

RatingsDirect®

Summary:

**Decatur County Community Schools,
Indiana**

**Decatur County 2010 School Building
Corp.; School State Program**

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Credit Profile

US\$20.0 mil ad valorem prop tax FMB (Decatur Cnty Comnty Schs) ser 2019 dtd 03/28/2019 due 01/15/2039

Long Term Rating AA+/Stable New

Underlying Rating for Credit Program A/Stable New

Decatur Cnty 2010 Sch Bldg Corp, Indiana

Decatur Cnty Comnty Schs, Indiana

Decatur Cnty 2010 Sch Bldg Corp (Decatur Cnty Comnty Schs) 1st mtg bnds

Long Term Rating AA+/Stable Affirmed

Rationale

S&P Global Ratings assigned its 'AA+' long-term rating and 'A' underlying rating for credit program to Decatur County 2010 School Building Corp., Ind.'s series 2019 ad valorem property tax first-mortgage bonds. At the same time, we affirmed our 'AA+' rating on existing debt issued by and on behalf of the school corporation. The outlook on all ratings is stable.

The 'A' rating reflects an ad valorem tax pledge and the 'AA+' rating reflects our view of the Indiana state aid intercept framework.

The school corporation is facing ongoing financial pressure as it seeks to realign its spending to match declining operating revenues. The tax base is steady and growing slightly, but enrollment has been declining for years and is projected to continue to shrink. The general operating fund is entirely reliant on per-pupil enrollment-driven state aid, and revenue is declining and there is little flexibility to increase it. The school corporation was slow to adjust spending, and consequently, significantly drew down its cash reserves in recent years due to budgetary imbalance. Available cash reserves remain strong, however, and management has begun to reduce spending, leading to progress in closing the budget gap. We expect that budgetary performance will continue to improve and that reserves will remain at least good. With this issuance, the debt burden grows significantly and fixed costs will increase too, but overall, long-term liabilities and fixed costs are not a significant pressure. The local economy remains stable but heavily dependent on manufacturing jobs, and if the sector experiences retraction, it could further pressure enrollment and operational balance.

Additional factors supporting the 'A' underlying rating include our view of the school corporation's:

- Currently stable and slowing growing local economy, but one that, in our view, is heavily reliant on manufacturing and could be prone to volatility;

- Adequate incomes, but strong market value per capita;
- Declining enrollment trends, which we expect will continue and therefore place consistent pressure on the budget;
- Pressured financial operations, with several years of deficit results, though the budget gap is closing and likely to be cured in the near future;
- Available reserves that are still strong, in our view, and though they may decline, are likely to remain at levels we consider at least good;
- Standard Financial Management Assessment (FMA), including regular reporting on financial matters and focus on long-term capital and financial planning; and
- Moderate overall debt burden, with low-to-moderate combined fixed charges.

Security

The series 2019 bonds are being issued pursuant to a trust indenture between the building corporation and the trustee, and a lease between the building corporation, as lessor, and the school corporation, as lessee. Lease rentals paid by the school corporation directly to the trustee secure the bonds. Rentals are payable from ad valorem taxes levied against all taxable property. The tax levy is not subject to annual appropriation under Indiana law, but there is abatement risk if the leased premises are not available for use. This risk is mitigated by requirements for the building corporation to maintain at least two years of lease interruption insurance, as well as casualty insurance equal to full replacement cost.

Bond proceeds will be used to finance renovation projects at each of the school corporation's four school buildings. The leased premise will consist of portions of the North Decatur Junior/Senior High School and North Decatur Elementary School, both of which will remain in use during the renovation period. Construction is scheduled to begin in April 2019 and be substantially completed by October 2019. The lease permits rent during renovation, beginning in June 2020, and full lease payments (and principal) begin in June/July 2021. We do not consider there to be construction risk as the facilities will remain in use during the project period and delays in construction will not disrupt the ability to make lease-rental payments sufficient to cover debt service.

