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## Moody's: Vulnerable U.S. Public School Districts Can Experience Credit Pressure from Competition.

New York, November 11, 2015 — Some US public school districts are facing heightened fiscal pressure owing to competition over enrollment from charter schools and school-choice programs, leaving the most vulnerable districts at risk for additional revenue loss, Moody's Investors Service says. This competition can quickly and unpredictably depress public schools' revenues, which can lead to a "downward spiral."

"Depending on how these competing entities are funded, the competition can represent severe credit pressure for the most vulnerable K-12 school districts," Moody's Assistant Vice President — Analyst Dan Seymour says in a new report on public schools, "Competition Creates 'Downward Spiral' for Vulnerable School Districts."

Publicly funded, independently operated charter school revenues are often shared from the same mix of property taxes and state aid that fund area public schools. Additionally, in some states school-choice programs allow students to attend schools in other districts. In both instances, the per-pupil funding follows the participating students, depriving the original public school district of the revenue.

Charter schools and school-choice programs do not affect school districts uniformly across the country, Moody's says. Many urban school districts with high percentages of students in charter schools, such as Cleveland Municipal School District (A2 stable) and Indianapolis Public Schools (Aa2 stable) remain highly rated. Generally, districts most reliant on state aid tied to enrollment are the most exposed.

The loss of students and revenue due to charter schools or school-choice programs can cause a downward spiral as districts react by cutting costs, which may, in turn, weaken their educational product and encourage more students to seek alternatives.

"The downward spiral happens when a district loses students to charters or school choice, then loses the revenues associated with those students," says Seymour. "The district cuts expenditures to cope, which weakens its educational product, encouraging more students to attend schools outside the district. The loss of those students results in additional revenue loss, and the spiral continues."

The most vulnerable school districts in Michigan (Aa1 stable) and Pennsylvania (Aa3 negative) are examples of those facing mounting credit pressures due to competition. In Michigan, the loss of revenue to charter schools and from students moving to other districts has led to 46 school district downgrades this year, while Pennsylvania's charter schools are the primary driver of credit strain for the state's most exposed districts, including the Philadelphia School District (Ba3 negative).

Despite these pressures, the majority of public school districts experience minimal fiscal stress due to competition, a testament to the solid nature of the sector's institutional framework. However, the fact that charter schools operate heavily in poorer, urban areas means that competition frequently exerts itself on the districts with the weakest demographics and lowest resilience against fiscal stress.

The report is available to Moody's subscribers here.