

## CREDIT OPINION

25 September 2018



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## Patchogue-Medford U.F.S.D., NY

Update to credit analysis following upgrade of GO to Aa3

### Summary

Patchogue-Medford UFSD (Aa3) benefits from a sizable tax base located on in Suffolk County (Baa1 stable) supported by above-average resident wealth and income. The district further benefits from a stable and healthy financial position and an above average but manageable debt burden.

On September 20, 2018 Moody's upgraded the district's general obligation unlimited tax (GOULT) rating to Aa3 from A1.

### Credit strengths

- » Sizable, affluent tax base within commuting distance to New York City
- » Stable financial position

### Credit challenges

- » Statewide property tax cap
- » Above-average debt burden

### Rating outlook

Moody's typically does not assign outlooks to local government credits with this amount of debt outstanding.

### Factors that could lead to an upgrade

- » Sustained trend of structurally balance operations resulting in significant reserve growth
- » Material improvement to tax base and resident wealth and income profile

### Factors that could lead to a downgrade

- » Deterioration of tax base or resident wealth and income profile
- » Sustained operating imbalance and depletion of reserves
- » Significant increase to debt burden

## Key indicators

Exhibit 1

<b>Patchogue-Medford U.F.S.D., NY</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>
<b>Economy/Tax Base</b>					
Total Full Value (\$000)	\$4,789,315	\$4,559,237	\$4,549,619	\$4,530,348	\$4,775,845
Population	51,794	51,872	51,948	50,880	52,967
Full Value Per Capita	\$92,469	\$87,894	\$87,580	\$89,040	\$90,166
Median Family Income (% of US Median)	144.4%	144.8%	143.4%	143.4%	143.4%
<b>Finances</b>					
Operating Revenue (\$000)	\$158,258	\$163,707	\$166,277	\$170,927	\$177,764
Fund Balance (\$000)	\$23,427	\$22,975	\$21,087	\$21,073	\$22,647
Cash Balance (\$000)	\$30,205	\$31,844	\$33,332	\$35,829	\$31,381
Fund Balance as a % of Revenues	14.8%	14.0%	12.7%	12.3%	12.7%
Cash Balance as a % of Revenues	19.1%	19.5%	20.0%	21.0%	17.7%
<b>Debt/Pensions</b>					
Net Direct Debt (\$000)	\$120,672	\$111,955	\$115,843	\$108,187	\$99,929
3-Year Average of Moody's ANPL (\$000)	\$194,882	\$219,278	\$228,307	\$186,044	\$221,574
Net Direct Debt / Full Value (%)	2.5%	2.5%	2.5%	2.4%	2.1%
Net Direct Debt / Operating Revenues (x)	0.8x	0.7x	0.7x	0.6x	0.6x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	4.1%	4.8%	5.0%	4.1%	4.6%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	1.2x	1.3x	1.4x	1.1x	1.2x

Source: Moody's Investors Service; Patchogue-Medford UFSD audited financial statements

## Profile

The Patchogue-Medford Union Free School District is located in Suffolk County and serves approximately 7,540 students.

## Detailed credit considerations

### Economy and tax base: sizable tax base located on southern shore of Long Island

The district's \$4.8 billion tax base is expected to remain stable given a strong regional real estate market. The district is located in Suffolk County (Baa1 stable) and benefits from its proximity to regional and local employment centers, including New York City (Aa2 stable). Although the district's full value has declined by an average of 0.3% annually for the past five years, declines are leveling off, as evidenced by 5.4% growth in 2017. The growth was driven by a strong regional real estate market and modest development. Development in the New Village of Patchogue includes approximately 300 residential units, retail and office space. Riverwalk Patchogue recently constructed a 160-unit condominium complex reflected in the full value growth. Resident wealth levels in the area are above average with the district's median family income at 143.7% of the US median.

