

RatingsDirect®

Summary:

Salem Community School Corp., Indiana; School State Program

Primary Credit Analyst:

Moreen T Skyers-Gibbs, New York (1) 212-438-1734; moreen.skyers-gibbs@spglobal.com

Secondary Contact:

Benjamin D Gallovic, Chicago + 1 (312) 233 7070; benjamin.gallovic@spglobal.com

Table Of Contents

Rationale

Outlook

Summary:

Salem Community School Corp., Indiana; School State Program

Credit Profile

US\$3.13 mil ad valorem prop tax 1st mtg bnds (Salem Community Schools) ser 2018 due 01/15/2026

<i>Long Term Rating</i>	AA+/Stable	New
-------------------------	------------	-----

<i>Underlying Rating for Credit Program</i>	A/Negative	New
---	------------	-----

Salem Comnty Sch Corp GO bnds of 2016 due 01/15/2024

<i>Long Term Rating</i>	AA+/Stable	Affirmed
-------------------------	------------	----------

<i>Underlying Rating for Credit Program</i>	A/Negative	Outlook Revised
---	------------	-----------------

Salem High Sch Bldg Corp, Indiana

Salem Comnty Sch Corp, Indiana

Salem High Sch Bldg Corp (Salem Comnty Sch Corp) Ad Valorem prop tax 1st mtg rfdg bnds

<i>Long Term Rating</i>	AA+/Stable	Affirmed
-------------------------	------------	----------

<i>Underlying Rating for Credit Program</i>	A/Negative	Outlook Revised
---	------------	-----------------

Salem Middle Sch Bldg Corp, Indiana

Salem Comnty Sch Corp, Indiana

Salem Middle Sch Bldg Corp (Salem Comnty Sch Corp) ad valorem prop tax 1st mtg bnds

<i>Long Term Rating</i>	AA+/Stable	Affirmed
-------------------------	------------	----------

<i>Underlying Rating for Credit Program</i>	A/Negative	Outlook Revised
---	------------	-----------------

Rationale

S&P Global Ratings has revised its outlook to negative from stable on its underlying rating on Salem Community School Corp., Ind.'s existing general obligation (GO) and ad valorem property tax first-mortgage bonds, issued by Salem High School Building Corp. and Salem Middle School Building Corp. on behalf of the school corporation. At the same time, we affirmed our 'A' underlying rating and 'AA+' long-term rating on its existing debt. The outlook on the long-term rating is stable.

We also assigned our 'AA+' long-term rating and 'A' underlying rating to Salem Middle School Building Corp.'s series 2018 ad valorem property tax first-mortgage refunding and improvement bonds, issued on behalf of Salem Community School Corp. The outlook on the long-term rating is stable while the underlying rating outlook is negative.

The outlook revision reflects our views regarding the uncertainty surrounding whether the district will be able to make the necessary budgetary adjustments to avoid further deterioration of its cash reserves after unexpected expenditures in 2018 are slated to lower its already thin cash reserves. Cash reserves are expected to reduce by 40%, to under \$500,000, or, in our opinion, about a low 3% of expenditures in 2018. Given the expected weakened cash reserves in 2018, in our opinion, the school corporation's financial flexibility will be significantly constrained. Furthermore, this is exacerbated by potential pressures from losing a major employer and taxpayer, and already declining enrollment, both

of which will further constrain its revenue raising flexibility. Therefore, if subsequent reductions in cash reserves occur, we will likely lower the rating.

Over the past three years, the general fund achieved at least balanced operations in light of ongoing enrollment declines, coupled with its limited revenue-raising flexibility. However, we believe that given the significant dip in cash reserves, that the school corporation's ability to achieve balanced operations and rebuild its cash reserves could now be hampered.

The 'A' underlying rating continues to reflect our view of the school corporation's general creditworthiness, including its:

- Ability to maintain at least balanced operations despite declining enrollment;
- Maintenance of adequate available cash reserves that consistently averaged 5% of expenditures over the past three years;
- A moderate debt burden, coupled with rapid amortization and no additional debt plans; and
- Diverse tax base, coupled with strong market value per capita.

Limiting credit factors include the school corporation's:

- Adequate, albeit below average incomes, coupled with an agricultural tax base that has seen reductions due to agricultural land assessments; and
- Overall enrollment decrease, which affects general fund revenue.

