S&P Global
Ratings

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Summary:

Elkhart Community Schools, Indiana Elkhart Community School Building Corp.; School State Program

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Summary:

Elkhart Community Schools, Indiana
Elkhart Community School Building Corp.; School State Program

Credit Profile		
US$10.0 mil 1st mtg bnds (Elkhart Comnty Schs) ser 2018A dtd 12/13/2018 due 01/15/2038		
Long Term Rating	AA+/Stable	New
Underlying Rating for Credit Program	A/Stable	New
US$5.0 mil 1st mtg bnds (Elkhart Comnty Schs) ser 2018B dtd 12/13/2018 due 01/15/2038		
Long Term Rating	AA+/Stable	New
Underlying Rating for Credit Program	A/Stable	New

Rationale

S&P Global Ratings assigned its 'AA+' long-term rating and 'A' underlying rating to Elkhart Community School Building Corp., Ind.'s series 2018A and 2018B first-mortgage bonds. At the same time, we affirmed our 'AA+' and 'A' ratings on existing debt issued by and on behalf of the school corporation. The outlook on all ratings is stable.

The school corporation is facing modest financial pressure with state aid revenues, hampered by stagnant enrollment, not keeping pace with operating costs. The district serves the urban core of the Elkhart area economy, which subjects it to additional pressures in the form of enrollment mobility and employment base volatility. Management is currently working to stabilize the budget. It is undergoing planned building and programming restructuring, and is also considering a mix of cost-cutting and potentially new revenue enhancements. We feel the district is adequately equipped to adjust its budget to maintain at least adequate reserves. Additionally, it is not burdened by large debt levels or high fixed costs, affording it more overall flexibility.

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

- Adequate incomes and adequate market value per capita;
- Growing local economy, but one that is highly concentrated in manufacturing and has been prone to volatility;
- Pressured financial operations, yet available reserves that remain good and that we expect will remain good through the next two years;
- Standard Financial Management Assessment (FMA), including regular reporting on financial matters and focus on long-term capital and financial planning; and
- Low overall debt burden.

Security

The 2018A and B bonds are being issued separately, under separate trust indentures and lease agreements. In each case, as well as with existing lease-backed debt, the building corporation is the lessor and the district the lessee. Lease rentals paid by the district directly to the trustees secure the bonds. Rentals are payable from ad valorem taxes against all taxable property. The tax levies are not subject to annual appropriation under Indiana law, but there is abatement risk if the leased premises are not available for use. For all leases, this risk is mitigated by requirements for the district to maintain at least two years of lease interruption insurance, as well as casualty insurance equal to full replacement cost.

The series 2018A bonds will be used to finance renovations to the existing Elkhart Memorial High School. The high school will serve as the leased asset and remain in use through the renovation, mitigating construction risk. Proceeds of the series 2018B bonds will primarily finance the construction of a new building that will house career and vocational programs. The new building will be part of the leased premise, so payment will depend on occupancy. The first principal payment is scheduled to occur six months after estimated project completion. Given this cushion and lack of complexity in the design, we consider construction risk mitigated.

The ad valorem property tax pledge securing the 2018A and B bonds, the series 2013A and B and series 2015 first-mortgage bonds, and the series 2012 general obligation (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, and often does, reduce the total tax levy. The levy to cover debt service, however, is statutorily protected, allowing the district 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 district's general creditworthiness, as we do not consider there to be limitations on the fungibility of resources to pay debt service. The tax levy securing the leases on the existing series 2014 and 2015 unlimited-tax first-mortgage bonds is not subject to circuit-breaker limitations.

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

Elkhart Community Schools serves approximately 77,000 residents over 78 square miles of Elkhart County, including a majority of the city of Elkhart, the town of Bristol, and all or part of four area townships in north-central Indiana, 15 miles east of South Bend and about five miles south of the Michigan state line. We consider residents' incomes to be adequate, with median household and per capita effective buying incomes at 86% and 78% of national levels, respectively. Estimated market value, measured as gross assessed value (AV) less tax-exempt properties, is $4.5 billion in 2018, equal to an adequate $59,102 per capita.

The area economy is mainly based on manufacturing, with further concentration in recreational vehicle (RV) production. More than 40% of countywide employment is manufacturing based, which is significantly higher than state and national (9.6%) averages. The job base in the county is performing very well and is growing, but we still consider the heavy sector concentration to be a credit weakness. Unemployment grew as high as 17.9% during the Great Recession, but has since rapidly declined, falling all the way to 2.5% in 2017 (below state and national levels). This demonstrates the potential for volatility in the job base, which can have a direct effect on enrollment.

