CREDIT OPINION

10 October 2024

Send Your Feedback

Philadelphia School District, PA

Update following upgrade to Baa2

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Summary

Philadelphia School District's (Baa2 positive) solid financial position further improved in fiscal 2024 on an unaudited basis from 21% of revenue at the end of fiscal 2023 - a historic high. Moving forward, however, the district is poised to return to structurally imbalanced financial operations due largely to significant charter and cyber school tuition costs that account for approximately 30% of the district's annual budget. While enrollment has continued to decline, the pace of enrollment loss has favorably moderated to -1.7%. Leverage is poised to grow from 181% of revenue at the end of fiscal 2023 due to forthcoming borrowing plans, but will remain manageable relative to operating revenue.

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 local tax revenue, and remits it daily to the district's fiscal agent, a financial institution with trust powers through a lockbox structure.

On October 9, we upgraded the district's issuer, general obligation unlimited tax (GOULT) and non-contingent lease backed by GOULT ratings to Baa2. The outlook remains positive.

Credit strengths

» Materially improved reserves and liquidity due predominantly 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 3.5 times as of fiscal 2023 year end

Credit challenges

» Marked competition from outside charter and cyber schools

» Return to structural imbalance currently projected in fiscal 2025 absent additional state support

» 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 the potential that the district's improved reserve position following further growth in fiscal 2024 will remain near historic highs over the next three to five years despite the resumption of operating deficits in fiscal 2025. The positive outlook further reflects the improved funding environment for school districts in Pennsylvania.

Factors that could lead to an upgrade

- Material reduction or elimination of structural deficit with maintenance of reserves above 17.5% of revenue
- Ability to manage enrollment pressure due to charter competition that leads to stable enrollment or moderation of enrollment loss
- Sustained improvement in funding environment

Factors that could lead to a downgrade

- Sustained draws on reserves and liquidity
- Acceleration of declining enrollment trend to over 5% compound average annual loss
- Significant borrowing beyond current expectations or pension liability growth that drives leverage to over 400% of revenue

Key indicators

Exhibit 1
Philadelphia School District, PA

	2020	2021	2022	2023	Baa Medians
Economy					
Resident income	73.9%	76.9%	76.0%	N/A	82.2%
Full value ($000)	$91,741,956	$99,268,222	$100,781,161	$105,789,486	$794,380
Population	1,581,531	1,596,865	1,593,208	N/A	13,781
Full value per capita	$58,008	$62,164	$63,257	N/A	$66,883
Enrollment	130,617	124,111	118,207	118,401	1,602
Enrollment trend	-0.9%	-1.8%	-3.7%	-3.2%	-3.2%
Financial performance					
Operating revenue ($000)	$3,124,381	$3,123,633	$3,145,328	$3,677,523	$23,114
Available fund balance ($000)	$110,396	$307,350	$517,991	$766,372	$3,156
Net cash ($000)	$382,569	$497,296	$801,767	$1,009,723	$3,672
Available fund balance ratio	3.5%	9.8%	16.5%	20.8%	15.7%
Net cash ratio	12.2%	15.9%	25.5%	27.5%	16.0%
Leverage					
Debt ($000)	$3,547,870	$3,337,448	$3,518,731	$3,330,146	$17,882
ANPL ($000)	$3,684,811	$4,380,739	$4,176,018	$3,186,007	$67,168
OPEB ($000)	$164,090	$183,920	$189,460	$154,646	$6,152
Long-term liabilities ratio	236.7%	253.0%	250.7%	181.4%	370.4%
Implied debt service ($000)	$215,621	$254,072	$234,088	$245,747	$1,371
Pension tread water ($000)	$163,108	$171,387	$141,291	$149,321	$1,782
OPEB contributions ($000)	$9,491	$9,593	$9,885	$9,819	$160
Fixed-costs ratio	12.4%	13.9%	12.2%	11.0%	13.9%

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 Ratings

Profile

Philadelphia School District is coterminous with the City of Philadelphia (A1 stable) and the largest public school district in Pennsylvania (Aa2 stable). The district operates more than 200 schools with enrollment of 117,985 as of the 2023-2024 school year.

