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Ratings

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## Summary:

# Council Rock School District, Pennsylvania; General Obligation


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**Summary:**

# Council Rock School District, Pennsylvania; General Obligation

| Credit Profile | | |
|---|---|---|
| US$8.95 mil GO bnds ser 2020 due 11/15/2035 | | |
| *Long Term Rating* | AA/Stable | New |
| Council Rock Sch Dist SCHSTPR | | |
| *Long Term Rating* | AA/Stable | Affirmed |
| *Underlying Rating for Credit Program* | NR | |
| Council Rock Sch Dist SCHSTPR | | |
| *Long Term Rating* | AA/Stable | Affirmed |
| *Underlying Rating for Credit Program* | NR | |

## Rationale

S&P Global Ratings assigned its 'AA' long-term rating to Council Rock School District, Pa.'s series 2020 general obligation (GO) bonds. At the same time, S&P Global Ratings affirmed its 'AA' long-term rating on the district's previously issued GO debt. The outlook is stable.

### Security and use of proceeds

The district's full faith and credit, subject to the Act 1 Index where applicable, secures the series 2020 bonds and the GO debt outstanding. The Act 1 Index restricts a district's ability to raise the tax levy above a certain index determined by the Pennsylvania Department of Education. We rate the district's limited-tax GO debt at the same level as the district's unlimited-tax GO debt, given our view that the revenue is coming from the same tax base, and we see no significant limitations on the fungibility of resources.

Proceeds from the series 2020 bonds will refund the district's 2015A bonds for interest cost savings. We understand the district is not extending the maturity of the refunded bonds and plans for relatively level savings.

### Credit overview

The district benefits from an extremely strong economy with access to employment in Philadelphia and other nearby economic centers. The district maintains an extensive capital plan that includes upcoming renovations to numerous school buildings. We expect the district will likely continue to use debt to fund these large projects, but we do not expect the debt profile to weaken because of management's plan to structure the new debt to take the place of existing debt service as it matures. The district's available reserves, while strong, are low compared with those of similarly rated peers. However, management reports that the board has shown a commitment to increasing property taxes when needed, and that the district's budget should benefit as construction and renovations to school buildings lead to lower maintenance costs. Therefore, we expect the district will continue to maintain its stable financial profile.

The rating reflects our opinion of the district's:

- Access to the Philadelphia metropolitan statistical area (MSA) economy, contributing to what we see as very strong income levels and extremely strong market value per capita;
- Good financial management practices and policies under our Financial Management Assessment (FMA) methodology; and
- Strong financial profile with structurally balanced operations.

The district's comparatively lower reserves and significant capital needs that will likely lead to additional debt, somewhat offset these strengths.

## Economy

Council Rock School District serves an estimated population of 72,364. At 189% and 198% of national averages, respectively, the district's median household and per capita effective buying incomes are very strong, in our view. At $155,725 per capita, the 2018-2019 market value totaling $11.3 billion is, in our opinion, extremely strong. The 10 largest taxpayers make up an estimated 1.9% of assessed value, which we consider very diverse. Although one of the district's largest taxpayers appealed its valuation, we do not anticipate a budgetary impact given the extremely small portion of the district tax base its commercial properties make up.

The district is in Bucks County, about 20 miles north of Philadelphia. The district encompasses Newtown Borough and the townships of Newtown, Northampton, Upper Makefield, and Wrightstown. The district's location provides residents with ample employment opportunities in Philadelphia and nearby Trenton and Princeton in New Jersey.

Student enrollment for fiscal 2020 totaled 10,812. Enrollment has been decreasing, but the district projects stable enrollment over the next few years. Management attributes the recent declines to lower birth rates that have led to smaller class sizes in the lower grade levels. However, management reports that in-migration into the district offsets those trends, and is thus projecting stable enrollment for the near future. Since enrollment is one of numerous factors in the commonwealth's basic education funding formula, we do not expect changes in enrollment to have a significant effect on the amount of state aid the district receives.

## Finances

The district maintains a strong financial profile, raising taxes as needed to ensure revenues align with expenditures. Although it has not needed to exceed Act 1 limitations, the board authorizes the ability to do so if needed. Combined with conservative budgeting, the district generally achieves surplus results, with any deficits related to transferring surplus funds to dedicated capital funds. Fiscal 2019 continued this trend, with the district reporting a surplus operating result of 0.4% of expenditures. Officials attribute the surplus to better-than-budgeted property tax collections and conservative budgeting of expenditures that led to savings. Local sources of revenue, including property and earned income taxes, make up the majority of the district's general fund revenues (about 76%), with state sources accounting for most of the remainder (about 22%).

The district adheres to its formal fund balance policy to maintain unassigned reserves at 5% of expenditures, with fiscal 2019 levels at 5.2%. Including the district's $9.9 million of committed funds earmarked for budget stabilization, future education initiatives, and self-insured health insurance, all of which is available for liquidity, if necessary, improves our view of its finances. These reserves bring the district's total available fund balance to $22.2 million, which is strong, in our view, at 9.3% of general fund expenditures at fiscal year-end (June 30) 2019.