### Financial operations and reserves: healthy financial position despite expected draws on reserves

The district's financial position is expected to remain stable in the near term. Fiscal 2017 closed with an operating surplus of approximately \$1.5 million net of an interfund transfer to the debt service fund. The surplus was primarily driven by conservative budget estimates for state aid revenues and special education. Available operating fund balance (General Fund and Debt Service Fund) increased to \$22.7 million (12.7% of revenues) in fiscal 2016 from \$21 million (12.3% of revenue) in fiscal 2016. The district maintains a Capital Reserve within the General fund, with a balance of \$4.6 million at the close of unaudited fiscal 2018. Capital Reserve is used to make critical repairs and fund other projects that are not covered by the district's regular maintenance budget.

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Fiscal 2018 unaudited results indicate another operating surplus after adjusting for the interfund transfer to the debt service fund. Cost savings in special education expenditures and conservative state aid estimates drove the positive results. That said, the available fund balance decreased to \$21.8 million (11.8% of revenues) due to reallocation of funds for planned capital improvement projects.

The fiscal 2019 budget increase by 3.12% and was balanced with a 3.12% tax levy increase (under the state cap). Notably, the district no longer utilizes reserves to balance its budget for a second consecutive year. Management budgeted approximately \$2.5 million in transfers to the Capital Fund. The district is in its third year of a five-year capital improvement plan that it will continue to fund through appropriation from annual surplus operations and existing reserves. The district's primary revenue, property taxes, accounted for 59% of fiscal 2017 revenues, followed by 38.3% in state aid.

## LIQUIDITY

The district's liquidity position is expected to remain healthy in the near term. The district ended fiscal 2017 with \$31.4 million (17.7% of operating revenues). The district relies on cash-flow borrowing due to the timing of property tax receipts. In fiscal 2017, the district borrowed \$30 million in tax anticipation notes (TANs), an amount that has remained relatively stable in recent years. TANs are borrowed for nine months beginning in September and are not outstanding at fiscal year-end.

## Debt and pensions: above-average debt burden; expected to remain manageable

The district's above-average direct debt burden of 2.1% of full value is expected to remain high but manageable given limited future borrowing plans. The district further benefits from 73% of its debt reimbursed by state building aid for qualified projects, reducing the debt profile to approximately 0.5% of full value. Amortization of principal is rapid, with 100% of the district's debt paid within ten years. Debt service in fiscal 2017 was a manageable 6.7% of total expenditure.

## DEBT STRUCTURE

All of the district's debt is fixed rate.

## DEBT-RELATED DERIVATIVES

The district is not party to any interest rate swaps or derivative agreements

## PENSIONS AND OPEB

The district continues to actively manage its pension and other post employment benefits (OPEB) costs by not deferring contributions and making payments early. The district participates in the New York State Teachers' Retirement System (TRS) and the New York State and Local Employees' Retirement System (ERS), two multi-employer, defined benefit retirement plans sponsored by the State of New York (Aa1 stable). For fiscal 2017, employer contributions to the plans totaled \$10 million, or a moderate 5.6% of operating revenues. The district's three year average adjusted net pension liability (ANPL) in fiscal 2017, under Moody's methodology for adjusting reported pension data, was \$221.6 million or an average 1.25X operating revenues.

The district makes OPEB payments on a pay-as-you-go basis, which amounted to \$9.6 million in 2017, or 5.4% of revenues. Total fixed costs for fiscal 2017, including debt service, required pension contributions and retiree health care payments, represented \$31.7 million, a manageable 16% of revenues.

## Management and governance: conservative management practices

District management employs conservative budgeting and financial management as evidenced in stable reserves and structural balance.

New York School Districts have an Institutional Framework score of A, which is moderate compared to the nation. Institutional Framework scores measure a sector's legal ability to increase revenues and decrease expenditures. New York School Districts operate within a state-imposed property tax cap, which limits their ability to increase their operating levy by the lesser of 2% or CPI (before exemptions and rollovers are added). This cap cannot be overridden at the local level, but can be overridden with 60% voter approval. Unpredictable revenue fluctuations tend to be low, or less than 5% annually. Across the sector, fixed and mandated costs are generally greater than 25% of expenditures. New York State has public sector unions and the additional constraint of the Triborough Amendment, which limits the ability to cut expenditures. Unpredictable expenditure fluctuations tend to be moderate, or between 5-10% annually

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