

CREDIT OPINION

12 January 2016

New Issue

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Contacts

Douglas Goldmacher 212-553-1477
Associate Analyst
 douglas.goldmacher@moody's.com

Jennifer Dierksen 212-553-4346
AVP-Analyst
 jennifer.dierksen@moody's.com

Somerset Hills School District, NJ

New Issue - Moody's assigns Aa1 und/A2 enh to Somerset Hills SD, NJ's \$5.8M GO Bonds

Summary Rating Rationale

Moody's Investors Service has assigned a Aa1 underlying rating and an A2 Chapter 72 enhanced rating to the Somerset Hills School District, NJ's \$5.8 million School Bonds, Series 2016. Moody's outlook on the Chapter 72 School Bond Reserve rating is negative. Concurrently, Moody's has affirmed the Aa1 rating on the district's outstanding GO parity debt.

The Aa1 rating reflects the district's large tax base and strong socioeconomic profile. The rating also takes into account the district's satisfactory reserve position.

The A2 enhanced rating with a negative outlook is based on the rating of the New Jersey School Bond Reserve Act (Chapter 72) enhancement program and the structure and legal protections of the transaction, which provide for the timely payment of debt service by the Chapter 72 program, if necessary. For additional information on the Chapter 72 program, please see Moody's rating report dated [June 10, 2015](#).

Credit Strengths

- » Above-average wealth levels

Credit Challenges

- » Recent tax base declines
- » Limited scope for new development

Rating Outlook

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

The enhanced rating's negative outlook reflects the weakening credit profile of the State of New Jersey (GO rating A2 negative) and its public school districts. Further deterioration could lead to a downgrade of the program's rating.

Factors that Could Lead to an Upgrade

- » Structurally balanced financial operations leading to healthier operating reserves
- » Material growth in the tax base

Factors that Could Lead to a Downgrade

- » Material deterioration of the tax base and socioeconomic indices
- » Structural imbalance leading to decrease in reserves

Key Indicators

Exhibit 1

Somerset Hills School District, NJ	2011	2012	2013	2014	2015
Economy/Tax Base					
Total Full Value (\$000)	\$ 3,825,514	\$ 3,668,641	\$ 3,600,113	\$ 3,498,436	\$ 3,522,932
Full Value Per Capita	\$ 341,350	\$ 324,774	\$ 316,883	\$ 322,943	\$ 312,427
Median Family Income (% of US Median)	N/A	208.8%	208.8%	208.8%	208.8%
Finances					
Operating Revenue (\$000)	\$ 37,608	\$ 38,730	\$ 40,261	\$ 40,221	\$ 41,971
Fund Balance as a % of Revenues	8.3%	9.0%	10.6%	9.9%	8.7%
Cash Balance as a % of Revenues	5.2%	7.0%	9.0%	6.9%	7.2%
Debt/Pensions					
Net Direct Debt (\$000)	\$ 37,948	\$ 37,368	\$ 35,107	\$ 32,773	\$ 30,429
Net Direct Debt / Operating Revenues (x)	1.0x	1.0x	0.9x	0.8x	0.7x
Net Direct Debt / Full Value (%)	1.0%	1.0%	1.0%	0.9%	0.9%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	N/A	0.2x	0.2x	0.2x	0.3x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	N/A	0.2%	0.3%	0.3%	0.4%

Source: Moody's Investors Service

Detailed Rating Considerations

Economy and Tax Base: Large tax base with above-average wealth levels

The district's \$3.5 billion tax base will remain stable due to its strong wealth levels and favorable location. The district is located in central New Jersey, 40 miles west of New York City (Aa2 stable). Socioeconomic indicators in the largely residential tax base are above-average, with median family income at 208% of the national median. The five-year compound annual decline for the district's equalized value is 2.2%, although the district actually grew 0.7% in 2015.

Although there is ample room for new development, material growth in the tax base is likely to be limited. As the largest of the constituent municipalities, the borough of Bernardsville (Aaa), has a series of zoning ordinances which require new residents to purchase plots of at least 5 acres in some areas. Furthermore, much of the empty land is attached to large farms estates which have made clear their intentions not to allow extensive development. The other municipalities are the borough of Peapack - Gladstone (Aa2) and the borough of Far Hills.

