



Announcement: Moody's: Charter schools pose greatest credit challenge to school districts in economically weak urban areas

Global Credit Research - 15 Oct 2013

New York, October 15, 2013 -- The dramatic rise in charter school enrollments over the past decade is likely to create negative credit pressure on school districts in economically weak urban areas, says Moody's Investors Service in a new report. Charter schools tend to proliferate in areas where school districts already show a degree of underlying economic and demographic stress, says Moody's in the report "Charter Schools Pose Growing Risks for Urban Public Schools."

"While the vast majority of traditional public districts are managing through the rise of charter schools without a negative credit impact, a small but growing number face financial stress due to the movement of students to charters," says Michael D'Arcy, one of two authors of the report.

Charter schools can pull students and revenues away from districts faster than the districts can reduce their costs, says Moody's. As some of these districts trim costs to balance out declining revenues, cuts in programs and services will further drive students to seek alternative institutions including charter schools.

Many older, urban areas that have experienced population and taxbase losses, creating stress for their local school districts, have also been areas where charter schools have proliferated, says Moody's. Among the cities where over a fifth of the students are enrolled in charter schools are Cleveland, Detroit, Kansas City, St. Louis, and Washington, D.C. Nationwide about one in 20 students is in a charter school.

One of the four risk factors Moody's identifies as making a school district vulnerable to charter school growth is that the school district is already financially pressured and grappling with weak demographics.

A second factor is having a limited ability to adjust operations in response to a loss of enrolment to charter schools.

"Shifts in student enrollment from district schools to charters, while resulting in a transfer of a portion of district revenues to charter schools, do not typically result in a full shift of operating costs away from district public schools," says Moody's Tiphany Lee-Allen, the Moody's Associate Analyst who co-authored the report. "Districts may face institutional barriers to cutting staff levels, capital footprints and benefit costs over the short term given the intricacies of collective bargaining contracts - leaving them with underutilized buildings and ongoing growth in personnel costs."

A third risk factor for a school district is being in a state with a statutory framework promoting a high degree of educational choice and has a relatively liberal approval process for new charters and few limits on their growth, as well as generous funding.

For example in Michigan, the statutory framework emphasizes educational choice, and there are multiple charter authorizers to help promote charter school growth. In Michigan, Detroit Public Schools (B2 negative), Clintondale Community Schools (Ba3 negative), Mount Clemens Community School District (Ba3 negative) and Ypsilanti School District (Ba3) have all experienced significant fiscal strain related to charter enrollment growth, which has also been a contributing factor to their speculative grade status.

A final risk factor is when a school district is not integrated into a healthier local government, as such integration can lead to greater diversity in revenues and more flexibility in balance sheets, positioning the district to better handle operating and financial changes.

For more information, Moody's research subscribers can access this report at https://www.moody's.com/research/Charter-Schools-Pose-Growing-Risks-for-Urban-Public-School-Districts--PBM_PBM158801.

NOTE TO JOURNALISTS ONLY: For more information, please call one of our global press information hotlines: New York +1-212-553-0376, London +44-20-7772-5456, Tokyo +813-5408-4110, Hong Kong +852-3758-1350, Sydney +61-2-9270-8141, Mexico City 001-888-779-5833, São Paulo 0800-891-2518, or Buenos Aires 0800-666-3506. You can also email us at mediarelations@moody's.com or visit our web site at www.moody's.com.

Michael D'Arcy
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

Naomi G Richman
MD - Public Finance
Structured 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



© 2013 Moody's Investors Service, Inc. and/or its licensors and affiliates (collectively, "MOODY'S"). All rights reserved.

CREDIT RATINGS ISSUED BY MOODY'S INVESTORS SERVICE, INC. ("MIS") AND ITS AFFILIATES ARE MOODY'S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES, AND CREDIT RATINGS AND RESEARCH PUBLICATIONS PUBLISHED BY MOODY'S ("MOODY'S PUBLICATIONS") MAY INCLUDE MOODY'S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES. MOODY'S DEFINES CREDIT RISK AS THE RISK THAT AN ENTITY MAY NOT MEET ITS CONTRACTUAL, FINANCIAL OBLIGATIONS AS THEY COME DUE AND ANY ESTIMATED FINANCIAL LOSS IN THE EVENT OF DEFAULT. CREDIT RATINGS DO NOT ADDRESS ANY OTHER RISK, INCLUDING BUT NOT LIMITED TO: LIQUIDITY RISK, MARKET VALUE RISK, OR PRICE VOLATILITY. CREDIT RATINGS AND MOODY'S OPINIONS INCLUDED IN MOODY'S PUBLICATIONS ARE NOT STATEMENTS OF CURRENT OR HISTORICAL FACT. CREDIT RATINGS AND MOODY'S PUBLICATIONS DO NOT CONSTITUTE OR PROVIDE INVESTMENT OR FINANCIAL ADVICE, AND CREDIT RATINGS AND MOODY'S PUBLICATIONS ARE NOT AND DO NOT PROVIDE RECOMMENDATIONS TO PURCHASE, SELL, OR HOLD PARTICULAR SECURITIES. NEITHER CREDIT RATINGS NOR MOODY'S PUBLICATIONS COMMENT ON THE SUITABILITY OF AN INVESTMENT FOR ANY PARTICULAR INVESTOR. MOODY'S ISSUES ITS CREDIT RATINGS AND PUBLISHES MOODY'S PUBLICATIONS WITH THE EXPECTATION AND UNDERSTANDING THAT EACH INVESTOR WILL MAKE ITS OWN STUDY AND EVALUATION OF EACH SECURITY THAT IS UNDER CONSIDERATION FOR PURCHASE, HOLDING, OR SALE.

