

CREDIT OPINION

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 Rate this Research

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Coatesville Area S.D. (Chester Co.), PA

Update following downgrade to Ba3

Summary

Coatesville Area School District, PA's financial position will remain highly challenged in the near term due to ongoing pressure from charter school tuition and special education costs. Charter enrollment is nearly 34% of total district enrollment as of 2019. The associated tuition costs, as well as the district's special education costs and its inability to curtail operating expenditures, has resulted in an ongoing structural imbalance that is expected to persist in the near term. The district will continue to rely on one-time savings from the refunding of debt, along with cash flow borrowing, in order to maintain a positive fund balance. The district's debt burden will remain elevated in the near term, while its capital needs continue to mount. These challenges to the district's credit profile are somewhat offset by its sizable and growing tax base and above average resident wealth.

On February 14, 2020, we downgraded the district's general obligation and lease revenue ratings to Ba3 from Ba1.

Credit strengths

- » Sizeable tax base
- » Solid wealth levels
- » Willingness to increase taxes

Credit challenges

- » Structurally imbalanced financial operations due to escalating charter school pressure
- » Continued need to deficit finance in order to cover expenses
- » Above average debt burden
- » Significant capital needs

Rating outlook

The negative outlook on the district's general obligation and lease-backed debt reflects its pressured financial condition and ongoing structural imbalance that is expected to persist in the near term.

Factors that could lead to an upgrade

- » Structurally balanced operations that are maintained over multiple reporting periods
- » Proven ability to manage and accurately budget for charter costs; a reduction or stabilization of charter enrollment, coupled with cost containment

Factors that could lead to a downgrade

- » Further structural imbalance with continued material draws on reserves
- » Additional deficit financing
- » Escalation of debt burden
- » Deterioration of tax base and wealth levels

Key indicators

Exhibit 1

Coatesville Area S.D. (Chester), PA	2015	2016	2017	2018	2019
Economy/Tax Base					
Total Full Value (\$000)	\$4,148,201	\$4,162,959	\$4,263,513	\$4,273,072	\$4,418,961
Population	64,320	64,564	64,916	64,916	64,916
Full Value Per Capita	\$64,493	\$64,478	\$65,677	\$65,825	\$68,072
Median Family Income (% of US Median)	115.2%	112.4%	114.4%	114.4%	114.4%
Finances					
Operating Revenue (\$000)	\$149,645	\$159,453	\$160,978	\$180,399	\$172,251
Fund Balance (\$000)	\$11,223	\$11,992	\$2,809	\$11,203	\$4,783
Cash Balance (\$000)	\$21,100	\$19,880	\$8,348	\$20,686	\$17,094
Fund Balance as a % of Revenues	7.5%	7.5%	1.7%	6.2%	2.8%
Cash Balance as a % of Revenues	14.1%	12.5%	5.2%	11.5%	9.9%
Debt/Pensions					
Net Direct Debt (\$000)	\$182,756	\$174,958	\$161,253	\$166,221	\$158,664
3-Year Average of Moody's ANPL (\$000)	\$139,420	\$141,638	\$153,854	\$162,967	\$161,707
Net Direct Debt / Full Value (%)	4.4%	4.2%	3.8%	3.9%	3.6%
Net Direct Debt / Operating Revenues (x)	1.2x	1.1x	1.0x	0.9x	0.9x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	3.4%	3.4%	3.6%	3.8%	3.7%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	0.9x	0.9x	1.0x	0.9x	0.9x

Sources: Moody's Investors Service, US Census Bureau, Coatesville Area School District audited financial statements

Profile

Coatesville Area School District serves 5,450 students in the City of Coatesville, PA, which is approximately halfway between Lancaster (A3) and Philadelphia (A2 stable) in Chester County (Aaa stable). The district operates one high school, three middle schools, and seven elementary schools. In addition, 3,050 students are enrolled at charter and cyber schools, representing a significant source of financial pressure for the district.

Detailed credit considerations

Economy and Tax Base: Sizable tax base with average income levels

The district's sizable property tax base is poised for relative stability moving forward, as management reports an absence of any significant residential or commercial development in progress. Favorably, the district's \$4.4 billion tax base has grown by a solid

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compound annual rate of 1.9%, on average, over the last five years, which is above the growth rate school districts in Pennsylvania and across the nation.