Financial Operations and Reserves: Satisfactory and stable reserves

The district's reserve position will remain modest over the next several years given the district's history of balanced finances. Fiscal 2015 ended with \$3.6 million of available fund balance, or an adequate 8.7% of fiscal 2015 revenues. The district has maintained a fairly stable fund balance, which has averaged \$3.7 million or 9.3% of revenues over the last five years.

Management expects fiscal 2016 to be flat with only slight changes to fund balance. Favorably, the district also has some flexibility on the expenditure side as fixed costs including debt, pensions, and other post-employment benefits total \$4 million, or a modest 9.6% of expenditures.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moody's.com for the most updated credit rating action information and rating history.

LIQUIDITY

The district's liquidity will remain adequate and stable in the near to medium term. The fiscal 2015 cash position was \$3 million, or 7.2% of revenues. The cash position has fluctuated modestly in recent years as the district built up and spent cash reserves in conjunction with capital expenditures.

Debt and Pensions: Modest debt and pension burden

The district's debt burden is expected to remain modest given no borrowing plans over the next few years. Post-sale, the net direct debt burden will be \$36.3 million, or 1% of equalized full value. The district's debt is structured to pay at a slightly above-average rate, with 79.2% retired within 10 years.

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 other derivative agreements.

PENSIONS AND OPEB

The district participates in the statewide New Jersey Teachers Pension and Annuity Fund, administered by the state. School districts do not currently contribute directly to this plan as the state makes on behalf payments equal to the annual statutorily required contribution. The district also contributes to the statewide Public Employees' Retirement System. The district's combined ANPL for the plans, as of June 30, 2015, under our methodology for adjusted reported pension data, is \$18.4 million or a low 0.44 times operating revenue. The adjustments are not intended to replace the district's reported liability information, but to improve comparability with other rated entities. The district's 2015 annual contributions to pensions, net of on-behalf contributions by the state to TPAF, were a modest \$763,000, or 1.8% of fiscal 2015 expenditures. Including the on-behalf payments, the district would have contributed a more substantial \$1.6 million, or 3.8% of 2015 expenditures.

Management and Governance

New Jersey school districts have an institutional framework score of "A," or moderate. Revenue predictability is moderate due to the combination of property taxes and state aid. Property taxes, the majority of revenues, are collected and made whole by the overlapping municipality, with the next largest component being state aid. Schools have a moderate ability to raise revenues as property tax increases are capped at 2% with certain exemptions. Exceptions are made for enrollment increases, accrued liabilities related to pensions, and certain health care benefits. Districts may also exceed the cap with voter approval. Expenditures are highly predictable as they mostly consist of personnel costs. Expenditure reduction ability is moderate due to union contracts.

Legal Security

The Series 2016 bonds and outstanding GO debt are secured by the district's general obligation unlimited tax pledge.

Use of Proceeds

The \$5.8 million in proceeds will be used to permanently finance various capital projects including the creation of special education classrooms, various repairs, and the conversion of an auditorium into a library/media center. Management notes that the special education classrooms will allow the district to bring a number of special ed students back into the district. This should lead to significant budgetary savings, although the precise amount is yet to be determined.

Obligor Profile

The Somerset School District is a district in central New Jersey. It has a K-12 enrollment of 2,031 students.

Methodology

The principal methodology used in the underlying rating was US Local Government General Obligation Debt published in January 2014. The principal methodology used in the enhanced rating was Rating Transactions Based on the Credit Substitution Approach: Letter of Credit-backed, Insured and Guaranteed Debts published in December 2015. Please see the Credit Policy page on www.moody.com for a copy of these methodologies.

Ratings

Exhibit 2

SOMERSET HILLS SCHOOL DISTRICT, NJ

Issue	Rating
School Bonds, Series 2016	Aa1
Rating Type	Underlying LT
Sale Amount	\$5,829,000
Expected Sale Date	01/20/2016
Rating Description	General Obligation
School Bonds, Series 2016	A2
Rating Type	Enhanced LT
Sale Amount	\$5,829,000
Expected Sale Date	01/20/2016
Rating Description	General Obligation

Source: Moody's Investors Service

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REPORT NUMBER 1011997