

Rating Action: Moody's downgrades Pennsylvania's pre-default intercept programs to A3 from A2, confirms post-default cap at A3; placed on review for further downgrade

Global Credit Research - 04 Nov 2015

13 districts' pre-default ratings downgraded to A3; 142 post-default ratings maintained at A3 post-default cap; 12 post-default ratings downgraded

New York, November 04, 2015 -- Moody's Investors Service has downgraded the Commonwealth of Pennsylvania's (Aa3 negative) pre-default intercept programs for school districts to A3 from A2. As a result of the downgrade of the programs, we have downgraded 13 pre-default intercept ratings on Pennsylvania school districts to A3 from A2 and placed these ratings under review for further downgrade. This action affects the State Public School Building Authority Lease Revenue Intercept Program (Sec. 785) and the Pennsylvania School District Fiscal Agent Agreement Intercept Program (Sec. 633). The pre-default rating on the Penn Hills School District remains at Baa1, and is also on review for downgrade. Moody's is also updating the rating on Pocono Mountain School District Series 2011 bonds. In the September 10, 2015 rating action, these bonds were inadvertently shown as carrying a post-default enhancement rating, when in fact they carry a pre-default enhancement rating. Moody's maintains an A3 rating on the Series 2011 bonds.

For districts enhanced by the commonwealth's post-default intercept program (Pennsylvania Act 150 Program), Moody's confirms the cap, or the highest rating districts can receive due to the post-default enhancement, at A3. The post-default enhancement is a bottom-up approach that begins with the underlying rating of the school district and then gives some potential uplift, subject to the cap. We currently maintain 142 ratings at the A3 post-default cap. In addition, Elizabeth Forward School District's (A2) post-default rating was downgraded to A3 from A2. This rating should have been placed on watch as part of the rating actions taken on September 10, 2015, but was not included due to an inadvertent error.

Moody's has also limited the uplift that post-default ratings can get from the underlying rating of a school district. Previously, we rated Pennsylvania school districts whose financings were enhanced by the post-default intercept program as many as two notches higher than the school district's underlying rating. With this action, we will only assign post-default enhanced ratings at most one notch higher than the underlying rating. The decision to limit the uplift to at most one notch is based on our post-default scorecard, which considers such factors as the timing of and trends in state aid distributions, and the mechanics of the program. As a result, we downgrade the enhanced ratings on 11 school districts. The enhanced ratings for Charleroi School District (Baa3 negative) were downgraded to Baa2 from Baa1; for Coatesville Area School District (Baa2 negative) to Baa1 from A3; for East Allegheny School District (Ba3 negative) to Ba2 from Ba1; for Frazier School District (Baa3 negative) to Baa2 from Baa1; for McKeesport Area School District (Ba1 negative) to Baa3 from Baa2; for Mid Valley School District (Baa3 negative) to Baa2 from Baa1; for Penn Hills School District (B3 negative) to B2 from B1; for Pocono Mountain School District (GO unlimited tax - Baa2) to Baa1 from A3 and (GO limited tax - Baa3) to Baa2 from A3; for Reading School District (Baa2) to Baa1 from A3; for West Mifflin Area School District (Baa3 negative) to Baa2 from Baa1; and for York City School District (Baa3 negative) to Baa2 from Baa1. As a result of today's rating action we have downgraded to Baa2 from A3 the post default enhanced ratings on Pocono Mountain School District's Series 2007C and 2009A bonds. The notching distinction for Pocono Mountain School District post default enhanced rating (GO limited tax) now reflects the rating uplift distinction between the unlimited and limited tax underlying ratings. All of the post-default ratings have been placed under review for further downgrade.

SUMMARY RATING RATIONALE

The downgrade of the Commonwealth of Pennsylvania's pre-default school district intercept program, and 13 ratings under the program, is a consequence of the commonwealth's chronically late budgets and the lack of clarity surrounding the intercept program's mechanical feasibility in the absence of an approved and implemented budget. While we expect the commonwealth to cover any missed debt service payments on enhanced bonds, the current lengthy budget impasse has heightened risks to bondholders, and raises doubt about whether the pre-default mechanisms will work effectively every time without funds appropriated to districts.

