S&P Global Ratings

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Summary:

Highland Multi-School Building Corp., Indiana School Town of Highland; School State Program

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Credit Profile		
US$11.415 mil ad valorem prop tax 1st mtg rfdg & imp bnds (Highland Sch Twn) ser 2018 due 01/15/2026		
Long Term Rating	AA+/Stable	New
Underlying Rating for Credit Program	A+/Stable	New

Rationale

S&P Global Ratings assigned its 'AA+' program rating and 'A+' underlying rating to Highland Multi-School Building Corp., Ind.'s series 2018 ad valorem property tax first mortgage refunding and improvement bonds, issued for the School Town of Highland (the district). At the same time, we affirmed our 'AA+' program rating and 'A+' underlying rating on debt issued by and on behalf of the district. The outlook is stable.

The 'A+' underlying rating reflects our view of an ad valorem property tax pledge and the district's:

- Access to the broad and diverse Chicago metropolitan statistical area economic base;
- Strong general fund and "rainy day" cash balance, which we believe will provide cushion to the district as it adjusts to an expected increase in circuit breaker losses in 2020; and
- Moderate debt levels, though with rapid amortization.

Partly offsetting the above strengths, in our view, are the district's elevated debt service carrying charges and expected increase in circuit breaker losses given the expiration of Lake County exemptions in 2020.

Proceeds from the 2018 ad valorem property tax first mortgage bonds will be used to refund the district's series 2008 first mortgage bonds for interest cost savings, and for various capital improvements at existing school facilities.

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 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 that a debt service transfer is late or 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 equaling the debt service shortfall.

The series 2018 bonds are secured by lease rental payments paid directly to an independent trustee pursuant to a trust indenture between the school building corporation and trustee and a lease between the school district and the school building corporation. Rent is payable from revenue from ad valorem taxes against all taxable property within the district'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 lease provisions requiring the district 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 mitigate abatement risk. Additionally, we see no construction risk, as the leased premises are already in use and will remain occupied during the project period. Lease payments will not depend on project completion.

The ad valorem property 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 district 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 district's general creditworthiness given that ad valorem taxes are collected from the district's entire tax base and that there are no limitations on the fungibility of resources available for debt service. Property taxes on the 2008 bonds and the refunding portion of the 2018 bonds are exempt from circuit breaker legislation through Dec. 31, 2019, at which point the exemptions expire. The new money portion of the 2018 bonds is not exempt from circuit breakers.

Economy

The district serves an estimated population of 22,847. In our opinion, median household effective buying income (EBI) is strong at 113% of the national level, but per capita EBI is good at 106%. Gross AV totaled $1.8 billion in 2018, which we consider very strong at $80,399 per capita. Net AV grew by a total of 3.1% since 2016 to $1.1 billion in 2018. The tax base is very diverse, in our view, with the 10 largest taxpayers accounting for approximately 12.5% of net AV.

The district is in Lake County, roughly 30 miles southeast of downtown Chicago. Many of the district's residents commute to Chicago, although a significant number are employed in manufacturing jobs throughout the county. According to management, leading employers within the district have been stable. County unemployment was 5.1% in 2017, above the state average of 3.5%. The district is mostly built out, and therefore increases in AV have largely hinged on appreciating values on existing properties. We anticipate that market values and incomes will remain relatively stable over the next few years.

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 drivers 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 circuit breaker tax caps may affect.

State aid accounted for 97.3% of general fund revenue in 2017 and enrollment came in at 3,242 students in the 2017-2018 school year. Enrollment has been on a downward trend over the past 10 years, though there are signs of stabilization. Enrollment increased by 95 students in the 2017-2018 school year, and preliminary counts show another increase of about 50 students for the 2018-2019 school year. Under current board policy, the district does not accept transfer students and loses only a few students to other districts. The school board has the ability to reverse this policy in the future, and we believe that it could use this as a means to increase enrollment.

Despite the downward trend in enrollment, the district has posted seven consecutive years of general fund operating surpluses, which has allowed it to strengthen its reserve position. The corporation's available cash reserve of $6.3 million (which consists of the combined general and rainy day funds) is strong on a cash basis of accounting, in our view, at 32% of general fund expenditures at calendar year-end 2017. Of that amount, $5.3 million (27.0% of expenditures) is in the general fund, and $950,000 (4.8% of expenditures) is in the rainy day fund. The corporation reported a surplus operating result of 2.2% of expenditures.

