MOODY'S
INVESTORS SERVICE

Rating Update: Moody's upgrades Hempfield Township, PA's GO rating to Aa2

Global Credit Research - 05 May 2015

Upgrade affects $7.9 million in rated GO debt

HEMPFIELD (TOWNSHIP OF) PA
Cities (including Towns, Villages and Townships)
PA

NEW YORK, May 05, 2015 --Moody's Investors Service has upgraded to Aa2 from Aa3 the rating on Hempfield Township, PA's general obligation (GO) debt. The Aa2 rating applies to approximately $7.9 million in rated debt outstanding.

SUMMARY RATING RATIONALE

The upgrade to Aa2 reflects the township's strong operating history leading to a significant build-up reserves; large and growing tax base; low debt burden and average wealth levels.

OUTLOOK

Outlooks are generally not assigned to local governments with this amount of debt outstanding.

WHAT COULD MAKE THE RATING GO UP

- Material increase in wealth levels

- Continued growth in General Fund reserves

WHAT COULD MAKE THE RATING GO DOWN

- Weakening of the township's tax base and socioeconomic profile

- Large declines in reserves and liquidity

- Significant increase in debt burden

STRENGTHS

- Large and favorably located Pittsburgh area tax base

- Ample General Fund reserves and liquidity

- Low debt burden

CHALLENGES

- High fixed costs related to OPEB

RECENT DEVELOPMENTS

Recent developments are incorporated in the Detailed Rating Rationale.

DETAILED RATING RATIONALE

ECONOMY AND TAX BASE: SIZEABLE TAX BASE WITH ROOM AND DEMAND FOR GROWTH

Hempfield Township's $2.8 billion tax base will remain strong over the next two to three years due to recent population growth and its proximity to the city of Pittsburgh (A1 positive). The township is located in Westmoreland County (Aa2) 30 miles southeast of Pittsburgh. The tax base has shown growth in recent years, with a five-year compound annual increase of 3.3%. Growth in the tax base can be attributed to its proximity to Pittsburgh, which is easily accessible given various major highways nearby the township. The township has also developed interest given its relatively low property tax rate, which has not been increased in over 20 years, and relatively low cost of living. As a result, population has seen modest increases over the past decade and median family income has risen to 111% of the nation, up from 99% in 1990. Management anticipates modest future growth in the tax base, and reported interest in various commercial development projects in the medium term.

FINANCIAL OPERATIONS AND RESERVES: RISING INCOME TAXES AND CONSERVATIVE BUDGETING BOLSTER RESERVES

The township's financial position will remain strong over the next two to three years given conservative budgeting and rising income tax revenues. The township has recorded six straight operating surpluses, which has resulted in fund balance more than doubling from 2008 levels. This positive performance has been driven by increased income tax revenues, which have grown with the uptick in economic development within the township. It is also a product of Act 32, a Pennsylvania (Aa3 stable) state law which has led to better tax collection procedures and enabled the discovery of previously unpaid income taxes. While income taxes can sometimes be volatile in nature, we expect the township's substantial tax base to remain a reliable source of income tax revenues going forward.

In 2013, the township ran its sixth consecutive surplus, and saw fund balance rise to $5.8 million, or a substantial 48% of General Fund revenues. The surplus can be attributed to rising income tax revenues, which have grown 44% from 2010. In 2013, income taxes were $3.6 million, or 30% of revenues. Property taxes remained flat at $1.5 million, or 13% of revenues, as the township has not needed to raise the millage to generate new revenues in over 20 years.

In 2014, based on preliminary management estimates, fund balance rose to approximately $6.2 million, indicating another year of surplus. In 2015, the township is planning a road construction project that will cost approximately $1.7 million, of which $1.2 million will be paid from the liquid fuels fund, leaving only $500,000 to be paid from the General Fund. Management expects reserve levels to remain at current levels going forward, and show modest growth given continued income tax growth and conservative budgeting practices.

Liquidity

The township's cash position in fiscal 2013 is substantial at $6.8 million, or a very strong 56% of revenues, and has risen 70% from 2008. Going forward, the township has a plan to transfer some of these funds into various reserves. Management is aiming to put around $2 million into an operating reserve, and maintain this reserve at 25% of revenues going forward. Additionally, management plans to initiate a Capital projects fund with a $1.3 million transfer and a Fire capital fund with around $1 million. If the plan goes through, management aims to set up the new funds with the ability to pay for future debt service.