The ad valorem tax pledge is subject to state circuit-breaker legislation, which caps the property tax burden for taxpayers based on a percentage of the real estate parcels' gross assessed value (AV). This can, and often does, reduce the total tax levy. The levy to cover debt service, however, is statutorily protected, allowing the corporation to distribute circuit-breaker losses first across nondebt service funds that receive property taxes. We rate these bonds at the same level as our view of the corporation's general creditworthiness, as we do not consider there to be limitations on the fungibility of resources to pay debt service.

The 'AA+' ratings are based on our state credit enhancement criteria, and reflect our assessment of the strength of the Indiana state aid intercept structure (as found in Section 20-48-1-11 of the Indiana Code). All school corporations can benefit from this statute without specific state qualification. However, in the absence of certain state aid coverage levels and bond terms, the statute may not provide sufficiently strong support in increasing the likelihood of payment in full and on time. For these reasons, we review state aid coverage and bond terms (see the report on Indiana School Corp., published May 16, 2017, on RatingsDirect).

Annual state aid appropriated and allocated for distribution during the state's fiscal year provides maximum annual

debt service (MADS) coverage by at least 2x, and appropriated but not yet distributed state aid covers maximum semiannual debt service by at least 1x. The bond terms require the school corporation to transfer payments to an independent trustee, registrar, or paying agent at least five business days in advance of the debt service due dates; and this third party has immediate notification and claimant responsibilities to the state treasurer, if a debt service transfer is not made on time or is insufficient. On notification, the treasurer will advance to the claimant any state aid that has been appropriated for allocation but not yet distributed, up to an amount of the debt service shortfall.

Economy

The school corporation's economic characteristics are slightly below average, though employment is stable. The school corporation serves all of Decatur County, except for residents in Greensburg, the seat and economic center of the county. The Greensburg School Corp. serves those residing in the city, and is completely surrounded by Decatur County School Corp. Greensburg lies along Interstate 74, about halfway between Indianapolis (52 miles northwest) and Cincinnati (61 miles southeast). Columbus, Ind. is also nearby (30 miles away), which is a regional employment center. Resident incomes are below average, but still adequate, with median household and per capita effective buying incomes equal to 90% and 78% of national levels, respectively. Market value per capita is very strong though, at \$89,480. This partly reflects a small population but highly valued farm land and some large manufacturing facilities.

The tax base is mostly rural and agriculture based, but employment is heavily dependent on manufacturing. Manufacturing jobs account for more than 30% of employment, which is well above national averages and also above state averages. Though the sector locally has been stable and expanding, we still view the concentration as an ongoing risk and negative credit factor. This reliance leaves the area more exposed to possible economic setbacks and volatility, especially as manufacturing likely is nearing growth maturity (see "For U.S. State And Local Governments, Winter Is Coming, But Maybe Not Yet," published Oct. 24, 2018). Decatur County's unemployment rate has declined several years in a row, dropping to a 2.9% average in 2017. However, it grew all the way to 13.9% during the Great Recession (and a 12.4% annual average in 2009), indicative of potential vulnerability. Fluctuations in jobs would have a significant effect on enrollment.

The three largest employers are in the sector, and include a Honda plant (2,900 employees), Valeo Engine Cooling Inc. (auto cooling modules, 1,400), and GECOM (automotive components, 860). The Honda plant opened in 2008 and has continued to expand. We understand it produces about 75% of Honda Civics sold in the U.S., and that Honda's new line (the Insight) will also be produced there. GEOCOM also recently expanded its operations. These large employers make the county a net gainer in daily population, as many come to work at these plants from outside the county. The 2010 countywide population was 25,740, up 8% over the past 30 years. The school corporation's population of 12,022 has been essentially flat during this period, though. There has been modest annual growth in net assessed value (AV), but new residential and commercial permit activity is stagnant. The net AV in 2018 was \$793.8 million and estimated market value (gross AV, less tax-exempt properties) is \$1.076 billion. The ten leading taxpayer make up a very diverse 8.2% of net AV.

The economy remains stable overall, but without new residential development and population growth, the tax base will continue to challenge the school corporation's financial footing.

