

RatingsDirect®

Summary:

Baugo School Building Corp., Indiana Baugo Community School; School State Program

Primary Credit Analyst:

Taylor Budrow, Chicago + 1 (312) 233 7082; taylor.budrow@spglobal.com

Secondary Contact:

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

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US\$5.0 mil ad valorem prop tax 1st mtg bnds (Baugo Comnty Sch) ser 2018 due 01/15/2027		
<i>Long Term Rating</i>	AA+/Stable	New
<i>Underlying Rating for Credit Program</i>	A/Stable	New
Baugo Sch Bldg Corp, Indiana		
Baugo Comnty Sch, Indiana		
Baugo Sch Bldg Corp (Baugo Comnty Sch)		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
<i>Underlying Rating for Credit Program</i>	A/Stable	Affirmed

Rationale

S&P Global Ratings assigned its 'AA+' long-term program rating and 'A' underlying rating to Baugo School Building Corp., Ind.'s series 2018 ad valorem property tax first mortgage bonds, issued for Baugo Community Schools. At the same time, S&P Global Ratings affirmed its 'AA+' long-term program rating and 'A' underlying rating on the school corporation's existing limited tax debt. The outlook on all ratings is stable.

Bond proceeds will be used for various school facility renovation and improvement projects.

The 'A' underlying rating reflects our view of the school corporation's:

- Strong market value per capita indicators;
- Good available reserves on a cash basis of accounting; and
- History of positive operating performance.

Partially offsetting the above strengths, in our view, are the school corporation's overall decline in enrollment in recent years, which is the primary determinate of state aid, and an economy centered on a somewhat volatile manufacturing industry.

The school corporation has been pressured in recent years by an overall decline in enrollment, which is the primary determinant of state aid. Despite declining enrollment, the school corporation has reported positive operating results in recent years due to proactive expenditure reductions, including savings achieved through attrition, to right-size the labor staff for the smaller enrollment. We view the significant portion of the corporation's local economy that is dependent on recreational vehicle or RV manufacturing as a credit weakness. However, the corporation's level of available reserves and moderation in enrollment declines, provide rating stability.

Security

The 'A' rating is based on the ad valorem property tax pledge. The 2018 ad valorem property tax first mortgage bonds are 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 against all taxable property within the school corporation's boundaries.

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 in the event the leased premises are not available for use. This risk is mitigated, in our view, by the lease requiring the school corporation to maintain at least two years of lease interruption insurance as well as casualty insurance equal to full replacement cost. Additionally, there is construction risk given that lease payments will be dependent on project completion. However, the lease permits interim lease rentals to be paid until the project is completed, which meet or exceed debt service requirements. In our view, this mitigates the construction risk as debt service payments would not be disrupted by construction delays.

The ad valorem property tax pledge, which secures the corporation's 2018 ad valorem property tax first mortgage bonds and other outstanding limited-tax 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.

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 payments being made 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 (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, 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 the debt service shortfall.

Economy

Baugo Community School serves an estimated population of 9,931. In our opinion, median household effective buying income (EBI) is good at 97% of the national level, but per capita EBI is adequate at 78%. The corporation's total \$627.2 million gross assessed value (AV) in 2018 is strong, in our view, at \$63,157 per capita. Net AV grew by a total of 8.5%

since 2016 to \$418.9 million in 2018. The 10 largest taxpayers make up an estimated 18.7% of net AV, which we consider diverse.

The school corporation is located in Elkhart County, 10 miles east of South Bend, and includes a portion of the city of Elkhart. Elkhart serves as a regional employment center, hosting an array of recreational vehicle production companies, including Forest River, one of the area's largest employers (with about 10,000 workers throughout the county), plus many other large industrial and service-based facilities. County employment relies heavily on a somewhat volatile manufacturing industry, with 41.2% of the workforce employed in the field. Layoffs during the recession contributed to, in our view, a previously very high county unemployment, but in recent years the local economy has improved. The Elkhart County average unemployment rate for 2017 was 2.5%. The school corporation's AV has increased in recent years and management expects slight to stable growth 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. Enrollment decreased overall in recent years, declining by 3.9% since 2013 to 1,855 students for the 2017-2018 school year. State aid accounted for 99.0% of general fund revenue in 2017.

The corporation's available cash reserve of \$1.1 million (which consists of the combined general and rainy day funds) is good on a cash basis of accounting in our view, at 8.9% of general fund expenditures at calendar year-end (Dec. 31) 2017. Of that amount, \$613,000 (5.2% of expenditures) is in the general fund, and \$440,000 (3.7% of expenditures) is in the rainy day fund. The corporation reported a surplus operating result of 0.5% of expenditures in 2017.

We expect the corporation's available reserves will remain good on a cash basis of accounting over the next few years. Despite overall decreases in enrollment, the school corporation has reported positive operating results in each of the past three years, primarily due to conservative budgeting assumptions and proactive expenditure adjustments in response to the lower enrollment.

For fiscals 2018 and 2019, the school corporation expects to report at least balanced general fund and rainy day fund cash balances as a continued result of proactive budgeting practices. For 2018, the school corporation expects to report ending general fund rainy day fund balances in line with balances at the end of 2017. The school corporation has made significant expenditure reductions in recent years, primarily in labor costs, which were achieved through attrition, in order to right-size the staff for the lower enrollment. In fiscal 2019, the school corporation expects to report at least balanced operating results as a continued result of the previous expenditure reductions. We understand that the corporation does not currently have any plans to significantly spend down either its general or rainy day fund balances. With the expectation of at least stable enrollment going forward, we anticipate that the school corporation will continue to make necessary budgetary adjustments to maintain its available balances.

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 and well-grounded revenue and expenditure assumptions with the use of five years of historical data, conservative estimates, and the use of outside sources of information when forecasting trends;
- Monthly reporting of budget to actual results to the board with the ability to amend the budget as needed;
- Maintenance of a long-term strategic plan, which outlines financial goals of the school corporation over the next several years, but no detailed and comprehensive financial forecast beyond the budgeted year;
- Maintenance of a long-term capital plan, which goes eight years beyond the budgeted year, is shared with the board, and updated at least annually, though the identification of funding sources is not comprehensive;
- Adhering to state guidelines when making investments with annual reporting of investment holdings and earnings to the board;
- No formal debt management policy, but it adheres to state limits; and
- Target of maintaining a general fund balance of at least \$600,000 as a sufficient cushion for any unforeseen expenditures; the school corporation is currently adhering to this target.

Debt

Overall net debt is moderate, in our opinion, at 4.5% of market value and \$2,851 per capita. Amortization is rapid, with 100% of the corporation's direct debt scheduled to be retired within 10 years. Debt service carrying charges were 19.5% of total governmental fund expenditures excluding capital outlay in calendar year 2017, which we consider elevated.

We understand that the school corporation could potentially issue an additional \$1.9 million in GO bonds in 2020. Additionally, management confirms it has no contingent liquidity risks from financial instruments with payment provisions that change upon certain events.

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 4.0% 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 post-employment benefits to eligible retirees in the form of supplemental health insurance and contributions made to retirement savings accounts.

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, significant capital spending, 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 available fund balance were to improve significantly and were maintained at a level commensurate with those of higher-rated peers or if its local economy diversified significantly, assuming no deterioration in the corporation's other credit factors, we could raise the rating.

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