Strong job growth in the county continues and it draws in more than 31,300 employees from other counties, compared to about 8,500 who leave it for work. Large employers include Thor Industries Inc. (13,622 employees), Forest River Industries Inc. (10,000), and LCI Industries (5,500), each of which manufacture RVs (and in some cases, additional modes of transportation) and have recently announced or are already undergoing expansions. As noted in our most recent credit conditions report (published Oct. 24, 2018), manufacturing is growing in the region and this will likely continue but could be nearing a maturation point. We also noted in our credit conditions report published April 26, 2018, that the effects of President Trump's tariffs are not likely to be very pronounced in the broader East North-Central region as a whole, but that they will likely affect certain concentrated areas more than others, possibly including this area.

In terms of taxpayers, the tax base remains very diverse, as the ten leading taxpayers account for just under 9% of total net AV. Net AV for pay 2019 is $3.17 billion, continuing a trend of small annual growth.

Finances

General fund operations of Indiana school corporations rely almost entirely on state tuition support, determined on a per-pupil basis. Consequently, under the current formula, enrollment trends and the amount of aid the state appropriates are the key generators of general fund revenue. Other core operating services such as transportation, bus replacement, and capital are accounted for in separate funds outside of the general fund. These funds are supported by local property taxes, which may be affected by circuit-breaker tax caps.

The school corporation's financial operations are coming under modest pressure, specifically as operating costs exceed enrollment-driven state aid and the existing referendum operating levy. Management is currently strategizing an approach to curb the spend–downs. It is looking at operating savings and possible spending cuts, as well as potential revenue enhancements.

The school reported deficit operating results in its combined general and operating referendum funds of $447,000 (0.5% of combined funds' expenditures) in 2016 and $1.97 million (2.1%) in 2017, the latter bringing the calendar year 2017 available cash reserves to $12.96 million, equal to a good 13.9% of operating expenditures. This balance included

$2.4 million (2.6%) in the general fund, $1 million (1%) in the referendum fund, and $9.5 million (10.2%) in the rainy day fund. Excluding one-time capital expenditures paid from the rainy day fund that occurred early in 2018, the adjusted available reserve was closer to $10.9 million, or 11.7%, which we consider good. We understand that the larger deficit in 2017 is due in part to a large scheduled salary increase across all pay groups.

Management projects a $260,000 (0.2%) deficit for the two combined operating funds in 2018, followed by up to a $3 million (3.2%) deficit in 2019, which could potentially lower available reserves to $7.6 million, or a still good 8.2%. Management anticipates using operating surpluses in its nongeneral/nonreferendum operating funds to offset more than $1 million of the projected 2019 deficit, which could lessen the draw on available reserves to only $9.1 million (9.8%). It is currently running an overall surplus in the property tax-reliant nonoperating funds, offering additional cushion and flexibility. At the same time, there is a growing imbalance in the school food services fund, which ended 2017 with a $1.6 million cash deficit position. Until this deficit is cured, the district will have to subsidize portions of the food services program with revenues from various operational funds. It is currently seeking solutions to this problem.

The district is also in the midst of significant restructuring. It will be renovating an existing high school to transition it to a grade 10-12 school, and it will convert its other high school into a grade 9-only facility. This will be funded with the series 2018A bond proceeds. Meanwhile, it is adding a new career/vocational facility (series 2018B bonds), and transitioning to block scheduling and focused concept programs in the grade 10-12 building. Management anticipates significant operational savings from these transitions, but just as importantly, it is hopeful that this helps attract and retain students. The district loses a substantial number of students to other area public and private schools, losing about 1,600 versus gaining fewer than 300 from elsewhere, and is seeking to reverse this trend.

Management anticipates that savings from these changes will address a portion of the projected deficit. We understand management is considering revenue-raising possibilities, but that there is also flexibility to make staffing reductions if needed to cure any remaining imbalance. Therefore, management anticipates maintaining available reserves above its minimum 5% target level.