Finances

Decatur County School Corp.'s financial operations are pressured, and will remain so until it can realign its spending to account for continued declines in enrollment and state aid. It still maintains strong available cash reserves, though, and is making progress on closing the budget gap.

Statewide changes in school accounting took effect Jan. 1, 2019. The changes created the education fund to replace the general fund, and consolidated several tax-backed operating funds (such as the capital projects, transportation, and bus replacement funds) together as the operations fund. Revenue can be transferred between these funds with some limitations. The education fund will continue to be funded solely through per-pupil enrollment-driven state aid, so enrollment trends and the amount of aid the state appropriates are still the key generators of operating revenue. The operations fund will remain funded through property tax revenues, which can be affected by tax caps.

Enrollment has been declining for years, and, based on professional demographer studies, is projected to continue to shrink. Fall 2018 enrollment stood at 1,949, down 8.8% over the previous five years. The school is a net gainer in transfer students, which has prevented even further declines. Citing its third-party study, management attributes the declines in part to very little residential development and a lack of housing turnover in the area. While local job opportunities have grown, there is limited housing in the county, so job seekers take residence elsewhere. Until this trend reverses and more housing becomes available, enrollment will likely continue to decline and pressure operations.

The school corporation has reported deficit operating results annually dating to at least 2013, but it has been incrementally lowering the budget gap and anticipates closing it completely in the next one-to-three years. Despite these deficits, the school corporation still closed calendar year 2018 with an available cash reserve of \$3.06 million, equal to a strong 22% of operating expenditures. This includes \$1.9 million in the general fund (14%) and another \$1.1 million in the unrestricted rainy day fund (8%). The deficit in 2018 was \$200,000 (negative 1.5%), down from \$731,000 in 2017 and \$1.4 million in 2016 (the year before the current administration began).

Management started reducing spending the last two years, almost exclusively through attrition-based staff reductions. It is closely examining retiree schedules and making efforts to consolidate job duties where available. It anticipates that by not replacing staff scheduled to retire in the next few years, the general fund will be back in balance and that its cash reserve will remain in its targeted 8% to 12% range. Wages are settled on a year-to-year basis, and we understand staff has been receiving modest raises. Management also indicates that class sizes are slightly below average. If the retirement targets are not met, management would likely consider eliminating some active positions.

The major tax-backed operating funds have historically been balanced, due in part to minimal circuit-breaker losses, and management expects the new operations fund to remain stable. The three major funds forming this new fund carried a combined \$1.8 million cash balance to conclude 2018 (compared to expenditures of \$3.7 million). Additionally, management does not anticipate spending down the rainy day fund in the near future.

In our view, the school corporation is close to returning the budget to a structurally balanced position, but even with continued small deficits, the available cash position will likely remain strong and provide flexibility. The operations fund is also a stabilizing factor in the overall financial profile.

The state audits school corporations biennially on a cash basis, using a June 30 fiscal year-end. In the interim, schools

submit semi-annual financial statements to the state that are reviewed by the Indiana Office of School Finance (IOSF), and then made available as unaudited reports. We base our analysis on these unaudited, state-issued cash reports, but on a Dec. 31, year-end basis. In most cases, schools operate, budget, and report financial performance to their school boards using a calendar year. Therefore, we believe the calendar year-end reports offer a good understanding of each corporation's financial performance and budget position. These unaudited reports prescribe to the state's uniform system of accounting and reporting that all schools are required to follow and, based on the IOSF review and on prior-year comparisons with audits, we consider them reliable to serve as a basis of our analysis.

Management

We consider the corporation's management practices standard under our FMA methodology, indicating the finance department maintains adequate policies in some, but not all, key areas.