Given our expectation that the district will continue to maintain operational balance, we expect any variations in reserve levels to result from capital needs. However, management does not anticipate another large transfer out for capital projects until fiscal 2021, when the transfer might again be as much as $3 million. However, the district reports that these maintenance costs should decline as various school renovations are completed. We note that if pensions, capital, or other expenditures materially reduce fund balance in the future, we could view this as a more significant credit weakness.

### Management

We consider the district's management practices good under our FMA methodology, indicating our view that financial practices exist in most areas, but that governance officials might not formalize or monitor all of them on a regular basis.

Key practices include management's:

- Two- to-three-year lookback at revenue and expenditures to formulate the current budget with results demonstrating the conservative nature of assumptions;
- Monthly reports on budget-to-actual results to the school board with the ability to amend the budget if needed;
- Five-year financial forecast and capital plan, which it updates annually and shares with the board;
- Investment policy with monthly treasurer's reports to the board; and
- Formal minimum unassigned fund balance policy of 5% of the following year's budgeted expenditures to preserve the district's financial integrity.

The district does not maintain a formal debt-management policy.

The district reports it has not had a cybersecurity attack, but is testing its systems, learning from the experience of peers that have experienced an attack, and making sure its insurance coverage is adequate. In terms of weather-related risks, management sees heavy rains as its biggest concern, but anticipates that the design of its renovations and construction within its facilities will improve its ability to handle those extreme weather events.

### Debt

At 3.1% of market value and $4,878 per capita, overall net debt is moderate, in our view. With 45% of the district's direct debt scheduled to be retired within 10 years, amortization is slower than average. Debt service carrying charges were 7.8% of total governmental fund expenditures excluding capital outlay in fiscal 2019, which we consider low.

The district has significant renovation and construction plans for its facilities, and likely will issue debt to support those needs, although the board hasn't taken any actions regarding this. The district intends to structure any additional debt in a way that keeps it debt service level with its current commitments, and can do this as other debt is scheduled to mature. We understand the district has no direct-purchase debt.

Pension and other postemployment benefit liabilities

- We view pension costs as a source of credit pressure, although we expect the district will continue to manage cost increases without jeopardizing its financial balance.

- Furthermore, given the state reimburses about half of increased pension costs, the impact is somewhat mitigated.
- While the district funds its other postemployment benefit (OPEB) obligations on a pay-as-you-go basis, which given long-term medical cost trends will likely lead to cost escalations, steps taken during contract negotiations to limit these benefits reduce the overall liability and potential for budgetary pressure.

The district participates in the following plans:

- Pennsylvania Public School Employees' Retirement System (PSERS): 54.00% funded, with a proportionate share of the plan's net pension liability of $391.8 million.
- A single-employer defined-benefit OPEB plan: 0% funded with a net OPEB obligation of $11.5 million.

The plan made funding progress in the most recent year, with contributions in excess of static funding, but less than our minimum funding progress metric. The district makes contractual contributions based on an actuarial calculation. The actuarially calculated contributions are on a level dollar amortization basis over an open 30-year period. This is an aggressive contribution methodology. With liabilities measured using a discount rate of 7.25%, we see some risk of cost escalation due to market volatility, but are primarily concerned with contributions not keeping up with an actuarial plan toward full funding. The district paid its full required contribution of $34.6 million toward its pension obligations in fiscal 2019, or 12.9% of total governmental expenditures.

The district also contributed $1.4 million, or 0.5% of total governmental expenditures, toward its OPEB obligations in fiscal 2019. Combined pension and OPEB carrying charges totaled 13.4% of total governmental fund expenditures in 2019.

## Outlook

The stable outlook reflects S&P Global Ratings' opinion of the district's strong available reserves and good financial management practices. The district's very-strong-to-extremely-strong economic indicators with access to the Philadelphia MSA economy further support the outlook. We anticipate that management will likely continue to make budgetary adjustments it deems necessary to maintain at least strong available reserves despite pension contribution pressure and transfers into the capital projects fund. Therefore, we do not expect to change the rating during the two-year outlook period.

### Downside scenario

If management were to continue to draw down available fund balance or if the unassigned fund balance were to decrease to a level below the district's fund balance policy, with no plans to correct it, we could lower the rating. We also could consider lowering the rating if the district's overall debt burden materially increased.

### Upside scenario

With all other factors remaining stable, if the available fund balance were to improve to, and be sustained at, levels we consider commensurate with those of higher-rated peers, we could raise the rating.

## Related Research

- Criteria Guidance: Assessing U.S. Public Finance Pension And Other Postemployment Obligations For GO Debt, Local Government GO Ratings, And State Ratings, Oct. 7, 2019

| Ratings Detail (As Of January 13, 2020) | | |
|---|---|---|
| Council Rock Sch Dist GO bnds | | |
| *Long Term Rating* | AA/Stable | Affirmed |
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| Council Rock Sch Dist GO bnds | | |
| *Long Term Rating* | AA/Stable | Affirmed |
| Council Rock Sch Dist GO bnds ser 2019B due 08/15/2028 | | |
| *Long Term Rating* | AA/Stable | Affirmed |
| Council Rock Sch Dist GO state credit enhancement | | |
| *Long Term Rating* | AA/Stable | Affirmed |
| *Underlying Rating for Credit Program* | NR | |
| **Council Rock Sch Dist GO State Credit Enhancement** | | |
| *Underlying Rating for Credit Program* | NR | |
| *Long Term Rating* | AA/Stable | Affirmed |