

Rationale

Standard & Poor's Ratings Services has raised its long-term rating, school issuer credit rating (ICR) and underlying rating (SPUR) to 'AA-' from 'A+' on Northwestern Lehigh School District, Pa.'s general obligation (GO) bonds. The upgrade reflects conservative budgeting practices that have yielded general fund surpluses and a significant amount of financial flexibility. At the same time, Standard & Poor's assigned its 'AA-' long term rating and ICR to the district's series 2013 GO bonds. The outlook is stable.

The ICR reflects our view of the following:

- A largely residential property tax base with strong-to-very strong income indicators and a very strong market value per capita;
- Access to the broader employment base of Allentown-Bethlehem-Easton;
- Very strong total available general fund balance at fiscal 2012 year-end that is bolstered by a sizable committed balance; and
- Moderate debt burden and limited capital needs for the near and intermediate term.

We believe that the risk associated with the district's variable-rate obligations, which make up about 30% of its debt profile, constrains the rating.

The district's full faith and credit pledge secures the bonds. Additional security is provided by the Pennsylvania State Aid Intercept Program. We understand bond proceeds will current refund the district's series 2008 GO bonds.

Located in central eastern Pennsylvania, Northwestern Lehigh School District encompasses a 107-square-mile section of Lehigh County. The approximate geographic center of the district is about 20 miles northwest of the city of Allentown. Population is estimated at 15,500, which is an 18% increase from the 2000 census. Overall trends in enrollment have been slightly negative in recent years; total enrollment fell to 2,267 in fiscal 2013, from 2,392 in 2009. Enrollment projections through 2018 show some volatility within a narrow band.

The district's assessed value (AV) totaled \$452 million in fiscal 2013, which is a 0.2% year-over-year increase. Land use is primarily residential (72% of fiscal 2012 AV) and agricultural (15%). A revaluation, applicable to fiscal 2014, is expected to raise the AV to the market value. The preliminary value is \$1.4 billion, which we consider very strong at about \$90,000 per capita. The district's median household effective buying income (EBI) measures 143% of the national average, which we consider very strong. On a per capita basis, the EBI of 122% is weaker but still strong. Lehigh County's unemployment rate averaged 8.7% in August 2012, which was slightly higher than the commonwealth's 8.1%.

The district posted general fund surpluses in each of the past five audited fiscal years, which we believe is reflective of financial stability. Fiscal 2012 closed (June 30) with a \$2.6 million general fund surplus on a \$33 million budget; leading revenue sources were current real estate taxes (59% of the total) and state sources (28%). Property tax collections have historically been stable at roughly 95% on a current-year basis. The fiscal 2012 year-end total available balance was \$5.3 million, which we consider very strong at 15.8% of expenditures. Not included in this amount is a \$9.6 million committed balance that we believe significantly enhances the district's financial flexibility. The largest expense categories include other postemployment benefits (OPEB) at \$2.8 million, future retirement rate increases at \$2.1 million, increases in health care premiums at \$1.8 million, and future debt service rate increases at \$1.8 million.

The fiscal 2013 budget totals \$36.8 million and includes a \$400,000 budgetary reserve as well as an \$898,000 reserve appropriation. Management expects at least balanced operations at year-end given conservative budgeting practices, including overbudgeting energy expenditures and interest on variable-rate debt obligations.

We consider Northwestern Lehigh School District's management practices to be "good" under Standard & Poor's Financial Management Assessment. This indicates that practices exist in most areas, although not all may be formalized or regularly monitored by governance officials. The district has a formal fund balance policy to maintain the unassigned general fund balance at no less than 8% of expenditures. The district also maintains a five-year financial plan.

The district has two variable-rate debt obligations outstanding that were issued through the Emmaus General Authority's bond pool program and are supported by letters of credit (LOC). They include:

- The 2007A GO notes issued through the 1989 bond pool that was remarketed in 2008, and supported by an LOC with US Bank N.A.
- The 2009 GO bonds issued under the 2000A bond pool and supported by an LOC between the Emmaus General Authority and US Bank N.A..

The LOCs contain what we deem permissive events of default that, if triggered, could result in the acceleration of the obligations. As a result, we evaluated the district's liquidity. The district's two-year low general fund cash balance of \$14 million (July 2011) would not be sufficient to cover the \$17 million of principal at risk and we view this as a credit weakness.

The district's overall debt burden, net of state aid, is about \$3,900 per capita and 4.2% of market value. We believe these indicators are moderate. Carrying charges are also moderate, accounting for 10.7% of total governmental expenditures in fiscal 2012. The district may issue additional bonds to finance upgrades at the high school.

The district's pension contributions in fiscal 2012 totaled \$1.4 million. Including the OPEB pay-go amount of \$279,000, the figure represented 5% of total governmental expenditures. The unfunded actuarial accrued OPEB liability is \$3.1 million.

Outlook

The stable outlook reflects Standard & Poor's expectation that the district will continue to maintain a fund balance at or near current levels given that management's conservative budgeting practices have yielded strong results. Though management continues to budget conservatively for its variable-rate notes, we believe the potential for acceleration creates liquidity risk. However, we do not expect to change the rating within the outlook's two-year time horizon.

Related Criteria And Research

- USPF Criteria: GO Debt, Oct. 12, 2006
- USPF Criteria: State Credit Enhancement Programs, Nov. 13, 2008
- USPF Criteria: Contingent Liquidity Risks, March 5, 2012