The series 2018 bonds are issued pursuant to a trust indenture between the school building corporation and the trustee, and a lease between the school building corporation, as lessor, and school corporation as lessee. Lease rentals paid by the school building corporation directly to the trustee secure the bonds. Rentals are payable from ad valorem taxes against all taxable property within the school corporation's boundaries.

The school corporation expects to use the bond proceeds from the series 2018 bonds to finance various renovations and improvements to the Salem Middle School.

The ad valorem property tax levy is not subject to annual appropriation under Indiana law. However, there is abatement risk, as the school corporation is required to abate lease rentals if the leased premises are not available for use. This risk is mitigated, in our view, by the lease requiring the district to maintain at least two years of lease interruption insurance, as well as casualty insurance equal to full replacement cost. Additionally, we believe that construction risk is mitigated as the leased premises are already occupied. Interest will be capitalized on July 15, 2019 through Jan. 15, 2020. Furthermore, the first lease payment on the series 2018 bonds is due June 30, 2020, well after the expected completion date of Oct. 31, 2019.

The ad valorem property tax pledge securing the leases and GO bonds 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, as 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 nondebt service funds that

receive property taxes. Despite the limitations, we rate this debt at the same level as our view of the district's general creditworthiness.

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 our 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 (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 distributed, up to an amount of the debt service shortfall.

Finances

The school corporation is estimating that it could end with an operating deficit of more than \$300,000 in 2018 calendar year. If this occurs, its general fund cash reserves could fall below \$400,000, or under 3% of expenditures. Should rainy day fund cash reserves remain at \$76,000 at the end of 2018, available cash reserves are expected to end at a nominal level below \$500,000, or roughly 3% of expenditures, which, in our opinion, is low. This reflects a significant drop of about 40% over 2016 ending cash reserves of \$713,000, or 5.4% of expenditures. In our opinion, if reserves fall further than expected with no indication for balanced operations in subsequent years, we could lower the rating. Furthermore, given how thin the reserves are, we believe that budgetary flexibility will be constrained and management's efforts to avoid further declines in cash reserves could be hampered.

According to officials, the estimated shortfall in 2018 is due primarily to increased costs associated with replacing several staff members that went on medical leave. According to officials, this was unexpected. We understand that the school is looking into areas to achieve efficiencies, potentially achieving savings through attrition, and restructure staff to avoid further shortfalls and deterioration in cash reserves. However, in our opinion, the budget is constrained, which is exacerbated by limited revenue-raising flexibility given the school corporation's reliance on state aid revenues while enrollment continues to decline. State aid revenues accounts for nearly 100% of school revenue and is determined on a per-pupil basis. As a result, operating revenue is very sensitive to enrollment fluctuations. The school operates three building facilities, one elementary, one middle, and one high school. Historically, with the exception of 2015-2016, enrollment has declined annually at a rate of about 2%. However, it totals 1,819 in 2018-2019, which reflects a 3.8% drop. The declines, according to management, are due to smaller family sizes and limited employment opportunities given the loss of a few manufacturing industries in past years. Although enrollment has been falling, the school is projecting marginal increases annually through 2023-2024 based on hopes that population and infrastructure improvements will generate growth.

In the past three years, however, despite enrollment declines, the general fund operated with at least balanced operations due to cost-control efforts. Officials also implemented some budget reductions to achieve balanced operating results. Therefore, the general fund ended with two positive results between \$16,000 and \$88,000 since 2015. In calendar year 2016, there was a slight draw of \$11,000. Nonetheless, the available cash reserves averaged \$700,000, or 5% of general fund expenditures.

At calendar year-end (Dec. 31) 2017, the corporation's available cash reserve of \$727,000 (which consists of the combined general and rainy day funds) is adequate on a cash basis of accounting, in our view, at 5.5% of general fund expenditures. Of that amount, \$651,000 (4.9% of expenditures) is in the general fund, and \$76,000 (0.6%) is in the rainy day fund. The rainy day fund carried a nominal cash balance and was funded with annual transfers from other nongeneral, property tax-reliant funds.

Officials are planning to rebuild the reserves up to 8% of operating expenditures. Management believes that it will likely take three-to-five years to achieve this target. Officials are anticipating a balanced budget for 2019.

Although, the general fund cash reserves are thin, the corporation has maintained consistent and stable cash reserves in its capital projects, transportation, and transportation bus replacement funds, which we believe adds some financial flexibility. In 2017, cash reserves was \$688,000 in these funds.