Detailed credit considerations

Economy: regionally important economy; below-average resident wealth and income with declining enrollment and marked competition from charter schools

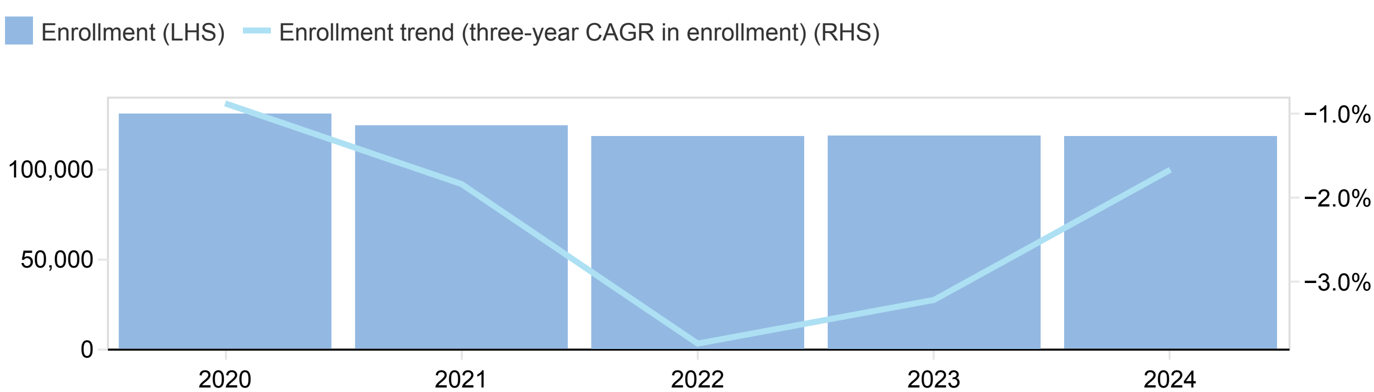
Philadelphia's economy will remain anchored by some of the nation's top higher education and healthcare institutions. Of the 15 biggest employers in Philadelphia, nine are either higher education or healthcare entities - most prominently the University of Pennsylvania (Aa1 stable) and the University 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 economic stability for the city. By way of residential development, the city continues to see construction of condominiums and rental apartments. Currently, there are 12 major housing developments under construction that will bring thousands of new residential units into the market. That said, given the type of housing being built, the district expects a muted impact on its enrollment.

Despite the city's sizable and resilient economy, resident income levels are below-average at approximately 76% of the national level. Property wealth, as measured by full value per capita, is only satisfactory at about $87,000 as of 2024.

Moreover, the school district continues to struggle with the type of enrollment loss seen by other major urban school districts in the commonwealth. Of note, however, is that enrollment loss has begun to moderate. From fiscal 2021 to fiscal 2024, district enrollment declined by a compound average annual 1.7% to 117,985 - a material improvement from fiscal 2023's trend of -3.2%.

Like many urban school districts across the commonwealth, the district also continues to face significant competition from charter and cyber schools. Currently, 63,010 students attend brick and mortar charter schools and an additional 13,867 students attend outside cyber schools - a combined equivalent of 65% of in-house enrollment. Favorably, however, this is a 3.1% decrease from the 2022-2023 school year, and management also reports an absence of new charter school approvals.

Exhibit 2
Enrollment



Source: Moody's Ratings

Financial operations: historically high reserves buoyed by extraordinary federal coronavirus aid, concealing structural imbalance

On an unaudited basis, the district's reserve position further improved in fiscal 2024 (which concluded on June 30). Management reports that the district added $100 million to its fund balance driven largely by the receipt of $541 million in federal coronavirus aid. While the vast majority of this funding was used to cover eligible capital needs, the district also utilized $70 million to invest in curriculum.

