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Ratings

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Summary:

Barnes County North Public School District No. 7, North Dakota; School State Program

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Credit Profile		
US$11.925 mil st aid rfdg certs of indebt ser 2019 dtd 12/04/2019 due 08/01/2033		
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 Barnes County North Public School District No. 7, N.D.'s series 2019 taxable state aid refunding certificates of indebtedness. The outlook is stable for both ratings.

The district's pledge of state aid receipts, with credit enhancement provided by the North Dakota school district credit enhancement program, secures the bonds. Officials will use the bond proceeds for the advance refunding of the district's existing series 2012 lease revenue bonds for interest cost savings.

The 'AA' long-term rating reflects our view of the credit enhancement provided by North Dakota through the school district credit enhancement program. According to the bond resolution, the district is required to deposit bond payments with an independent paying agent five days prior to the debt service due date, and if funds are not received or are insufficient, the paying agent acts as notification agent to the state to have state aid payments intercepted in time to cover debt service. The district's most recent annual state aid distribution covers maximum annual debt service (MADS) on the bonds by more than 2x, which in our view reduces the risk that available state aid will be insufficient to fully cover debt service.

The 'A' rating reflects our view of the underlying security. Under our "Issuer Credit Ratings Linked To U.S. Public Finance Obligors' Creditworthiness" criteria (published Jan. 22, 2018), we rate the obligations on par with our view of the district's general creditworthiness, as we consider the pledge of state aid--the district's primary source of operating revenue--a form of general fund pledge, where the ability to pay debt service on the bonds is closely tied to the district's operational health.

Credit overview

The district's distinguishing credit strengths include its strong cash reserves in excess of 30% of expenditures, its recent history of stable operations, and its significant unused levy capacity. Key rating constraints include an almost exclusively agricultural economic base and an elevated direct debt burden with high carrying charges, the combination of which, in our view, creates some operational vulnerabilities. In particular, the area has a history of demographic decline--evident in population loss going back several decades--and the district is heavily dependent on enrollment for state funding, both to pay debt service on the bonds and to fund a portion of its operating budget. Still, we think downside pressure is limited in the near term so long as the district continues to sustain an operationally balanced budget with strong reserves, as it has done historically, while upside potential will largely depend on a steady trend of enrollment growth and diversification in the area economy.

- Extremely strong per capita market value and good per capita and median household effective buying incomes (EBI) that are just above the national average;
- Strong reserve position, with a general fund cash balance of about $1.5 million (30% of expenditures) at the end of fiscal 2019 and ample unused levy capacity equal to nearly one third of 2019 tax receipts, which provides a significant hedge against declines in enrollment or taxable value, should they occur; and
- Overall debt burden that we consider high on a per capita basis and low as a share of market value, with debt service carrying charges that are elevated.

Outlook

The 'AA' long-term rating is one notch below the rating on North Dakota's GO debt; the rating and outlook move in tandem with the state's rating and outlook.

Downside scenario

We do not expect to lower the 'A' underlying rating in our two-year outlook horizon, but could do so if the district's reserves were to decline materially below management's target level of 30% of expenditures or if the district otherwise saw declines in enrollment or taxable value that we believed would cause significant operational pressure.

Upside scenario

Upside rating potential largely depends on a consistent trend of enrollment growth, with corresponding improvements in state aid, providing a more substantial margin for the district to meet its debt payments on the 2019 bonds while maintaining operational balance.

Credit Opinion

An agriculture-based economy, with some pressures

Barnes County North Public School District No. 7 covers 730 square miles of primarily agricultural land and is headquartered in Wimbledon, approximately 90 miles west of Fargo and 130 miles east of Bismarck. The area has seen steady population decline since at least the 1980s. Although the pace of decline appears to have slowed in recent years, we think the trend represents a vulnerability, particularly given that state funding for schools is tied to enrollment in North Dakota. Enrollment declined from school years 2014-2015 through 2018-2019, however, these were fairly modest and the district is reporting an increase of 14 students (5.4%) for the current school year. Management indicates that enrollment should remain relatively stable in the near term, though we think that some measure of volatility is likely over the longer term given the demographic trends in recent years.

Market value has increased by small margins in each of the past two years, as has taxable value. Cargill, Inc. is the largest taxpayer at 8% of taxable value. We understand that the malt factory that it owns in the district closed a few years ago, but that the company still pays taxes on the property. Cargill appealed its assessment in 2018, but later withdrew the appeal, and we expect the company could appeal its valuation in future years. Otherwise, management expects to see ongoing growth in taxable value.

The tax base could be subject to some medium-term volatility, in our view, whether from a potential Cargill assessment appeal or from volatility in commodity prices pressuring agricultural land values. Still, we understand that the district is currently levying well under its authorized levy limits, which we recognize gives it some flexibility to realize losses in taxable value without materially affecting operations. Management reports that the district has 25 mills of unutilized levy authority across the general, special reserve, and building funds, which could raise close to $750,000 in annual revenues based on current valuations, equal to about 31% of total fiscal 2019 property tax receipts.

