

# MOODY'S

## RATINGS

### **Rating Action: Moody's Ratings upgrades Philadelphia School District, PA's issuer, GOULT, and non-contingent lease backed by GOULT to Baa2; outlook remains positive**

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09 Oct 2024

New York, October 09, 2024 -- Moody's Ratings (Moody's) has upgraded Philadelphia School District, PA's issuer, general obligation unlimited tax (GOULT) and non-contingent lease backed by GOULT ratings to Baa2 from Baa3. The outlook remains positive, and the enhanced rating of A1 is unaffected. At the end of fiscal 2023, the district had approximately \$3.3 billion in debt outstanding.

The upgrade of the ratings reflects the district's materially improved reserve position after the receipt of extraordinary federal coronavirus aid, along with the district's improved financial trajectory in light of said aid. The upgrade further reflects the improved funding environment in the commonwealth, and the district's manageable leverage that will not materially grow relative to revenue despite additional borrowing plans.

#### RATINGS RATIONALE

The Baa2 issuer rating reflects the district's solid financial position, which further improved in fiscal 2024 on an unaudited basis from 21% of revenue at the end of fiscal 2023 - the highest in at least two decades. The rating anticipates that the district is poised to return to structurally imbalanced financial operations moving forward due largely to significant charter and cyber school tuition costs that account for approximately 30% of the district's annual budget. The rating also reflects the district's persistent trend of declining enrollment, though the pace of enrollment loss has favorably moderated to -1.7%. Additionally, 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 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 Baa2 rating on the GOULT and GOULT-backed non-contingent lease debt is based on the district's general obligation full faith and credit pledge.

## 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 OF THE RATINGS

- 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 OF THE RATINGS

- 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

## 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 lock box mechanism has never been tripped, and a sinking fund payment never been missed.

The City of Philadelphia acts as tax collector for certain of the district's local taxes (property, business use and occupancy, liquor, and non-business income taxes) and such taxes are remitted daily 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 an 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.

## PROFILE

Philadelphia School District is coterminous with the City of Philadelphia 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.

## METHODOLOGY

The principal methodology used in these ratings was US K-12 Public School Districts published in July 2024 and available at <https://ratings.moodys.com/rmc-documents/425431>. Alternatively, please see the Rating Methodologies page on <https://ratings.moodys.com> for a copy of this methodology.

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