Financial Operations and Reserves: Weakening financial position; Use of scoop and toss refunding to stabilize finances

The district's pressured financial position will further weaken in the near to middle term in light of rising instruction costs that continue to outpace revenue growth. The district's financial operations remain structurally imbalanced. In fiscal 2019, the district ran a \$6.5 million General Fund operating deficit, which resulted in fund balance ending at \$4.8 million or a very narrow 2.8% of revenue. The district's outside cyber and charter school tuition amounted to \$45.6 million in fiscal 2019, a 25% increase from fiscal 2018. Additionally, total special education expenses totaled \$48.9 million, a 14% increase from fiscal 2018. Favorably, the district increased its property tax levy 5.3% in fiscal 2019.

The district has a history of cash flow borrowing and deficit financing in order to maintain a positive fund balance. Absent these efforts, the district's available reserves at the end of fiscal 2019 would have been much lower. In fiscal 2019, the district entered into two privately placed debt arrangements to "scoop and toss" their debt service payments for fiscal 2020. In fiscal 2018, the district issued \$12.3 million in new money debt in order to finance deficits for the following three years. Fiscal 2017's charter school cost pressures necessitated the issuance of a tax anticipation note (TAN) for \$12 million. While that debt was repaid by September of 2017, the district relied on its Series of 2014B general obligation bonds to provide liquidity when its fund balance was negative in 2014, and issued TANs in 2013 and 2014, as well.

Management anticipates an operating deficit of \$5 million to \$7 million in fiscal 2020 despite a property tax levy increase of 3.9%. Management reports that charter and cyber school tuition will grow by an additional 18%, further straining the district's financial operations. Moreover, had the district not undertaken the privately placed scoop and toss refundings of debt, the deficit would be closer to \$10 million. The district expects to issue TANs in 2021 in order to provide cash flow for operations.

Future assessments of the district's credit rating will focus on its ability to return to structurally balanced operations without the use of deficit financing or one-time savings from the refunding of debt.

LIQUIDITY

The district's cash position will remain satisfactory over the next fiscal year, though it is inflated by its deficit financing and the deferral of payments to charter schools and its intermediate unit. At the end of fiscal 2019, it had net cash of \$17.1 million in its General Fund, which equated to 9.9% of revenue.

Debt and Pensions: Elevated debt burden with significant borrowing needs; No near term borrowing plans

The district's elevated debt burden will taper in the middle term due to above average amortization and the absence of plans to issue additional long term debt over the next three years. Notably, the district reports having significant capital needs, which amount to \$150 million to \$200 million. Due to the district's strained finances, however, management reports that it is unable to accommodate the additional debt service requirements. At the end of fiscal 2019, the district had \$158.7 million in net direct debt outstanding, which equated to 3.6% of full value. In fiscal 2019, the district's debt service requirements equated to \$16.1 million or a moderate 9.0% of annual expenditures. Due to the aforementioned refunding, debt service requirements will be lower in fiscal 2020 before returning to current levels in fiscal 2021.

DEBT STRUCTURE

All of the district's debt is fixed rate and amortizes over the long term, with an above average 83% of principal maturing over the next ten years.

The district recently entered into two privately placed debt arrangements amounting to \$65.4 million or 41% of total debt.

DEBT-RELATED DERIVATIVES

The district is not exposed to any swaps or other derivatives.

PENSIONS AND OPEB

The district contributes to the Public School Employee Retirement System (PSERS), a multi-employer cost-sharing plan administered by the Commonwealth of Pennsylvania. During fiscal 2018, the district contributed \$6.7 million, which was matched in full by the state's reimbursement for half the total annual cost. The fiscal 2019 three-year average Moody's adjusted net pension liability, under

Moody's methodology for adjusting reported pension data, was \$161.7 million, or a below average 0.94 times operating revenues. The adjustments are not intended to replace the district's reported liability information, but rather to improve comparability with other rated entities. We determined the district's share of liability for the state-run plan in proportion to its contributions to the plan.

Total fixed costs, including debt service, pension contributions, and post-employment health benefits totaled \$23.9 million or 13.9% of fiscal 2019 revenue.

