Moody’s Upgrades Pennsylvania’s School District Enhancement Programs

Response to PA Act 85 of 2016: One Rating Agency Clarifies Its Position

Moody’s Investors Service upgraded Pennsylvania’s pre-default and post-default school district enhancement ratings yesterday, Monday, August 15, 2016. The majority of Pennsylvania school district enhanced ratings were raised as a result, and some ratings were lifted by multiple notches. This was in response to new legislation, Pennsylvania’s Act 85 of 2016, passed in July. Act 85 strengthens Pennsylvania’s intercept mechanism in case of a future budget impasse.

Pre-Default Intercept Changes

Moody’s upgraded all pre-default ratings from Baa1 to A2. The rating agency also reinstituted its top-down treatment of Pennsylvania pre-default enhanced ratings, putting an end to the exception Moody’s had been making for only Pennsylvania school district pre-default enhanced ratings during the last few months.

Post-Default Intercept Changes

The ceiling for a post-default enhanced rating was raised from Baa1 to A3, and the maximum uplift was raised to two notches (from one). The Pennsylvania post-default enhanced ratings are still based on a bottom-up approach from the underlying rating, and an underlying rating is required for a school district to receive a post-default enhanced rating.

Moody’s raised the outlook for the enhanced ratings from "Negative" to “Stable.”

Enhanced Ratings Summary, PA Intercept Program for School Districts

<table>
<thead>
<tr>
<th>Program</th>
<th>Type</th>
<th>As of August 15, 2016</th>
<th>Prior to August 15, 2016</th>
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<tr>
<td></td>
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<td>Moody’s</td>
<td>S&amp;P</td>
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<tr>
<td>State Public School Building Authority</td>
<td>Pre-Default</td>
<td>A2</td>
<td>Remains Discontinued</td>
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<tr>
<td>Lease Intercept (SPSBAL)</td>
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<tr>
<td>Fiscal Agent Option (Sect 633)</td>
<td>Pre-Default</td>
<td>A2</td>
<td>Remains Discontinued</td>
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<tr>
<td>Pennsylvania Act 150</td>
<td>Post-Default</td>
<td>2 notch up from</td>
<td>Remains Discontinued</td>
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<td></td>
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<td>underlying, A3 Ceiling &amp; B1 floor</td>
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Source: Moody’s, S&P, Fitch, PNC Capital Markets
Pennsylvania's Act 85 of 2016 Strengthens PA's Intercept in Case of Future Budget Impasse

A new law allows the Pennsylvania Department of Education, in the event of a state budget impasse, to request available Pennsylvania General Fund money if needed to make a debt service payment. This became a concern last year when Pennsylvania school districts were not receiving state aid payments during an extended budget delay, reducing the value of the state's enhancement program for school districts because there was no state aid to intercept.

It is important to understand that while the new provisions strengthen the PA intercept mechanism, they do not guarantee debt service payments will be paid. There are limitations. First, payments cannot exceed 50% of a school district’s annual general fund subsidy. Second, funds are limited to available cash balances at the time of the intercept. Lastly, the Commonwealth is restricted from issuing tax anticipation notes or entering into a loan agreement with the PA Treasury for liquidity to provide intercept payments.

Moody’s provided clarification of its position in response to Act 85. It remains unclear how, or if at all, Standard & Poor’s will adjust its opinion and reinstitute enhanced ratings for the Pennsylvania School District Intercept Programs as a result of this new law. We do not expect Fitch to make any near-term adjustments. Fitch’s pre-default enhanced ratings remained at A+ in 2015 and 2016.

Click here to see a copy of Moody’s press release announcing the upgrade action. Click here for a list of affected ratings. (A Moody’s subscription is required to see the list of affected ratings.)

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