DEBT AND PENSIONS: MINIMAL DEBT AND PENSION BURDENS; ELEVATED OPEB

The township has a minimal debt burden, which should remain low given limited future borrowing plans. At the close of fiscal 2013, the township had $9 million in unrated GOULT debt and $12.9 million in township-guaranteed revenue debt of the Hempfield Township Municipal Authority, $7.9 million of which is rated. With this guaranteed debt, the township's debt burden is a manageable 0.9% of full value. The township's debt service costs were also manageable at 7.5% of expenses in fiscal 2013. However, if the approximately $2 million in guaranteed authority debt service is added in, debt service rises to an elevated 25% of expenditures. The township has not yet been called to pay this debt service, and given the relatively strong position of the authority, and its ability to raise sewer rates, we do not expect the township will become liable for these payments going forward.

In 2013, the authority had $3.1 million in cash, or a healthy 231 days cash on hand. Senior lien coverage on the authority's revenues bonds was also strong at 1.34x, although total coverage fell to 0.98x in 2013 when subordinate loans are included. While the authority could present a future drain on resources, its current position is strong and not pressuring the township's finances. Going forward, the authority does not have a rate increase planned, but expects increased revenues from new customers as the township continues to grow.

Debt Structure

Currently, all of the township's debt is fixed rate. In 2019, one $5 million note converts to variable rate, with interest paid at .85% of One Month Libor plus 200 basis points with a max interest rate of 4.75% through 2030.

Debt-Related Derivatives

The township is not party to any interest rate swaps or other derivatives.

Pensions and OPEB

Hempfield's pension burden is manageable. The township maintains one single employer defined benefit pension plan. In 2013, the township contributed $442,000 to the plan, or a modest 3.8% of expenses. When looking at Moody's adjusted net pension liability (ANPL), under our methodology for adjusting reported pension data, the township's pension burden is a modest $6.7 million or 0.54 times 2013 operating revenues and 0.3% of full value. Moody's uses the ANPL to improve comparability of reported pension liabilities. The adjustments are not intended to replace the township's reported liability information, but to improve comparability with other rated entities. The township's OPEB liability, however, is elevated. In 2013, the township made $1.1 million in OPEB contributions, which accounted for an above average 10% of expenses.

MANAGEMENT AND GOVERNANCE: HISTORY OF CONSERVATIVE BUDGETING AND COST CONTROL

The township's management has contributed to its financial strength through conservative budgeting and discipline by department heads in controlling expenditures. Management is also conservatively managing its reserve positions, and expects to keep 25% of revenues in an operating reserve going forward. Additionally, management has taken steps to minimize its fixed costs. Going forward, new employees will be ineligible for OPEB, and new non-union employees will be enrolled in defined contribution pension plans.

Pennsylvania cities (including towns, villages, and townships) have an institutional framework score of Aa, or strong. Cities enjoy the authority to adjust the property tax millage without limitation. While many cities rely on economically sensitive revenues such as income taxes, they have the authority to increase property taxes to offset any declines in these revenues. Organized labor does have a strong presence in the state, and state labor law gives bargaining groups significant leeway to seek arbitration. Most cities have been challenged to control and predict labor costs.

KEY STATISTICS

- Full Value: $2.8 billion

- Full value per capita: $65,391

- Median family income as % of US: 111%

- 2013 General fund balance as a % of revenues: 48%

- 5-year dollar change in fund balance as a % of revenues: 28%

- Cash balance as a % of revenue: 56%

- 5-year dollar change in cash as a % of revenues: 23%

- Institutional Framework (PA cities): Aa

- 5-year average of operating revenues/operating expenditures: 1.05x

- Net direct debt/full value: 0.4%

- Net direct debt/operating revenues: 0.74x

- 3-year average Moody's ANPL/Full Value: 0.17%

- 3-year average Moody's ANPL/operating revenues: 0.38x

OBLIGOR PROFILE

Hempfield township is located in Westmoreland County about 30 miles southeast of Pittsburgh. The township has a population of 43,200.

LEGAL SECURITY

Debt service on the rated debt is secured by the township's general obligation unlimited ad valorem tax pledge.

USE OF PROCEEDS

Not applicable.

PRINCIPAL METHODOLOGY

The principal methodology used in this rating was US Local Government General Obligation Debt published in January 2014. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

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