Revenue and expenditure assumptions are mostly well founded and based on analysis of historical data in unison with state funding figures. The department of local government finance certifies the annual appropriations, as well as the tax levy. The school board receives monthly finance reports that include information on month-end cash balances and month- and year-to-date revenue and expenditures. The board reports do not present on actual progress against the budget or historical levels, however, and they do not include information on investment holdings or earnings. For capital planning, the school has a bus replacement schedule and rolling three-year capital spending plan for each school building, as required by the state. Details are somewhat limited, though, in our view. There is no long-term financial forecasting practiced. Management informally targets at least an 8% to 12% reserve in the education fund, and communicates this with the board. There is no formal reserve policy, though. The school board does have an adopted investment policy and there is also a brief short-term debt policy in place.

In our view, the new management team has a good understanding of the budget challenges and is looking ahead at what will be required to balance the budget.

Debt

Including the 2019 bonds, the school corporation's overall net debt burden will be moderate, at 5.5% of estimated market value and \$4,956 per capita. Total direct debt will double, to \$40 million, of which 59% is scheduled to mature in ten years, which is a slightly above-average pace. Bond proceeds will allow the school corporation to address significant renovation needs, but the school corporation will still have capital needs to address and could potentially issue moderate amounts of additional debt in the next few years.

Currently, debt service carrying charges are low at under 6%, but we expect they will grow to moderate, though still manageable levels in the near term. Combined with low pension and retiree costs, total fixed charges are low-to-moderate, which is a strength. We note that the district does not have any direct bank loans outstanding.

Pension and other postemployment benefit liabilities

The school corporation contributes to two retirement plans administered by the state: the Indiana State Teachers' 1996 account (TRF '96) and the Public Employees' Retirement Fund (PERF). These are both cost-sharing, multiple-employer defined-benefit retirement plans. (They share all risks and costs, including benefit costs, proportionately by the participating employers.) Certain employees are also covered under the Indiana Teacher's Pre-1996 account (TRF Pre-'96). The state has assumed the entire liability of this account, which it funds on a pay-as-you-go basis and the

school corporation is not obligated to make payments to this account.

The school corporation continues to pay 100% of its required pension contributions (which are actuarially determined); the 2017 payment was equal to \$1.03 million, or 4.6% of total funds' expenditures.

As of June 30, 2018, the TRF '96 fund was 98% funded and PERF was 78.9% funded in accordance with Governmental Accounting Standards Board (GASB) Nos. 67 and 68. We view the plans' actuarial assumptions, including an assumed rate of return of 6.75%, as generally reasonable and slightly more conservative than the national average. Considering the plans' strong funded ratios, reasonable actuarial assumptions, and low historical contribution requirements for plan participants, we do not expect the required pension costs to increase significantly in the medium term.

The school corporation also makes some contributions to defined-contribution 401(a) and VEBA accounts, and pays out unused sick and vacation days. These costs amounted to \$157,000 (less than 1%) in 2018, and the total lifetime benefit a retiree can receive is capped at \$14,500. Additionally, the school corporation allows retirees to remain on its health insurance plans, but retirees are responsible for paying the full premiums.

Outlook

The stable outlook on the 'AA+' ratings reflects the outlook on the state of Indiana's issuer credit rating.

The stable outlook on the 'A' rating reflects our view that the school corporation's budget gap has been reduced considerably, and that any further draws on reserves will likely not be substantial. The budget gap was marginal in 2018, and we feel that management is planning ahead and will continue to adjust spending in a manner that will maintain reserves at levels no worse than what we consider good. The consistently steady performance in the operations fund is also a stabilizing factor, as this fund provides some additional flexibility for the overall financial profile. Therefore, we do not anticipate the rating changing within the two-year outlook period.

Downside scenario

If management is unable to reduce the budget gap and spending continues to outpace revenues, and this subsequently leads to further draws on available cash reserves, we could lower the rating. Any substantial disruption in the local employment base could also lead to downward pressure.

Upside scenario

Rating improvement is possible if the budget is returned to, and consistently maintained at a balanced position, and if this also leads to an improved available reserve position. Rating improvement would also likely depend on stabilizing enrollment trends and more robust financial planning and policies.

Related Research

- U.S. State And Local Government Credit Conditions Forecast, Oct. 24, 2018

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors,

have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

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