ALL INFORMATION CONTAINED HEREIN IS PROTECTED BY LAW, INCLUDING BUT NOT LIMITED TO, COPYRIGHT LAW, AND NONE OF SUCH INFORMATION MAY BE COPIED OR OTHERWISE REPRODUCED, REPACKAGED, FURTHER TRANSMITTED, TRANSFERRED, DISSEMINATED, REDISTRIBUTED OR RESOLD, OR STORED FOR SUBSEQUENT USE FOR ANY SUCH PURPOSE, IN WHOLE OR IN PART, IN ANY FORM OR MANNER OR BY ANY MEANS WHATSOEVER, BY ANY PERSON WITHOUT MOODY'S PRIOR WRITTEN CONSENT. All information contained herein is obtained by MOODY'S from sources believed by it to be accurate and reliable. Because of the possibility of human or mechanical error as well as other factors, however, all information contained herein is provided "AS IS" without warranty of any kind. MOODY'S adopts all necessary measures so that the information it uses in assigning a credit rating is of sufficient quality and from sources Moody's considers to be reliable, including, when appropriate, independent third-party sources. However, MOODY'S is not an auditor and cannot in every instance independently verify or validate information received in the rating process. Under no circumstances shall MOODY'S have any liability to any person or entity for (a) any loss or damage in whole or in part caused by, resulting from, or relating to, any error (negligent or

otherwise) or other circumstance or contingency within or outside the control of MOODY'S or any of its directors, officers, employees or agents in connection with the procurement, collection, compilation, analysis, interpretation, communication, publication or delivery of any such information, or (b) any direct, indirect, special, consequential, compensatory or incidental damages whatsoever (including without limitation, lost profits), even if MOODY'S is advised in advance of the possibility of such damages, resulting from the use of or inability to use, any such information. The ratings, financial reporting analysis, projections, and other observations, if any, constituting part of the information contained herein are, and must be construed solely as, statements of opinion and not statements of fact or recommendations to purchase, sell or hold any securities. Each user of the information contained herein must make its own study and evaluation of each security it may consider purchasing, holding or selling. NO WARRANTY, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS, COMPLETENESS, MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE OF ANY SUCH RATING OR OTHER OPINION OR INFORMATION IS GIVEN OR MADE BY MOODY'S IN ANY FORM OR MANNER WHATSOEVER.

MIS, a wholly-owned credit rating agency subsidiary of Moody's Corporation ("MCO"), hereby discloses that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by MIS have, prior to assignment of any rating, agreed to pay to MIS for appraisal and rating services rendered by it fees ranging from \$1,500 to approximately \$2,500,000. MCO and MIS also maintain policies and procedures to address the independence of MIS's ratings and rating processes. Information regarding certain affiliations that may exist between directors of MCO and rated entities, and between entities who hold ratings from MIS and have also publicly reported to the SEC an ownership interest in MCO of more than 5%, is posted annually at www.moodys.com under the heading "Shareholder Relations — Corporate Governance — Director and Shareholder Affiliation Policy."

For Australia only: Any publication into Australia of this document is pursuant to the Australian Financial Services License of MOODY'S affiliate, Moody's Investors Service Pty Limited ABN 61 003 399 657 AFSL 336969 and/or Moody's Analytics Australia Pty Ltd ABN 94 105 136 972 AFSL 383569 (as applicable). This document is intended to be provided only to "wholesale clients" within the meaning of section 761G of the Corporations Act 2001. By continuing to access this document from within Australia, you represent to MOODY'S that you are, or are accessing the document as a representative of, a "wholesale client" and that neither you nor the entity you represent will directly or indirectly disseminate this document or its contents to "retail clients" within the meaning of section 761G of the Corporations Act 2001. MOODY'S credit rating is an opinion as to the creditworthiness of a debt obligation of the issuer, not on the equity securities of the issuer or any form of security that is available to retail clients. It would be dangerous for retail clients to make any investment decision based on MOODY'S credit rating. If in doubt you should contact your financial or other professional adviser.