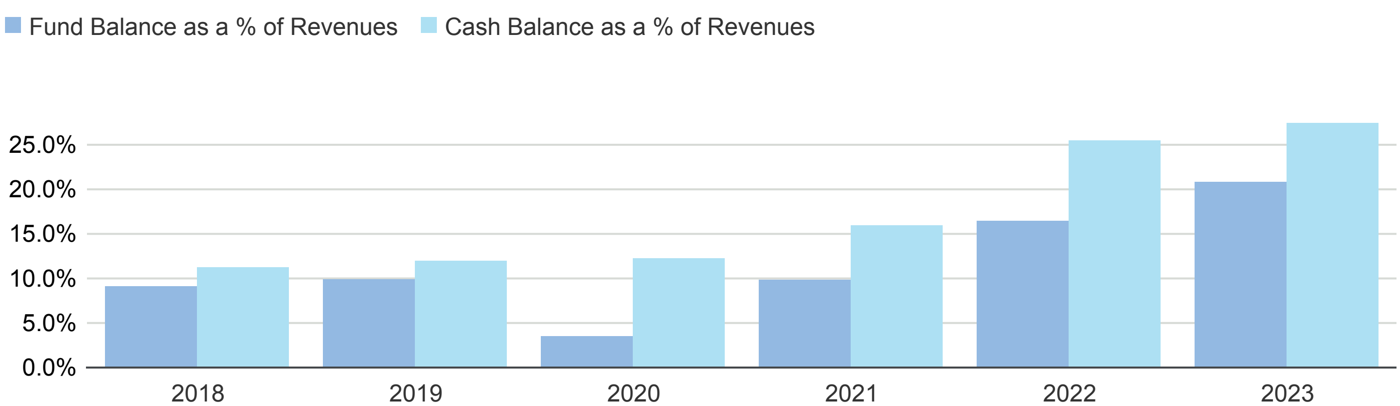
The ongoing receipt of federal coronavirus aid has masked the district's structural operating deficit since fiscal 2021. The district has also been able to offset substantial necessary expenses that it would have otherwise had to cover with General Fund revenue, effectively building its reserve position to a historically high 21% of revenue ($766 million, General Fund and Debt Service Fund combined) at the end of fiscal 2023. The tremendous and rapid three-year ascent followed the receipt of $736 million of federal coronavirus aid in fiscal 2022 and $264 million in fiscal 2023, all of which was recognized in the district's Categorical Funds, which is used for specific purpose funding.

Management reports a true structural operating deficit of approximately $90 million, which is 10% less than previously anticipated due largely to growth in local and state revenue - particularly on the heels of the 2023 commonwealth Supreme Court ruling on adequacy funding. The district is equally reliant on local and state aid for general operations, each accounting for nearly half of the district's revenue. Local revenue is comprised largely of city property taxes, though also includes business use, liquor, and non-business income taxes. The district has limited budgetary flexibility due to its elevated charter/cyber school tuition and special education expenses, which account for 30% of revenue and 12% of revenue, respectively.

While the district received approval to utilize its final $240 million of federal coronavirus aid for capital projects in fiscal 2025, it will simultaneously run its first deficit in four years. Despite the expectation that these deficits will persist, we expect reserves to remain markedly higher than their historical median (since the 2000 fiscal year) of 3% of revenue. Future assessments of the district's credit quality will hinge on the reduction of its structural operating deficit.

Exhibit 3

Financial Trends



Source: Moody's Ratings

Liquidity

Liquidity improved in fiscal 2024 due to the above-mentioned operating surplus, though it is poised to begin to decline in fiscal 2025. The district will continue to issue one-year tax revenue anticipation notes (TRANs) to supplement its liquidity throughout the year.

At the end of fiscal 2023, the district had net cash of $1 billion, which equated to approximately 28% of revenue.

Leverage: leverage will remain manageable despite near-term borrowing plans

The district's leverage will grow over the next three years due to borrowing plans related to its comprehensive capital plan. While the plan is still being finalized, management reports that the average age of its school buildings is over 70 years, which will necessitate significant investments. Management currently anticipates issuing between $250 million and $300 million in the fall of 2025, which will have a modest impact on the district's overall leverage considering a budget size of $3.7 billion. Future assessments of the district's credit quality will evaluate the scope and implementation of its capital plan, along with how much support the district will receive from the city and state.