Given the strong general fund reserve position, the district plans to spend down a portion starting in 2018. Management is projecting a $390,000 use of reserves in the general fund, which will go toward covering salary increases. The district aims at a minimum to keep general fund reserves at 10% to 12% of expenditures. However, management reports that the district will not spend down reserves to this level, in part because it would like to retain cushion because of an expected increase in circuit breaker losses starting in 2020. A portion of the district's debt obligations are exempt from circuit breaker limits, though this exemption expires at the end of 2019, which management estimates will result in additional circuit breaker losses of about $1.2 million per year. The district's debt service costs are decreasing, which management anticipates will offset the increase in circuit breaker losses to some extent. But the reserves will also act as a cushion, allowing management to make potential expenditure cuts or go to voters for a referendum levy, once the actual circuit breaker impact is known. In addition to general fund reserves, the district plans to maintain at least $950,000 in the rainy day fund through 2020. Our rating and outlook on the district's debt reflects our belief that the district has the flexibility to adjust its budget to address the increase in circuit breaker losses, and also that the district will act relatively quickly to avoid a significant reduction in reserves.

The state audits school corporations biennially on a cash basis, using a June 30 fiscal year end. In the interim, schools submit semiannual financial statements to the state that are reviewed by the Indiana Office of School Finance 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 Indiana Office of School Finance 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 our view that the finance department maintains adequate policies in some but not all key areas.

Management uses historical trends and some outside sources to help formulate a line-item budget. The school board receives a monthly report that shows monthly revenue, expenditures, transfers, and cash balances, but the report does not present budget-to-actual results. The report also includes the district's bank holdings. The district has a state mandated three-year capital plan and a master facility plan that was created in 2015. The master facility plan is not rolling. The district maintains no formal long-term financial projections, and adheres to state guidelines for investing and debt management. Last, the district's reserve target is not formalized, but is being met.

Debt

Overall net debt is moderate, in our opinion, at 5.6% of market value and $4,499 per capita. With 74% of the corporation's direct debt scheduled to be retired within 10 years, amortization is rapid. The debt service carrying charge was 17.1% of total governmental fund expenditures excluding capital outlay, which we consider elevated, in calendar 2017.

The district has about $52.4 million in debt outstanding. According to management, the district plans to issue about $630,000 in common school fund loans for technology purchases, but otherwise has no debt plans. The district has no privately placed or bank-purchased debt obligations.

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 among 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 3.4% 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 Statement 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 provides certain other postemployment benefits to retirees, on a pay-as-you-go basis. In 2017, this payment was equal to 0.6% of total funds' expenditures.

Outlook

The stable outlook on the 'AA+' program rating reflects our view of the strength of the Indiana state aid intercept program. The rating is set one notch below and moves in tandem with the state issuer credit rating.

The stable outlook on the 'A+' underlying rating reflects our expectation that the rating will remain unchanged within the two-year outlook horizon. It is based on our anticipation that the district will adjust its budget as necessary to address an expected increase in circuit breaker losses in 2020, while maintaining strong cash reserves.

Downside scenario

We could lower the rating if the district is slow to react to the increase in circuit breaker losses or if increased labor costs become a budget pressure, causing reserves to decline to levels consistent with those of 'A' rated peers.

Upside scenario

We could raise the rating if the district withstands the increase in circuit breaker losses without significant deterioration in reserves, and if we come to believe the district will be able to sustain reserves at levels comparable with those of 'AA-' rated peers.

Ratings Detail (As Of September 11, 2018)		
Highland Sch Twn GO bnds ser 2016 due 12/30/2023		
Long Term Rating	AA+/Stable	Affirmed
Underlying Rating for Credit Program	A+/Stable	Affirmed
Highland Multi-Sch Bldg Corp, Indiana		
Highland Sch Twn, Indiana		
Highland Multi-Sch Bldg Corp (Highland Sch Twn) ad valorem prop tax 1st mtg bnds (Highland Sch Twn)		
Long Term Rating	AA+/Stable	Affirmed
Underlying Rating for Credit Program	A+/Stable	Affirmed
Highland Multi-Sch Bldg Corp (Highland Sch Twn) ad valorem prop tax 1st mtg rfdg & imp bnds (Highland Sch Twn) ser 2018 due 01/15/2026		
Long Term Rating	AA+/Stable	Rating Assigned
Underlying Rating for Credit Program	A+/Stable	Rating Assigned
Highland Multi-Sch Bldg Corp (Highland Sch Twn) GO (AGM)		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed
Underlying Rating for Credit Program	A+/Stable	Affirmed
Highland Sch Bldg Corp, Indiana		
Highland Sch Twn, Indiana		
Highland Sch Bldg Corp (Highland Sch Twn)		
Long Term Rating	AA+/Stable	Affirmed

Many issues are enhanced by bond insurance.

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.