As noted, the school is very dependent on enrollment-driven state aid, which accounts for 95% of combined operating revenue. Enrollment has fluctuated over the past ten years, but has been coming down more recently, and is 12,204 for the fall 2018 school year (down 7% over a three-year period). Management projects minor increases in the coming years, related to ongoing job growth and the school restructurings. In our view, the strong employment trends should provide a means for enrollment stabilization, but based on recent history, planning for enrollment growth could be optimistic. The school corporation's current referendum levy generates about $4.5 million per year and expires after 2021.

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 well founded and based on analysis of historical data in unison with input from state and local sources and the school's financial consultants. The school board receives monthly finance reports. These include information on investment holdings, month-end cash balances, month- and year-to-date revenue and expenditures, and unspent appropriations. In recent years, management has begun working with consultants to prepare long-term financial forecasts based on various scenarios, which are used for budgeting and planning purposes, particularly associated with a plan to consider a referendum rate adjustment. Additionally, it annually updates its state-mandated three-year projections for capital spending, which are enhanced by a separately maintained 20-year capital plan that is formally updated every five years. There is a formal investment policy (adhering to state statutes), but no formal debt or reserve policies. Informally, the school corporation targets a 5% to 10% reserve in its combined general, referendum, and rainy day funds. Reserves are currently within this range, and are projected to remain in the target level through the next two years.

Debt

Including the 2018A and B bonds, the school corporation's overall net debt burden remains low, at 2.7% of estimated market value and $1,602 per capita. Total debt direct debt will increase to about $86 million, of which 80% is scheduled to retire within ten years, which we consider rapid amortization. The school currently forecasts issuing additional tax-backed bonds in 2019 ($15 million) and 2020 ($5 million), which could push the debt burden to a low-to-moderate level. Debt service carrying charges are typically low-to-moderate, and were a moderate 8.5% of expenditures (less capital outlay) in 2017. We note that the district does not have any direct bank loans outstanding.

Overall, the district's debt profile remains a credit strength, and despite additional bonding plans, is not likely to grow significantly.

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 $8.3 million, or 5.2% 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 district's required pension costs to increase significantly in the medium term.

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 S&P Global Ratings' assessment of the strength of the state aid intercept framework. It also reflects our view that annual state aid and undisbursed state aid for the school corporation will continue to provide sufficient coverage. The 'AA+' rating and outlook move in tandem with the state issuer credit rating (ICR) and outlook.

The stable outlook on the 'A' ratings reflects our opinion that the district is equipped to address its financial pressures, and that it will make adjustment as needed to maintain adequate or better available reserves. This is embedded in what we consider a history of making spending cuts as needed, operational flexibility outside of the main operating funds, and management's focus on long-term planning. As a result, we do not anticipate the rating changing within the two-year outlook period.

Downside scenario

If budgetary pressures prove higher than anticipated and the district is not quick to address them, leading to depletion of reserves beyond current expectations, we may lower the rating.

Upside scenario

Rating improvement is possible if there was a significant strengthening of the available reserve position, combined with a long-term trend of enrollment stability and at least a modest increase in economic diversity.

Ratings Detail (As Of November 8, 2018)		
Elkhart Comnty Schs GO State Credit Enhancement (enhanced)		
Long Term Rating	AA+/Stable	Affirmed
Underlying Rating for Credit Program	A/Stable	Affirmed
Elkhart Comnty Sch Bldg Corp, Indiana		
Elkhart Comnty Schs, Indiana		
Elkhart Comnty Sch Bldg Corp SCHSTPR		
Long Term Rating	AA+/Stable	Affirmed
Underlying Rating for Credit Program	A/Stable	Affirmed
Elkhart Comnty Sch Bldg Corp SCHSTPR		
Long Term Rating	AA+/Stable	Affirmed
Underlying Rating for Credit Program	A/Stable	Affirmed
Elkhart Comnty Sch Bldg Corp SCHSTPR		
Long Term Rating	AA+/Stable	Affirmed
Underlying Rating for Credit Program	A/Stable	Affirmed
Elkhart Comnty Sch Bldg Corp (Elkhart Comnty Schs) GO State Credit Enhancement (enhanced)		

Ratings Detail (As Of November 8, 2018) (cont.)		
Long Term Rating	AA+/Stable	Affirmed
Underlying Rating for Credit Program	A/Stable	Affirmed
Elkhart Comnty Sch Bldg Corp (Elkhart Comnty Schs) State Enhancement (enhanced)		
Long Term Rating	AA+/Stable	Affirmed

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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