

MOODY'S

INVESTORS SERVICE

Rating Update: Moody's affirmed A2 underlying/A2 enhanced to Millcreek Township, PA's GO; removes negative outlook

Global Credit Research - 27 May 2015

Rating affects \$11.5 million in rated GO debt outstanding.

MILLCREEK TOWNSHIP SCHOOL DISTRICT, PA
Public K-12 School Districts
PA

NEW YORK, May 27, 2015 --Moody's Investors Service affirms Millcreek Township School District, PA's A2 underlying rating and A2 enhanced rating. The district has approximately \$53.6 million in GO debt outstanding, of which \$11.5 million is rated by Moody's. The negative outlook has been removed.

SUMMARY RATING RATIONALE

The A2 underlying rating reflects the district's large tax base with above-average wealth indices; an improved financial position with narrow General Fund reserves; manageable debt burden, and above average pension liabilities.

The A2 enhanced rating is based on the Pennsylvania Act 150 School District Intercept program, a post-default program authorized under Section 633 of the Public School Code of 1949.

OUTLOOK

Outlooks for underlying ratings are usually not assigned to local government credits with this amount of debt outstanding.

WHAT COULD MAKE THE RATING GO UP

- Sustained growth in reserve and liquidity levels
- Implementation and adherence to strong fiscal policies

WHAT COULD MAKE THE RATING GO DOWN

- Multi-year declines to reserve and liquidity levels
- Substantial increases to the debt burden that adversely affect district finances

STRENGTHS

- Large tax base with above-average wealth levels
- Manageable debt burden with rapid principal repayment

CHALLENGES

- Narrow financial position
- Above average pension obligations

RECENT DEVELOPMENTS

The district ended fiscal 2014 with the first operating surplus in six years partly due to a new administration with conservative budgeting practices.

Additional details on this recent development are discussed in the Detailed Rating Rationale section.

DETAILED RATING RATIONALE

ENHANCEMENT FROM PA ACT 150 PROGRAM

The district's bonds are enhanced on a post-default basis by Pennsylvania's Act 150 intercept program. In the case of nonpayment of debt service by a school district, the Secretary of Education is authorized to directly remit appropriated state aid to bondholders until the deficiency is cured. Payments can be accelerated within the current fiscal year and all forms of state aid are interceptable.

ECONOMY AND TAX BASE: LARGE TAX BASE WITH ABOVE-AVERAGE WEALTH IN ERIE COUNTY

The district's large \$3.9 billion tax base is expected to remain stable given its mostly residential nature and limited new development. The district serves Millcreek Township in Erie County (Aa2, stable). Assessed value has witnessed steady growth with a five-year compound annual increase of 4.2%. Wealth and income indices are above average relative to the state and nation, with 2010 median family income at 116%. Erie County's unemployment of 5.7% (March 2015) is above that of the commonwealth (5.5%) and above the nation (5.6%).

FINANCIAL OPERATIONS AND RESERVES: IMPROVING FINANCIAL POSITION; ALBEIT NARROW RESERVES

The district's financial position will likely continue to improve given newly appointed management's conservative budgeting practices. The district ended fiscal 2014 with a surplus of \$857,000, the first operating surplus in six years. The district's total General Fund balance in fiscal 2014 of \$2.4 million, or 2.8% of revenues represents an increase from \$1.4 million, or 1.6% of revenues in fiscal 2013. The surplus is the result of conservative budgeting of property tax revenues.

The fiscal 2015 budget was balanced without any reserve appropriations but includes a 0.29 mill increase, over the Act 1 index. Based on year-to-date results, officials anticipate ending the year with a \$1.4 million surplus. Going forward, management plans to increase the capital reserve with one time revenues over the next year, including tax appeal settlements, and asset sales. The district is expected to continue to improve its financial operations given management's conservative budgeting practices.

The district has limited exposure to charter school pressure with less than 3% of the budget appropriated for related expenses. Management has also taken steps to review student residency requirements to better manage costs.

Liquidity

The district's liquidity is also likely to improve due to conservative management. The district's cash position was \$8.2 million, or 9.4% of revenues, at the close of fiscal 2014.

DEBT AND OTHER LIABILITIES: ELEVATED DEBT BURDEN AND PENSION OBLIGATIONS

The district's direct debt burden is expected to remain manageable due to the rapid payout schedule (100% of principal in 10 years) and no near-term borrowing plans. The district's direct debt burden is 1.4% of equalized valuation, and increases to 2.7% of equalized value when accounting for the district's pro rata share of overlapping municipal and county debt obligations. Debt service accounted for 7% of fiscal 2014 operating expenditures. The district has no future borrowing plans at this time.

Debt Structure

All of the district's debt is fixed rate and amortizes over the long term.

Debt-Related Derivatives

The district has no derivatives or interest rate swap agreements.

Pensions and OPEB

The district contributes to the Public Schools Employees' Retirement System of Pennsylvania, a multi-employer cost-sharing defined benefit plan. The district is required to fully fund its Annual Required Contribution (ARC), which was \$6.9 million in 2014, or 8% of expenditures. The adjusted net pension liability, under Moody's methodology for adjusting reported pension data, is \$122 million, or an above average 1.43 times operating revenues. Moody's uses the adjusted net pension liability to improve comparability of reported pension liabilities.

The adjustments are not intended to replace the district's reported liability information, but to improve comparability with other rated entities. We determined the district's share of liability for the state-run plan in proportion to its contributions to the plan. Total fixed costs for fiscal 2014, including pension, OPEB and debt service, represented \$16 million, or a modest 18.6% of annual expenditures.

MANAGEMENT AND GOVERNANCE

Pennsylvania school districts have an institutional framework score of 'A' or moderate. Revenues are comprised of local property taxes and state aid, which is determined by the state funding formula. School district property taxes are subject to the Act 1 cap, which makes raising new revenues in a weak economic environment far more difficult, although improvements in the Act 1 index, driven by the CPI, could generate additional operating flexibility. Expenditures are somewhat predictable, and, to an extent, can be cut in response to revenue declines.

Millcreek's new management started in 2014 and has started formal policies to grow the capital reserve.

KEY STATISTICS

- Equalized Value, Fiscal 2014: \$3.9 billion
- Equalized Value Per Capita, Fiscal 2014: \$73,864
- Median Family Income as % of US Median (2010 Census): 116.4%
- Available Fund Balance as % of Revenues, Fiscal 2014: 2.44%
- 3-Year Dollar Change in Fund Balance as % of Revenues: -5.19%
- Cash Balance as % of Revenues, Fiscal 2014: 9.39%
- 3-Year Dollar Change in Cash Balance as % of Revenues: -5.3%
- Institutional Framework: "A"
- 3-Year Average Operating Revenues / Operating Expenditures: 0.99 times
- Net Direct Debt as % of Assessed Value: 1.4%
- Net Direct Debt / Operating Revenues: 0.6 times
- 3-Year Average ANPL as % of Assessed Value: 2.42%
- 3-Year Average ANPL / Operating Revenues: 1.1 times

OBLIGOR PROFILE

The school district serves approximately 7,000 students in Millcreek Township.

LEGAL SECURITY

The bonds are secured by the district's general obligation limited tax pledge, as tax increases to pay debt service are limited by Act 1.

USE OF PROCEEDS

Not applicable.

PRINCIPAL METHODOLOGY

The principal methodology used in this underlying rating was US Local Government General Obligation Debt published in January 2014. The principal methodology used in this enhanced rating was State Aid Intercept Programs and Financings: Pre and Post Default published in July 2013. Please see the Credit Policy page on www.moodys.com for a copy of these methodologies.

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