At the end of fiscal 2023, the district's debt burden amounted to a manageable 91% of revenue. Total leverage - which includes the district's Moody's adjusted net pension liability (ANPL) and adjusted other post-employment benefits (OPEB) liability - amounted to a manageable 181% of revenue. The associated fixed-costs ratio was a very manageable 11% of 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 lockbox structure, originally established in 1982. The lockbox mechanism has never been tripped, and a sinking fund payment never been missed.

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 3.5 times in fiscal 2023, a slight decline from fiscal 2022.

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 a budget appropriation of the state.

At fiscal 2023 year end, state aid substantially exceeded the amount necessary to pay debt service on the district's bonds.

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 2023, the district contributed $211 million, which was matched in full by the state's reimbursement for half the annual cost. The fiscal 2023 Moody's ANPL, under Moody's methodology for adjusting reported pension data, was $3.2 billion, or a moderate 106% of annual operating revenues. The district's adjusted net OPEB liability amounted to a manageable $155 million, or 4% of revenue.

ESG considerations

Philadelphia School District, PA's ESG credit impact score is CIS-2

Exhibit 4
ESG credit impact score

CIS-2

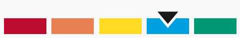
ESG considerations do not have a material impact on the current rating.

Source: Moody's Ratings

Philadelphia School District's ESG Credit Impact Score of **CIS-2** reflects the limited impact that environmental, social and governance risks have on the district's credit rating.

Exhibit 5
ESG issuer profile scores

ENVIRONMENTAL
E-2



SOCIAL
S-3

GOVERNANCE
G-2

Source: Moody's Ratings

Environmental

Philadelphia School District has 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 has moderate exposure to social risks related to labor and income, education, and health and safety. Exposure to social risks related to demographics, housing, and access to basic services is 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 low.

Governance

Philadelphia School District has limited exposure to governance risk. 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 slightly 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 five notch distinction between the assigned rating of Baa2 and the scorecard-indicated outcome of Aa3 reflects the persistence of structurally imbalanced financial operations that have been masked by the receipt of extraordinary federal coronavirus aid over the last three fiscal years. Operating deficits are poised to resume in the current fiscal year, ultimately resulting in a reduction in fund balance. The distinction also reflects the significant competition from charter and cyber schools that the district faces, which will continue to drive enrollment loss.

Exhibit 6
Philadelphia School District, PA

	Measure	Weight	Score
Economy			
Resident Income (MHI Adjusted for RPP / US MHI)	76.0%	10.0%	Baa
Full value per capita (full valuation of the tax base / population)	86,723	10.0%	A
Enrollment trend (three-year CAGR in enrollment)	-1.7%	10.0%	A
Financial performance			
Available fund balance ratio (available fund balance / operating revenue)	20.8%	20.0%	Aa
Net cash ratio (net cash / operating revenue)	27.5%	10.0%	Aaa
Institutional framework			
Institutional Framework	A	10.0%	A
Leverage			
Long-term liabilities ratio ((debt + ANPL + adjusted net OPEB) / operating revenue)	181.4%	20.0%	Aa
Fixed-costs ratio (adjusted fixed costs / operating revenue)	11.0%	10.0%	Aaa
Notching factors			
No notchings applied			
Scorecard-Indicated Outcome			Aa3
Assigned Rating			**Baa2**

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 available on their ESGView page.
Sources: US Census Bureau, Philadelphia School District, PA's financial statements and Moody's Ratings

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 Ratings
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 Ratings
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 Ratings
Long-term liabilities ratio	Debt, ANPL and OPEB liabilities as % of operating revenue	Audited financial statements, official statements; Moody's Ratings
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 Ratings
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 Ratings
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 Ratings

REPORT NUMBER 1425300

CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
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EMEA	44-20-7772-5454