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 school corporation's financial performance and budget position. These unaudited reports subscribe 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 Financial Management Assessment methodology, indicating the finance department maintains adequate policies in some, but not all, key areas.

Revenue and expenditure assumptions take into account historical data, coupled with information gathered from its tax assessor. State aid is the main revenue source, looking at past trends, class size, and birth rates. The school board examines financial results monthly and provides the board with monthly budget-to-actual revenue and appropriation reports. Management does not maintain financial or formalized multiyear capital projections with identified sources and uses for each particular year. The board aims to keep reserves at 8% of operating expenditures, a level it currently doesn't meet. Officials haven't formally adopted investment and debt management policies but adhere to state guidelines. The corporation has no investments currently, but provides the board with its monthly bank reconciliation reports.

Debt

Overall net debt is moderate, in our opinion, at 3.6% of market value and \$2,010 per capita. With 100% of the corporation's direct debt scheduled to be retired within 10 years, amortization is rapid. Debt service carrying charges were 10.4% of total governmental fund expenditures, (excluding capital outlay) in 2017, which we consider moderate.

According to management, the school corporation does not have additional debt plans at this time.

Pension and other postemployment benefits 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 4.1% 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 also three defined-contribution plans.

It is our understanding that the school corporation does not have any costs associated with health care benefits for its retirees.

Economy

Salem Community School Corp. is in Washington County in south-central Indiana and serves a population of 12,768. The corporation headquarters are in Salem, the county seat, which is about 30 miles north of Louisville, Ky. While some residents make the daily commute (about 40 minutes) to the more diverse Louisville metropolitan area, most work in the county, with agriculture, lumbering, and light manufacturing providing most of the employment opportunities, along with local government and service-oriented work. Therefore, in our opinion, at 76% and 71% of national averages, respectively, the corporation's median household and per capita effective buying incomes are adequate, in our view. The corporation's total \$722.0 million gross AV in 2018 is strong, in our view, at \$56,548 per capita.

The 10 largest taxpayers make up an estimated 11.8% of net AV, which we consider very diverse. Its largest taxpayer, GKN Sinter Metal, Inc. announced in early 2018 that it will be divesting within 12-18 months. GKN represents 2.3% of the tax base. We are not currently aware of what the potential effects will be, if any, to the local economy.

Net AV declined by a total of 0.5% overall from 2016 to \$440 million in 2018, but in 2018, it increased slightly by 0.6%. However, for 2019, the certified net AV totals \$420 million, reflecting about a 4% decline. According to the corporation, although it could lose between \$150,000 and \$170,000 in tax revenues due to the reduction in net AV, it is not anticipating any material effect on its financial position. However, we believe that this could add budgetary pressures if the general fund has to subsidize its tax-supported funds.

Outlook

The negative outlook on the underlying rating reflects our opinion that there is a one-in-three chance that we could lower the rating on the corporation in one or two years if cash reserves experience further declines. We believe it will be difficult for the corporation to restore structural balance if enrollment continues to decline coupled with the potential loss of its major employer and taxpayer. However, if the corporation is able to make the necessary budgetary adjustments and achieve balanced operations in light of these budgetary challenges, then we could revise the outlook to stable.

The stable outlook on the 'AA+' ratings reflects our opinion of the strength of Indiana's state aid intercept structure.

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.

Copyright © 2018 by Standard & Poor's Financial Services LLC. All rights reserved.

No content (including ratings, credit-related analyses and data, valuations, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of Standard & Poor's Financial Services LLC or its affiliates (collectively, S&P). The Content shall not be used for any unlawful or unauthorized purposes. S&P and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. S&P's opinions, analyses and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P does not act as a fiduciary or an investment advisor except where registered as such. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives. Rating-related publications may be published for a variety of reasons that are not necessarily dependent on action by rating committees, including, but not limited to, the publication of a periodic update on a credit rating and related analyses.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, S&P reserves the right to assign, withdraw or suspend such acknowledgment at any time and in its sole discretion. S&P Parties disclaim any duty whatsoever arising out of the assignment, withdrawal or suspension of an acknowledgment as well as any liability for any damage alleged to have been suffered on account thereof.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain non-public information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, www.standardandpoors.com (free of charge), and www.ratingsdirect.com and www.globalcreditportal.com (subscription), and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees.

STANDARD & POOR'S, S&P and RATINGSDIRECT are registered trademarks of Standard & Poor's Financial Services LLC.