

RatingsDirect®

Summary:

Evansville-Vanderburgh School Corp., Indiana; School State Program

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Credit Profile

US\$5.0 mil GO bnds (Sch Imp) ser 2018 dtd 11/06/2018 due 01/15/2023

Long Term Rating AA+/Stable New

Underlying Rating for Credit Program A+/Stable New

Evansville-Vanderburgh Sch Corp GO bnds

Long Term Rating AA+/Stable Affirmed

Underlying Rating for Credit Program A+/Stable Affirmed

Rationale

S&P Global Ratings assigned its 'AA+' long-term program rating and 'A+' underlying rating to Evansville-Vanderburgh School Corp., Ind.'s series 2018 general obligation (GO) bonds. At the same time, S&P Global Ratings affirmed its 'AA+' long-term program rating and 'A+' underlying rating on the school corporation's outstanding bonds. The outlook is stable.

Management indicates the series 2018 GO bond proceeds will be used for various renovations and improvement projects to school facilities in addition to technology and equipment purchases.

The 'A+' rating is based on the school district's ad valorem tax pledge, and reflects our view of its:

- Good combined available reserves on a cash basis of accounting,
- History of positive operations, and
- Moderate overall debt profile with rapid amortization.
- Partially offsetting the above strengths in our view are the school corporation's economic indicators, which while at levels that we consider adequate to strong, are not commensurate with those of its higher-rated peers.

The school corporation has benefitted in recent years from relatively stable enrollment, which is the primary determinant of state aid. As a result, the school corporation has increased its combined general and rainy cash balances to a level that we consider good as a percentage of its operating budget, and significant on a nominal basis at \$18.2 million at the end of fiscal 2017. We view the school corporation's economic indicators as a credit weakness. However, the corporation's level of available reserves and history of stable enrollment provide rating stability.

Security

The ad valorem property tax pledge, which secures the corporation's 2018 GO bonds and other outstanding debt is subject to state circuit-breaker legislation, which caps the property tax burden for taxpayers based on a percent 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 school corporation to distribute circuit-breaker losses first across non-debt service funds that receive property taxes. We rate the debt at the same level as our view of the corporation's general creditworthiness.

Other outstanding first mortgage bonds are secured by lease rental payments paid directly to an independent trustee pursuant to a trust indenture between the school corporation and the trustee and a lease between the school corporation and the building corporation. Rent is payable from ad valorem taxes against all taxable property within the corporation's boundaries, and rental payments are not subject to annual appropriation under Indiana law. Lease payments are subject to abatement if the leased property is damaged or destroyed, though abatement risk is mitigated by lease provisions requiring the corporation to maintain rental value insurance sufficient to cover two years' rent and property or casualty insurance sufficient to cover the full replacement cost of the leased property.

The 'AA+' rating is based on our state credit enhancement criteria, and reflects 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 covers maximum annual debt service 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, in the event 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

Evansville-Vanderburgh Corp School serves an estimated population of 182,286. At 82% and 86% of national averages, respectively, the corporation's median household and per capita effective buying incomes are adequate in our view. The corporation's total \$11.5 billion gross AV in 2018 is strong, in our view, at \$62,889 per capita. Net AV grew by a total of 4.2% since 2016 to \$6.9 billion in 2018. Roughly 11.4% of net AV comes from the 10 largest taxpayers, representing a very diverse tax base in our opinion.

The school corporation is located in Vanderburgh County in southwestern Indiana, bordering Kentucky and Illinois, approximately 140 miles southwest of Indianapolis, Ind., and 100 miles west of Louisville, Ky. The city of Evansville is also home to the University of Evansville, where enrollment totals approximately 2,500 students, and the University of Southwestern Indiana, where enrollment is approximately 11,000. The school corporation's AV has increased in recent years and management expects slight to stable increases to continue as a result of ongoing development, which we view as likely.

Finances

General fund operations of Indiana school corporations rely almost entirely on state tuition support, which is determined on a per-pupil basis. As a result, operating revenue is very sensitive to enrollment fluctuations. Student enrollment has remained relatively stable in recent years, decreasing by 0.2% since 2015 to 22,190 students for the 2017-2018 school year. Management expects overall enrollment stability to continue, which we view as likely. State aid accounted for 94.3% of general fund revenue in 2017.

The corporation's available cash reserve of \$18.2 million (which consists of the combined general and rainy day funds) is good on a cash basis of accounting in our view, at 11.4% of general fund expenditures at calendar year-end (Dec. 31) 2017. Of that amount, \$10.4 million (6.5% of expenditures) is in the general fund, and \$7.8 million (4.9% of expenditures) is in the rainy day fund. The corporation reported a surplus operating result of 0.2% of expenditures in 2017.

We expect that the corporation's available reserves will remain good on a cash basis of accounting over the next few years. Due in part to relatively stable enrollment in conjunction with conservative budgeting practices, the school corporation has reported operating surpluses in each of the past five years.