Operations remain stable, with reserves in excess of target levels

The district's current financial position and the additional flexibility provided by unused levy capacity represent key credit strengths. Management targets an unrestricted general fund cash balance of 30% of expenditures, a level that is just under the district's statutory limit of 35%. In fiscal 2019, management used a portion of its reserves in excess of target levels to prepay debt payments coming due at the end of the calendar year, resulting in a draw on reserves despite an operationally balanced year-end result. Similarly, the fiscal 2020 budget is structured with a $236,000 use of reserves, all of which is tied to the prepayment of debt, and which we understand is contingent on the availability of surplus reserves at the end of the year.

We see few signs of unaddressed cost pressures and think that management is well positioned to run an operating budget that is balanced or better in most years. The district is small, with a typical class size of around 20 students, has no significant new staffing needs or capacity pressures, and operates out of a single building that was constructed recently. We think that key operational risks are tied to the potential revenue pressure from enrollment decline or pressure on the tax base. However, mitigating these risks, in our view, are the district's revenue flexibility and limited cost pressures, absent a large departure from current conditions.

Standard financial management policies and practices

The district budgets using a traditional line-item methodology incorporating up to three years of historical data, and the board regularly monitors budget-to-actual performance and bank holdings through monthly reports on both. The district does not currently have a long-term financial plan or a capital plan, but is working with a consultant on a strategic plan that will include a five-year financial projection and a capital improvement plan. We understand that the strategic plan will be reviewed and updated annually upon completion. The district has no investment policy or debt management policy, and has a 30% reserve target, which management indicates is to keep a contingency reserve that is less than the state maximum, but that will provide cash sufficient for its debt payments.

Low overall debt burden, with no future bonding plans

The district operates out of a single building that was constructed with the proceeds from its 2012 bond issue. While it has no future debt plans, the district could construct a new locker room facility--which was excluded from the scope of the original school building project--using cash on hand in its building fund. The district otherwise has no significant capital needs. While debt is high on a per capita basis, it is low as a share of market value. Carrying charges are elevated, although the district expects debt service to be level through the bonds' life, which mature by 2033. The district has no direct-purchase or variable-rate debt.

Pension costs are low, but could accelerate over time

The school participates in the North Dakota Teachers Fund for Retirement (TFFR), a cost-sharing, multiple-employer defined-benefit pension plan with benefit and contribution provisions established by the state in accordance with North Dakota Century Code. TFFR is poorly funded--at only 65.5% in 2018--and includes actuarial assumptions and methods that backload contributions and that we think introduce a risk of funding volatility. The 7.75% rate of return assumption is high, in our view, and indicates an asset allocation that is more prone to volatility in a market downturn, and its level percentage payroll of the net liability over 25 years under a 4.25% payroll growth assumption entails progressively higher contributions, assuming all assumptions are met perfectly. In 2018, plan contributions were less than both our static-funding and minimum-funding progress metrics, which we think suggests a higher likelihood of future cost acceleration.

The district's contributions were a manageable 3.9% of governmental fund expenditures in fiscal 2019 and its proportionate share of the net pension liability is $3.1 million. Although we do not expect near-term cost increases to significantly pressure the district's budget, we believe that the plan funding levels, in combination with actuarial assumptions and methods, introduce a greater likelihood of accelerating costs that could create more acute budgetary pressure. The district does not subsidize retiree health benefits or otherwise offer any other postemployment benefits.

Barnes County North Public School District No. 7, N.D.--Financial And Operating Statistics

	Characterization	Most recent	Historical information		
			2019	2018	2017
Economic indicators					
Population				1,824	1,843
Median household EBI as a % of U.S.	Good			104	113
Per capita EBI as a % of U.S.	Good			110	119
MV per capita ($)	Extremely strong		326,457	326,457	312,581
Top 10 taxpayers as a % of AV	Diverse		22.0		
Financial indicators					
Total adjusted available fund balance ($000)			1,595	1,677	1,620
Total adjusted available fund balance as a % of operating expenditures	Strong		32.6	33.8	32.7
Governmental funds cash as a % of governmental fund expenditures			48.1	43.4	39.9
General fund operating result as a % of general fund operating expenditures			(1.67)	1.15	(1.92)
FMA			Standard		
Enrollment		275	261	268	285
Debt and long-term liabilities					
Overall net debt as a % of MV	Low	2.4	2.3	2.4	
DS as a % of governmental funds expenditures	Elevated		21.6	22.6	22.6
Pension ADC ($000)			202		
OPEB contribution ($000)			0.0	0.0	

Barnes County North Public School District No. 7, N.D.--Financial And Operating Statistics (cont.)		
ADC plus OPEB as a % of governmental fund expenditures	3.9	3.6

EBI--Effective buying income. MV--Market value. AV--Assessed value. FMA--Financial Management Assessment. DS--Debt service. ADC--Actuarially determined contribution. OPEB--Other postemployment benefits.

Related Research

Criteria Guidance: Assessing U.S. Public Finance Pension And Other Postemployment Obligations For GO Debt, Local Government GO Ratings, And State Ratings, Oct. 7, 2019