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Philadelphia Schools Find Charters Costly to Budget: Muni Credit

(Bloomberg) — Philadelphia's school district, the nation's eighth-largest, wants to get more children into high-achieving schools. Doing so threatens its finances.

The panel that runs the district accepted five of 39 applications on Feb. 18 for new charter schools, which are publicly funded and privately run. The vote agitated both sides of the debate — parents and unions who say charters divert funds from the traditional system, and an opposing group of parents and advocates who wanted more approvals to help students stranded in failing schools.

The debate in Philadelphia echoes those in other urban districts, such as in New Jersey, Ohio and Michigan, that also face fiscal stress from charters. Philadelphia school officials next month plan to sell debt for the first time since 2011 that isn't deficit financing. The rejection of most of the charter candidates boosts the junk-rated district because adding the schools would strain its budget, Moody's Investors Service said this week.

"From an educational point of view, from a social point of view, they are a positive, especially for really dedicated students," said Ted Molin, a senior credit analyst at Wilmington Trust Co. in Delaware. "But from a pure fiscal or credit point of view, I would have to say, unfortunately, they're a negative."

Budget Gap

While Philadelphia's rating and finances have strengthened over the past several years, the district, run by a board of mostly state appointees, has deteriorated. Officials closed schools and sold about \$300 million of debt to fill a budget gap in 2012. They've lobbied state and local lawmakers for more funds, including a \$2-a-pack cigarette tax in Philadelphia and a portion of city sales-tax receipts.

Costs still outstrip revenue, as the district faces an \$80 million deficit for the year beginning in July. In the next five years, 86 percent of the \$282 million increase in expenses results from higher charter-school and retirement costs and debt service, according to the district's plan.

Officials are requesting more state aid to educate students, 81 percent of whom qualify for free or subsidized meals. They're also appealing a court decision that stopped them from implementing labor changes, such as health-care contributions from teachers, that would have saved \$200 million over four years.

Charter Costs

About 30 percent of the system's 204,000 students attend charters, up from about 14 percent a decade ago. The district estimates each charter student adds a net \$7,000 of expenses. Charter costs next year may tally \$769 million in a \$2.7 billion district budget, the five-year plan shows.

The district in March plans to sell about \$46 million of bonds for capital projects and \$270 million to

refinance older securities, said Fernando Gallard, a spokesman. The refunding may save \$23.4 million, or 8.1 percent of par, according to a Moody's estimate. The schools, which have \$3.2 billion in debt, sell securities under a program that diverts state aid to bond payments, boosting security for investors.

Moody's ranks the school system Ba3, three levels below investment grade, while it grades the bonds A1, eight levels higher, because of the state program.

Molin at Wilmington Trust, which handles \$4 billion of munis, said the company probably wouldn't add to its district holdings with the new deal because "underlying credit characteristics seem to be deteriorating."

Negative Loop

Philadelphia's district is the only one in Pennsylvania, and one of few in the U.S., without authority to levy taxes, said Dan Seymour, assistant vice president at Moody's.

Efforts to balance the books with cuts to staff and services "have hurt the educational product," he said from New York. That in turn has led more students to leave traditional schools, creating stranded costs. "It's a negative feedback loop."

The addition of five charter schools would cost the district \$6.8 million by 2019, Gallard said. The rejected schools can appeal.

Gallard said even when the system was stronger financially, students didn't perform as well as officials would have liked.

"There is a fiscal impact, but overall our goal is to improve the access to high-achieving schools for our students," he said.

Plowing more money into the same system won't improve outcomes, said Mark Gleason, executive director of the Philadelphia School Partnership, a nonprofit that provides grants to city schools and wanted more charters approved.

Less than half of students in traditional public schools showed proficiency in reading and math in last year's state tests, according to Gleason's group. For charter students, the rates rise to 55 percent for math and 52 percent for reading, it says.

"The district is in a precarious financial situation, but the disadvantaged kids in Philadelphia are in a more precarious situation," Gleason said. "These are kids who are not getting a fair shot at life."

by Romy Varghese

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To contact the reporter on this story: Romy Varghese in Philadelphia at rvarghese8@bloomberg.net

To contact the editors responsible for this story: Stephen Merelman at smerelman@bloomberg.net
Stacie Sherman, Mark Tannenbaum