In fiscal 2018, the school corporation expects to report at least a \$17.8 million available balance across its general and rainy day funds, conservatively expecting a \$400,000 decrease, equivalent to approximately 0.25% of operating expenditures. The corporation expects for at least balanced operating results to continue in fiscal 2019, which due to the corporation's consistent operating results and conservative budgeting practices, we consider likely. The school corporation has a history of conservative budgeting practices and proactive expenditure reductions in response to declining enrollment. We recognize that the slight operating surplus in fiscal 2017 came after a \$2.5 million land purchase for the potential site of a future school facility. We understand that the school corporation does not currently have any plans to significantly spend down either its general or rainy day fund reserves.

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 have deemed them reliable to serve as a basis of our analysis.

Management

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

Highlights include:

- Realistic revenue and expenditure assumptions with the use of three to five years of historical data, conservative estimates, and the use of outside sources of information when forecasting trends;

- Monthly reporting to the board of revenue and expenditures compared to budgeted amounts, which includes beginning and ending cash balances by fund;
- No comprehensive formal long-term financial plan past the budgeted year;
- The maintenance of a three-year, state-mandated capital plan, but no longer-term and comprehensive plan;
- Formal investment management policy with annual reporting of investment holdings and earnings to the board;
- Formal debt management policy, which places limits on the amount of debt the school corporation can undertake including a requirement for direct debt to remain below 6% of gross assessed value; the corporation is adhering to this limit; and
- Formal policy of maintaining a combined general fund and rainy day fund balance of at least 8%-15% of operating expenditures for cash-flow purposes and as a sufficient cushion for any unforeseen budgetary pressures; the school corporation is currently adhering to the policy.

Debt

Overall net debt is 4.3% of market value and \$2,701 per capita, which we believe to be moderate. Amortization is rapid, with 77% of the corporation's direct debt scheduled to be retired within 10 years. Debt service carrying charges were 11.0% of total governmental fund expenditures excluding capital outlay in calendar year 2017, which we consider moderate.

We understand that the school corporation could potentially issue an additional \$5 million in each of the next few years for facility improvement projects.

The school corporation maintains energy savings contract that was privately placed with First Federal Bank, N.A. in November 2017 and is payable from the school corporation's general fund. The approximately \$3.43 million loan, of which \$3.30 million remains outstanding as of Sept. 6, 2018, was issued for various solar energy projects and will mature in 2033. We recognize that the agreement contains no events of default or covenant violations that we deem nonstandard pursuant to our contingent liquidity criteria.

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 (the plans 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 4.6% of total funds' expenditures.

As of June 30, 2017, the TRF '96 fund was 90.4% funded and PERF was 76.6% funded in accordance with Governmental Accounting Standards Board (GASB) Nos. 67 and 68. We view the plans' actuarial assumptions, including this assumed rate of return of 6.75%, as generally reasonable because they are 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 school corporation's required pension costs to increase significantly in the medium term.

The school corporation provides other postemployment benefits to eligible employees in the form of medical, dental, and vision insurance. From conversations with management, we understand that the school corporation has been prefunding its other postemployment benefit (OPEB) liability and expects to have sufficient cash on hand to fully fund the liability, however, we recognize that an actuarial study on the OPEB liability has not been completed in recent years. The school corporation paid \$243,000 in OPEB benefits in 2017, equivalent to 0.15% of operating expenditures.

Outlook

The stable outlook on the long-term rating reflects the outlook on the state of Indiana and moves in tandem with the state.

The stable outlook on the underlying rating reflects our expectation that the school corporation will maintain combined available reserves at a level that we consider good on a cash basis of accounting for the next two years. As a result, we do not expect to change the rating during the two-year outlook horizon.

Downside scenario

We could lower the rating if declining enrollment or another budgetary pressure leads to a material decrease in the school corporation's currently good level of available reserves.

Upside scenario

If the school corporation's economic indicators were to increase significantly in conjunction with improvement in the school corporation's available fund balance, assuming no deterioration in the corporation's other credit factors, we could raise the rating.

Related Research

Alternative Financing: Disclosure Is Critical To Credit Analysis In Public Finance, Feb. 18, 2014

Ratings Detail (As Of October 9, 2018)		
Evansville-Vanderburgh Sch Corp GO bnds (Sch Imp) ser 2018 dtd 11/06/2018 due 01/15/2023		
Long Term Rating	AA+/Stable	Rating Assigned
Underlying Rating for Credit Program	A+/Stable	Rating Assigned
Evansville-Vanderburgh Sch Bldg Corp, Indiana		
Evansville-Vanderburgh Sch Corp, Indiana		
Evansville-Vanderburgh Sch Bldg Corp (Evansville-Vanderburgh Sch Corp) 1st mtg rfdg bnds (Evansville-Vanderburgh Sch Corp) ser 2016 dtd 11/22/2016 due		
Long Term Rating	AA+/Stable	Affirmed
Underlying Rating for Credit Program	A+/Stable	Affirmed

Summary: Evansville-Vanderburgh School Corp., Indiana; School State Program

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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