The confirmed cap of A3 on school district bonds enhanced on a post-default basis (Pennsylvania Act 150 School District Intercept Program) also reflects the increased risks to bondholders given state budget delays, as well as competing claims for state aid from pre-default obligations, pensions, and charter school tuition. The rating for Elizabeth Forward School District was downgraded to the cap of A3 from A2, as it should have been placed on watch as part of the rating action taken on September 10, 2015.

The downgrade of 11 post default ratings reflects revising the potential uplift from a district's underlying rating to one notch from the previous two notches under the post-default methodology. The decision to limit the uplift to at most one notch is based on our post-default scorecard, which considers such factors as the timing of and trends in state aid distributions, and the mechanics of the program. More specifically, this change reflects a lack of funding and an increasing uncertainty surrounding program mechanics in the absence of a state budget.

The intercept-enhanced ratings for individual financings reflect Moody's assessment of credit risk pursuant to our methodology, "State Aid Intercept Programs and Financings: Pre and Post Default." Credit considerations include availability of funds, timing of state aid payments, state aid trend, strength of notification requirement, and timing between notification and intercept. Additional credit factors include a debt service coverage ratio and, for post-default structures, the underlying rating of the individual school districts.

Please click on the following link to access the full list of affected credit ratings. This list is an integral part of this press release and identifies each affected issuer: http://www.moody.com/viewresearchdoc.aspx?docid=PBM_PBM185645

OUTLOOK

The review for downgrade reflects the ongoing uncertainty regarding the amount and availability of state aid for debt service obligations given the commonwealth's prolonged budget stalemate.

As we continue to review the underlying credit quality of school districts in Pennsylvania, we may further downgrade enhanced ratings on some of these financings, particularly on financially weak school districts.

In addition, we plan to continue to review the differences between the pre-default intercept structures and the post-default program. In particular, we will examine the functional differences between the two when there are no appropriations to school districts.

WHAT COULD MAKE THE RATING GO UP

- Stronger demonstrated track record of timely budget adoption and school appropriation funding
- Establishment of a clearer plan for provision of payments in the absence of a budget
- Upgrade of the Commonwealth of Pennsylvania's rating
- Upgrade of underlying ratings (applies to post-default enhanced ratings)

WHAT COULD MAKE THE RATING GO DOWN

- Failure to make debt service payments or appropriate school aid to allow issuers to make timely payments
- Downgrade of the Commonwealth of Pennsylvania's rating
- Further delays in budget approval which hinder school districts' ability to pay debt service and meet other obligations
- Downgrade of underlying ratings (applies to post-default enhanced ratings)

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was State Aid Intercept Programs and Financings: Pre and Post Default published in July 2013. Please see the Credit Policy page on www.moody.com for a copy of this methodology.

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The person who approved the Pennsylvania School District Fiscal Agent Agreement Intercept Program (Section 633) & Pennsylvania State Public School Building Authority Current Year Intercept Program and Pennsylvania State Public School Building Authority Lease Intercept Program Issuer level ratings is Orlie Prince, VP-Senior Analyst/Manager, Public Finance Group, Journalists Tel: 212-553-0376, Subscribers Tel: 212-553-1653.

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Jennifer Dierksen
Asst Vice President - Analyst
Public Finance Group
Moody's Investors Service, Inc.
250 Greenwich Street
New York, NY 10007
U.S.A.
JOURNALISTS: 212-553-0376
SUBSCRIBERS: 212-553-1653

Dan Seymour
Asst Vice President - Analyst
Public Finance Group
Moody's Investors Service, Inc.
250 Greenwich Street
New York, NY 10007
U.S.A.
JOURNALISTS: 212-553-0376
SUBSCRIBERS: 212-553-1653

Orlie Prince
Senior Vice President
Public Finance Group
JOURNALISTS: 212-553-0376
SUBSCRIBERS: 212-553-1653

Releasing Office:
Moody's Investors Service, Inc.
250 Greenwich Street
New York, NY 10007

U.S.A.
JOURNALISTS: 212-553-0376
SUBSCRIBERS: 212-553-1653



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