

# **Bond Case Briefs**

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## **Fitch: Pennsylvania Interim Budget Supports Value of School Credit Enhancement Programs.**

Fitch Ratings-New York-11 January 2016: Pennsylvania's interim budget reinforces Fitch Ratings' belief that the commonwealth remains committed to supporting full and timely payment of school district debt service commitments despite its ongoing budget contention. Fitch rates the commonwealth's pre-default school aid intercept (per section 633 and 785(a) of the School Code) and direct-pay (section 785(b) of the School Code) enhancement programs 'A+' with a Stable Rating Outlook, one notch below Pennsylvania's 'AA-' general obligation (GO) rating (also with a Stable Outlook).

In August, Fitch commented that the credit quality of the school credit enhancement programs (and of the commonwealth and its appropriation-backed debt) were not affected by the budget impasse because the commonwealth remained committed to ensuring timely debt service payment. Fitch maintained its ratings through the ongoing impasse. The interim budget signed by the Governor on Dec. 29, with significant line item vetoes, provides six months of Basic Education Funding for school districts. More importantly, it provides for a full year of appropriation authority in other line items for school districts, including special education and transportation aid, and thereby establishes a clear path for the commonwealth to direct revenues to bond trustees as needed for the school credit enhancement programs.

Since the beginning of the impasse, the commonwealth actively engaged with school districts and helped those facing fiscal pressure through measures including advancing funding available from prior year appropriations, or assisting districts in securing short-term borrowings backed by future state aid payments. The interim budget signed by the Governor last week provides further relief for school districts. Approximately \$3 billion in immediate aid went out last week, and several hundred million in additional state and federal aid will be paid to districts over the remainder of the fiscal year.

While the interim budget does not fully fund the Basic Education subsidy for school districts (the largest share of state aid), it does fund all other state and federal aid for school districts through the full fiscal year. This full-year funding provides appropriation authority and revenue streams the state Treasurer and Department of Education can utilize to meet school district debt service obligations under terms of Pennsylvania's school credit enhancement programs.

The interim budget also fully appropriates for debt service payments the commonwealth and related entities make from state revenue sources. This includes the Commonwealth Financing Authority and Pennsylvania Economic Development and Financing authority appropriation-backed bonds rated by Fitch ('A+' / Outlook Stable and 'A' / Outlook Stable, respectively).

The commonwealth still faces fiscal challenges ahead, at a level consistent with the 'AA-' GO rating that trails most states. The governor and legislature will enter a new budget season in just a few short weeks, facing significant structural budget challenges. The recent opening of a \$2 billion line of credit with the state's Treasury (from which the Commonwealth borrowed \$1 billion to date)

reflects those pressures. Pennsylvania also lacks any balance in its dedicated budgetary reserve funds, limiting its fiscal flexibility in the next downturn in the economic cycle. Fitch views these challenges as substantial, but manageable at the 'AA-' rating level given the state's large, diversified economic base and moderate tax burden which provides some capacity to match expenditure growth.

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