Moody's

Rating Action: **Moody's assigns Baa3 UND/A1 ENH to Philadelphia School District, PA's Series A and B of 2023 GO Bonds & MIG 1 to Series A of 2023-2024 TRANS**

11 Oct 2023

New York, October 11, 2023 -- Moody's Investors Service has assigned a Baa3 general obligation unlimited tax (GOULT) underlying rating and an A1 enhanced rating to Philadelphia School District, PA's anticipated $300 million General Obligation Bonds, Series A of 2023 and $50 million General Obligation Bonds, Series B of 2023 (Green Bonds). Concurrently, Moody's has assigned a MIG 1 short term rating to the district's anticipated $400 million Tax and Revenue Anticipation Notes, Series A of 2023-2024. Moody's maintains the district's Baa3 issuer, general obligation unlimited tax (GOULT) and non-contingent lease backed by GOULT debt ratings. The outlook is positive. Post-issuance, the district will have approximately $3.8 billion in debt outstanding.

RATINGS RATIONALE

The district's Baa3 issuer rating reflects its markedly improved reserve position, due largely to federal coronavirus aid. That said, we expect the district's reserves to largely stabilize at this 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 outsid 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 rating further reflects the district's strong relationship with the City of Philadelphia (A1 stable), which is coterminous with the district and has a sizable and expanding economic base. However, resident wealth and income levels are below average. The city acts as tax collector for the district's pledged revenue, and remits it daily to a trustee through a lockbox structure.

The lack of distinction between the district's issuer rating and the Baa3 rating on the GOULT and GOULT-backed non-contingent lease debt is based on the district's general obligation full faith and credit pledge.

The A1 enhanced rating reflects our current assessment of the Pennsylvania School District Intercept Program, which provides that state aid will be allocated to bondholders in the event that the school district cannot meet its scheduled sinking fund deposit dates. The A1 rating reflects the district's direct-pay arrangement with the state for its lease debt, and the engagement of a fiscal agent for its general obligation debt, which would ensure timely notification to the state in the event of a debt service deposit shortfall.

The MIG 1 rating for the district's Tax and Revenue Anticipation Notes (TRAN) reflects our credit view of state legislation that provides for the intercept of state aid as well as tax revenue due to the district at the time of the TRAN repayment and can be diverted to noteholders in the event that cashflow is inadequate to repay the note at maturity. The district's 2022 state aid covers all regular annual debt service plus the par amount of anticipated 2023-2024 TRANs by 2.2 times.

RATING OUTLOOK

The positive outlook on the underlying ratings 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 OF THE RATINGS

- Maintenance of budget balance and strong reserves once federal funding rolls off (long term rating)

- Improved funding environment (long term rating)

- Ability to manage enrollment pressure due to charter competition (long term rating)

FACTORS THAT COULD LEAD TO A DOWNGRADE OF THE RATINGS

- Sustained draws on reserves and liquidity (long term rating)

- Acceleration of declining enrollment trend (long term rating)

- Significant borrowing beyond current expectations (long term rating)

- Downgrade of the Commonwealth of Pennsylvania (Aa3 positive), which impacts the intercept program rating (enhanced and short term ratings)

- Materially reduced state aid that is insufficient for adequate debt service coverage (enhanced and short term ratings)

- Material decline in the school district's liquidity position (short term ratings)

LEGAL SECURITY

The district's general obligation unlimited tax (GOULT) bonds, including the Series A and B of 2023 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, 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 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 on long term debt 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.

The Series A Notes are general obligations of the School District (but do not carry the pledge of the full faith, credit and taxing powers of the School District) and are equally and ratably secured, until paid or until deposits for such payment have been made into the Series A Sinking Fund by a pledge of, a security interest in and a lien and charge on the taxes and revenues of the School District to be received from their date of issuance to June 30, 2024. Notwithstanding the foregoing, the amounts irrevocably directed by the School District to be deposited on a daily basis directly into the School District's fixed rate general obligation bond sinking funds ("Daily Sinking Fund Deposits") are not subject to such pledge, security interest, lien and charge.

USE OF PROCEEDS

Proceeds from the sale of the Series A of 2023 bonds will be used to finance various districtwide capital improvement projects.

Proceeds from the sale of the Series B of 2023 bonds will be used to finance projects that will reduce the energy consumption of the district.

Proceeds from the sale of the Series A of 2023-2024 notes will be used to pay certain of the current operating budget expenses of the School District prior to the receipt of School District taxes and certain other School District revenues to be received during Fiscal Year 2024.

PROFILE

Philadelphia School District is coterminous with the City of Philadelphia (A1 stable) and is the largest public school district in Pennsylvania (Aa3 positive). The district operates more than 200 schools with enrollment of 117,067 as of the 2022-2023 school year.

METHODOLOGY

The principal methodology used in the underlying ratings was US K-12 Public School Districts Methodology published in January 2021 and available at https://ratings.moodys.com/rmc-documents/70054. The principal methodology used in the enhanced ratings was State Aid Intercept Programs and Financings Methodology published in March 2022 an available at https://ratings.moodys.com/rmc-documents/356903. The principal methodology used in the short-term rating was US Municipal Short-term Debt Methodology published in May 2023 and available at https://ratings.moodys.com/rmc-documents/398329. Alternatively, please see the Rating Methodologies page on https://ratings.moodys.com for a copy of these methodologies.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on https://ratings.moodys.com/rating-definitions.

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