

# MUNICIPAL BOND MARKET NOTE

## JANNEY FIXED INCOME STRATEGY

August 31, 2011



### Summary of PA School Intercept "Enhanced" Ratings

#### Pre-Default

Moody's: Aa2 (Negative)  
S&P: A+ (Stable)  
Fitch: AA (Negative)

#### Post-Default

Moody's: Aa3 (Negative)  
S&P: A (Stable)  
Fitch: No rating

**The Intercept Program is not a general obligation of the Commonwealth of Pennsylvania.**

## Pennsylvania School District Enhanced Ratings Intercept Program

- The school district intercept program creates a level of security that enhances many school districts' underlying credit, giving all Pennsylvania districts an opportunity for added support.
- Investors should always make the distinction between a school district's underlying credit ratings and the intercept program's enhanced credit ratings.
- The lower rated "post-default" intercept mechanism is more commonly utilized than the higher rated "pre-default" intercept program because the pre-default is only available to or utilized by a select number of school districts.

### The Intercept Program Creates a Minimum Enhanced Rating

The Pennsylvania School District Enhanced Ratings Intercept Program creates a level of support above many school districts' underlying credit quality, thereby giving most districts at least a minimum "enhanced" rating of Aa3/A. This enhanced rating is derived from the credit quality of the Commonwealth of Pennsylvania. But, investors should also always strongly consider the underlying credit profile and rating(s) of school districts before making investment decisions.

The Pennsylvania School District Enhanced Ratings Intercept Program is based on the Commonwealth School Code's intercept provisions which enforce the payment of school districts' bond debt service. Section 633 of the Commonwealth's Public School Code, as amended by Act 150 of 1975, provides that the Secretary of Education will withhold current or future state aid payments from a school district which fails to make a debt service payment. Those funds will be sent to bondholders through the paying agent.

### Security for the Intercept Program

The program's ratings are based on the Commonwealth's general obligation rating and legislative appropriations for public education. All public school aid (subsidies) made by the Commonwealth are subject to annual appropriation by the Commonwealth's General Assembly. The intercept program is not a general obligation of the Commonwealth of Pennsylvania.

### Pre-Default and Post-Default Mechanisms

There are two versions of the intercept program:

- **Pre-Default**- This is the slightly higher rated pre-default program. The pre-default version requires school districts to pay a debt service payment by the 15th day before the debt service payment is due. If there is a debt service deficiency, on the payment date, the paying agent will notify the Secretary of Education, who will send the required amount of the school's appropriated educational funding to the paying agent, in order to make the debt service payment on the actual date it is due.
- **Post-Default**- This is the more common version. If a school district misses a debt service payment the paying agent will notify the Secretary of Education who will send appropriated educational funding to the paying agent who will make the debt service payment, but after the date debt service is due.

### PA GO and Enhanced School Intercept Program Ratings

State/Program	Moody's		S&P		Fitch		Notes
	Rating	Outlook	Rating	Outlook	Rating	Outlook	
PA State GO	Aa1	Neg	AA	Stable	AA+	Negative	PA GO rating
Pre-Default Intercept	Aa2	Neg	A+	Stable	AA	Negative	Only a few # of issuers
Post-Default Intercept	Aa3	Neg	A	Stable	NR	-	More widely used

Source: Moody's, S&P, Fitch and Janney Fixed Income Strategy.

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The Intercept Program's ratings are based on legislative appropriations for public education. But, the Intercept Program is not a general obligation of the Commonwealth of Pennsylvania.

All Pennsylvania school districts are automatically subject to the debt service intercept provisions and can receive the enhanced post-default program ratings if they are eligible per the rating agencies' criteria.

## Issuer Eligibility

All school districts within the Commonwealth are automatically subject to the debt service intercept provisions and therefore can receive the enhanced post-default program ratings if eligible under the rating agencies' criteria. A school district's annual state aid must be at least equal to future maximum annual debt service for the rating agencies to assign the enhanced program's ratings. There are a very limited number of school districts that do not meet this requirement.

## Recent School District Financing Examples

- **Blackhawk School District, (underlying ratings of: Moody's- A2, S&P- NR, Fitch- NR)-** priced a bond issue in August 2011 with an "A2" Moody's underlying rating. The underlying is below the "Aa3" rating for the post-default mechanism. Therefore, in some cases investors might see the rating referred to as only "Aa3/NR/NR." While this is not necessarily wrong, it could be perceived as misleading. This is an example of why investors should always differentiate between the underlying and the enhanced intercept rating.
- **School District of Philadelphia, (underlying ratings of: Moody's- Ba1, S&P- A+, Fitch- BBB+)-** sold a bond issue in March 2010 and it was enhanced by the intercept program's pre-default ratings of "Aa2/A+/AA."
- **Mars Area School District, (underlying ratings of: Moody's- NR, S&P- A+, Fitch- NR)-** sold an issue in April 2011 with an underlying rating that is higher than the "A" rated post-default mechanism. In a case such as this investors will generally see the rating shown as "NR/A+/NR." While the school intercept program may also be referenced it would likely not be highlighted because it possesses a lower rating than the underlying.

## Analyst Certification

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