ESG Considerations:

ENVIRONMENTAL CONSIDERATIONS

Coatesville Area School District's location in southeastern Pennsylvania indicates limited exposure to heat stress and an absence of exposure to sea level rise. On the other hand, there is exposure to weather-related events.

SOCIAL CONSIDERATIONS

The district's wealth indicators are above average. Median family income equates to 114% of the nation. Poverty in the district is average at 12%, while unemployment in Chester County as of November 2019 was slightly below average at 3.1%, compared with the nation (3.3%). The district's full value per capita was well slightly above average when compared with districts across the Commonwealth at \$68,000.

Despite continued population growth in the district, enrollment has declined substantially over the last five years as more students choose to attend cyber and charter schools. Enrollment is currently 5,450 - a significant decline from the over 7,000 students that attended school in the district five years ago. The district has significant exposure to cyber and charter schools with current enrollment of 3,050. Should the trend of increasing students attending charter and cyber schools continue, management reports that the two enrollment figures will intersect by 2025.

GOVERNANCE CONSIDERATIONS

The district's fund balance policy mirrors the commonwealth's recommendation to maintain 5% to 8% of annual expenditures as unassigned. That said, the district has a history of being out of compliance with this policy. The district has historically budgeted inadequately for its charter/cyber school tuition and special education costs. The current Director of Business Administration recently joined the district on an interim basis in Spring of 2019.

Pennsylvania school districts have an institutional framework score of "A," or moderate. Revenues primarily consist of local property taxes, income taxes, and state aid. Revenue predictability is low as state aid can fluctuate annually based on state budget appropriations. Districts have a moderate ability to raise revenues as they are subject to the Act 1 cap, which requires voter approval for property tax increases above an Act 1 index, driven by the CPI. Expenditures primarily consist of instructional expenses, which are moderately predictable. Districts maintain a moderate ability to cut costs based on union contract negotiations and rising pension costs.

Rating methodology and scorecard factors

The US Local Government General Obligation Debt methodology includes a scorecard, a tool providing a composite score of a local government'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 local government credits.

Exhibit 2

Coatesville Area S.D. (Chester), PA

Rating Factors	Measure	Score
Economy/Tax Base (30%) ^[1]		
Tax Base Size: Full Value (in 000s)	\$4,418,961	Aa
Full Value Per Capita	\$68,072	Aa
Median Family Income (% of US Median)	114.4%	Aa
Notching Factors: ^[2]		
Other Analyst Adjustment to Economy/Taxbase Factor: Significant charter/cyber school pressure		Down
Finances (30%)		
Fund Balance as a % of Revenues	2.8%	A
5-Year Dollar Change in Fund Balance as % of Revenues	-1.2%	Baa
Cash Balance as a % of Revenues	9.9%	Aa
5-Year Dollar Change in Cash Balance as % of Revenues	1.6%	A
Notching Factors: ^[2]		
Unusually volatile revenue structure		Down
Other Analyst Adjustment to Finances Factor: Additional use of reserves expected		Down
Management (20%)		
Institutional Framework	A	A
Operating History: 5-Year Average of Operating Revenues / Operating Expenditures	1.0x	A
Notching Factors: ^[2]		
Unusually Strong or Weak Budgetary Management and Planning		Down
Debt and Pensions (20%)		
Net Direct Debt / Full Value (%)	3.6%	A
Net Direct Debt / Operating Revenues (x)	0.9x	A
3-Year Average of Moody's Adjusted Net Pension Liability / Full Value (%)	3.7%	A
3-Year Average of Moody's Adjusted Net Pension Liability / Operating Revenues (x)	0.9x	A
Notching Factors: ^[2]		
Unusual Risk Posed by Debt Structure		Down
Other		
Credit Event/Trend Not Yet Reflected in Existing Data Sets: \$150 to \$200 million in capital needs		Down
	Scorecard-Indicated Outcome	Ba2
	Assigned Rating	Ba3

[1] Economy measures are based on data from the most recent year available.

[2] Notching Factors are specifically defined in the US Local Government General Obligation Debt methodology.

[3] Standardized adjustments are outlined in the GO Methodology Scorecard Inputs publication.

Sources: Moody's Investors Service, US Census Bureau, Coatesville Area School District audited financial statements

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