (MHI Adjusted for RPP / US MHI)	76.9%	10.0%	Baa
Full value per capita (full valuation of the tax base / population)	72,621	10.0%	A
Enrollment trend (three-year CAGR in enrollment)	-3.7%	10.0%	Baa
Financial performance			
Available fund balance ratio (available fund balance / operating revenue)	16.5%	20.0%	A
Net cash ratio (net cash / operating revenue)	25.5%	10.0%	Aaa
Institutional framework			
Institutional Framework	A	10.0%	A
Leverage			
Long-term liabilities ratio ((debt + ANPL + adjusted net OPEB) / operating revenue)	250.7%	20.0%	A
Fixed-costs ratio (adjusted fixed costs / operating revenue)	12.2%	10.0%	Aaa
Notching factors			
No notchings applied			
Scorecard-Indicated Outcome			A1
Assigned Rating			**Baa3**

The complete list of outstanding ratings assigned to the Philadelphia School District, PA is available on their issuer page. Details on the current ESG scores assigned to the Philadelphia School District, PA are avialable on their ESGView page.
Sources: US Census Bureau, Philadelphia School District, PA's financial statements and Moody's Investors Service

Appendix

Exhibit 7
Key Indicators Glossary

	Definition	Typical Source*
Economy		
Resident income	Median Household Income (MHI), adjusted for Regional Price Parity (RPP), as a % of the US	MHI: American Community Survey (US Census Bureau) RPP: US Bureau of Economic Analysis
Full value ($000)	Estimated market value of taxable property accessible to the district	State repositories, district's audited financial reports, offering documents or continuing disclosure
Population	Population of school district	American Community Survey (US Census Bureau)
Full value per capita	Full value / population of school district	
Enrollment	Student enrollment of school district	State data publications
Enrollment trend	3-year Compound Annual Growth Rate (CAGR) of Enrollment	State data publications; Moody's Investors Service
Financial performance		
Operating revenue ($000)	Total annual operating revenue in what we consider to be the district's operating funds	Audited financial statements
Available fund balance ($000)	Committed, assigned and unassigned fund balances in what we consider to be the district's operating funds	Audited financial statements
Net cash ($000)	Net cash (cash and liquid investments minus short-term debt) in what we consider to be the district's operating funds	Audited financial statements
Available fund balance ratio	Available fund balance / Operating Revenue	Audited financial statements
Net cash ratio	Net Cash / Operating Revenue	Audited financial statements
Leverage		
Debt ($000)	District's direct gross debt outstanding	Audited financial statements; official statements
ANPL ($000)	District's pension liabilities adjusted by Moody's to standardize the discount rate used to compute the present value of accrued benefits	Audited financial statements; Moody's Investors Service
OPEB ($000)	District's net other post-employment benefit (OPEB) liabilities adjusted by Moody's to standardize the discount rate used to compute the present value of accrued benefits	Audited financial statements; Moody's Investors Service
Long-term liabilities ratio	Debt, ANPL and OPEB liabilities as % of operating revenue	Audited financial statements, official statements; Moody's Investors Service
Implied debt service ($000)	Annual cost to amortize district's long-term debt over 20 years with level payments	Audited financial statements; official statements; Moody's Investors Service
Pension tread water ($000)	Pension contribution necessary to prevent reported unfunded pension liabilities from growing, year over year, in nominal dollars, if all actuarial assumptions are met	Audited financial statements; Moody's Investors Service
OPEB contributions ($000s)	District's actual contribution in a given period, typically the fiscal year	Audited financial statements; official statements
Fixed-costs ratio	Implied debt service, pension tread water and OPEB contributions as % of operating revenue	Audited financial statements, official statements, pension system financial statements

*Note: If typical data source is not available then alternative sources or proxy data may be considered. For more detailed definitions of the metrics listed above please refer to the US K-12 Public School Districts Methodology.
Source: Moody's Investors Service

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