FitchRatings

RATING ACTION COMMENTARY

Fitch Rates Philadelphia School District, PA's $352 Million GOs 'A+'; TRANs 'F1+'; Outlook Positive

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Fitch Ratings - New York - 11 Oct 2023: Fitch Ratings has assigned an 'A+' rating to $300 million in School District of Philadelphia, PA's (SPD) general obligation bonds series of A of 2023 and $50 million general obligation bonds, series B of 2023 (Green Bonds) based on the intercept provisions of the Pennsylvania School Code of 1949. The Issuer Default Rating (IDR) of the district is 'BB+', which is not a consideration for the credit enhancement ratings.

Fitch has also assigned a 'F1+' rating to the school district of Philadelphia, Pennsylvania Tax and Revenue Anticipation Notes (TRANs), Series A of 2023-2024, based on provisions of the statutory intercept of commonwealth revenues.

The Rating Outlook on the Pennsylvania School Intercept Rating is Positive.

RATING ACTIONS

ENTITY / DEBT	RATING	PRIOR

Philadelphia School District (PA)

Philadelphia School District (PA) /General Obligation - Unlimited Tax/1 ST	ST	F1+	New Rating	WD

VIEW ADDITIONAL RATING DETAILS

The bonds, which are expected to sell the week of Oct. 16 via negotiated sale. The proceeds of the bonds will fund certain SPD capital projects including projects designed to reduce energy usage. The notes will fund current operating budget expenses of SPD prior to the receipt of taxes and other district revenues for fiscal year 2024. The notes will mature on June 28, 2024.

SECURITY

The district pledges its full faith, credit and taxing power to repayment of the GO bonds. The bonds are also subject to protections under Pennsylvania statutes outlining intercept of commonwealth aid for school districts (Pennsylvania School Credit Intercept Provision). The commonwealth's pre-default intercept mechanism provides for full and timely payment of debt service through the ability to intercept all state revenues appropriated to the district.

For the direct pay series A of 2023 GO bonds issued by the district, payments from the State Treasurer are made directly to the trustee for debt service payments 15 days prior to the debt service due dates on March 1 and Sept. 1. The district has covenanted that it will include payments in its budget appropriations. For these payments, the district irrevocably has pledged its full faith, credit and taxing power.

The TRANs are being issued pursuant to section 8125 of the Commonwealth's Local Government Unit Debt Act (LGUDA) and the school district governing board's resolution. The TRANs are secured by a pledge of, security interest in, and lien and charge on, the taxes and revenues of the school district to be received from the date of issuance of the TRANs until June 28, 2024. This includes revenues appropriated by the Commonwealth to the district and district revenues and taxes in the custody of the state treasurer under the intercept provision of section 8125 (subsection b), which enhances the TRANs' security.

ANALYTICAL CONCLUSION

The 'A+' long-term rating on the bonds reflects the credit enhancement (CE) provided by the Pennsylvania School Credit Intercept Provision that provides protections under Pennsylvania statutes outlining intercept of Commonwealth aid for school districts (Pennsylvania School Credit Intercept Provision). The rating reflects the Commonwealth's appropriation backed obligations, which is one notch lower than Pennsylvania's 'AA-' Issuer Default Rating. The Positive Outlook reflects Pennsylvania's recent use of a significant revenue surplus to build its reserves to historical highs, suggesting a potentially material improvement in the commonwealth's operating performance.

The 'F1+' short-term note rating is mapped to the Commonwealth's long-term general credit quality, given the credit enhancement (CE) provided by the Pennsylvania School Credit Intercept Provision. The notes ratings map to the appropriation-backed rating on the Commonwealth, as the pledged state aid revenues are subject to annual appropriation. The ratings consider the sufficiency of the undisbursed portion of pledged commonwealth revenues appropriated to the school district and district tax revenues held in the custody of the state treasurer that are available for intercept in the event the district is unable to repay note holders.

Key Rating Drivers

RATING BASED SOLELY ON PROGRAM: The enhanced ratings are based solely on the programmatic rating of the school credit enhancement intercept and do not consider the underlying credit quality of the district.

STRONG PROGRAM MECHANICS: The structure of the commonwealth's pre-default intercept mechanism for short-term debt issued by first class school districts (currently only the school district of Philadelphia, or SDP) provides for full and timely payment of debt service through the ability to intercept all state revenues appropriated to the district.

PENNSYLVANIA'S CREDIT QUALITY: Revenues appropriated by the commonwealth to the SDP are statutorily pledged to note holders. The 'F1+' rating on the notes is mapped from an 'A+' long-term rating, which is one notch below the commonwealth's 'AA-' Issuer Default Rating (IDR), reflecting the appropriation risk associated with these pledged revenues.

SOLID COVERAGE FROM AVAILABLE APPROPRIATIONS: The district's cash flows provide a high level of coverage to support Fitch's highest short-term rating of 'F1+' on the TRANS and the 'A+' credit enhanced rating assigned to SPD's long-term general obligation bonds.

Economic Resource Base

The district is coterminous with the city of Philadelphia, which serves as a regional economic center in the Northeast with a stable employment base weighted toward the higher education and healthcare sectors. Jobs expansion had been steady and strong prior to the outbreak of the coronavirus, but comparatively low wealth levels and modest population increases persist, limiting growth prospects. The city's 2022 Census population is 1.6 million, up 2.7% from the 2010 Census. School enrollment has been declining, pressured by growth in charter schools.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--An upgrade of the Commonwealth's IDR, which is the basis of the rating on the Pennsylvania School Credit Intercept Program rating.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--A downgrade of the Commonwealth's IDR would conversely led to a rating downgrade of the Intercept Program rating;

--Material or sustained decrease in state aid resulting in a decline in the coverage levels of the debt obligations.

CREDIT PROFILE

The district is the nation's eighth-largest school district and the largest in the commonwealth. The 2023 enrollment totaled 197,290 students, of whom 77,900 or 39% were enrolled in charter schools or alternative education programs. Charter school enrollment including cyber-charter enrollment increased during the pandemic but the district expects enrollment to stabilize and remain relatively flat in 2024 and beyond.

The district's projected cash flow forecast for fiscal 2024, based on the amounts appropriated in the Commonwealth's enacted fiscal 2024 budget and a monthly disbursement schedule provided by the Commonwealth's department of education, indicates that there would be $4.9 billion in gross revenues appropriated to the district. Total revenues include gross Commonwealth subsidies ($1.9 billion), intermediate unit funding ($154 million, primarily for special education), and distribution of local revenues of $1.8 billion. These revenues provide very strong coverage for the district's total sinking fund debt service payments including all of the outstanding GO bonds and the 2023-2024 TRANs.

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

Philadelphia School District (PA) has an ESG Relevance Score of '4' for Labor Relations & Practices due to {DESCRIPTION OF ISSUE/RATIONALE}, which has a negative impact on the credit profile, and is relevant to the rating[s] in conjunction with other factors.

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

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APPLICABLE CRITERIA

U.S. Public Finance Tax-Supported Rating Criteria (pub. 04 May 2021) (including rating assumption sensitivity)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

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99th percentile. Sector-specific best- and worst-case scenario credit ratings are listed in more detail at https://www.fitchratings.com/site/re/10238496

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