MOODY'S INVESTORS SERVICE

CREDIT OPINION
9 July 2020

Rate this Research

Contacts

Kenneth R Surgenor +1.214.979.6848
Analyst
kenneth.surgenor@moodys.com

Thomas Jacobs +1.212.553.0131
Senior Vice President/Manager
thomas.jacobs@moodys.com

North Kansas City School District 74, MO

Update to credit analysis

Summary

The credit profile of North Kansas City School District 74, MO (Aa2 stable) benefits from the district's large and growing tax base with proximity to employment opportunities throughout the Kansas City metro area, stable financial operations with maintenance of healthy operating reserves, and modest enrollment growth which drives state aid. The district's credit profile is constrained by debt and unfunded pension liabilities that are elevated relative to the tax base but manageable relative to the operating budget.

We regard the coronavirus outbreak as a social risk under our ESG framework, given the substantial implications for public health and safety. We do not see any material immediate credit risks for the district given strong operating reserves and the district's unlimited debt service tax levy. However, the situation surrounding coronavirus is rapidly evolving and the longer term impact will depend on both the severity and duration of the crisis. If our view of the credit quality of the district changes, we will update our opinion at that time.

Credit strengths

» Large, growing tax base with proximity to employment opportunities throughout the Kansas City metropolitan area

» Stable financial operations and maintenance of healthy operating reserves

» Modest enrollment growth

Credit challenges

» Elevated debt and pension burdens with additional near term debt issuance planned

» Slower than average principal amortization

Rating outlook

The stable outlook reflects our expectation that the district's conservative budgeting practices will maintain balanced operations while incorporating rising pension contributions and additional near term debt issuance.

Factors that could lead to an upgrade

» Significant moderation of debt and pension leverage while maintaining balanced operations

» Material strengthening of operating reserves

» Upgrade of the Missouri Direct Deposit Program (enhanced)

Factors that could lead to a downgrade

» Material further leveraging of the tax base absent offsetting taxable value or revenue growth

» Erosion of operating reserves

» Downgrade of the Missouri Direct Deposit Program (enhanced)

Key indicators

Exhibit 1

North Kansas City School District 74, MO	2015	2016	2017	2018	2019
Economy/Tax Base					
Total Full Value ($000)	$8,593,848	$8,679,910	$8,954,585	$9,328,181	$9,611,162
Population	125,430	127,643	129,596	131,029	137,366
Full Value Per Capita	$68,515	$68,001	$69,096	$71,192	$69,968
Median Family Income (% of US Median)	99.4%	98.5%	99.8%	99.9%	99.9%
Finances					
Operating Revenue ($000)	$242,661	$250,081	$263,093	$270,049	$279,737
Fund Balance ($000)	$54,096	$60,135	$65,742	$77,469	$73,057
Cash Balance ($000)	$82,098	$80,897	$87,607	$93,899	$109,242
Fund Balance as a % of Revenues	22.3%	24.0%	25.0%	28.7%	26.1%
Cash Balance as a % of Revenues	33.8%	32.3%	33.3%	34.8%	39.1%
Debt/Pensions					
Net Direct Debt ($000)	$216,040	$224,685	$363,294	$308,087	$279,214
3-Year Average of Moody's ANPL ($000)	$622,167	$631,346	$721,339	$799,931	$850,957
Net Direct Debt / Full Value (%)	2.5%	2.6%	4.1%	3.3%	2.9%
Net Direct Debt / Operating Revenues (x)	0.9x	0.9x	1.4x	1.1x	1.0x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	7.2%	7.3%	8.1%	8.6%	8.9%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	2.6x	2.5x	2.7x	3.0x	3.0x

Note: The financial operations are exclusive of crossover refunding activity in fiscal years 2017-19.
Source: North Kansas City SD 74's audited financial statements fiscal years 2015-19; US Census Bureau

Profile

The 82 square mile district is located in the Kansas City metropolitan area on the north side of the Missouri River, almost entirely within Clay County (Aa1), and serves students from 12 municipalities. Enrollment totaled approximately 20,400 in fiscal 2020, up 1.7% over the prior year; enrollment has increased by more than 1,000 student since 2016, total growth of 5.4% over that period.

Detailed credit considerations

Economy and tax base: large, growing tax base included in the Kansas City metro area

The coronavirus pandemic is driving an unprecedented economic slowdown. We currently forecast US GDP to decline significantly during 2020 with a gradual recovery commencing toward the end of the year. Local governments with the highest exposure to tourism, hospitality, healthcare, retail, and oil and gas could suffer particularly severe impacts. The effect on local governments will vary based on the extent and duration of local disruption and could be more or less severe than the nation overall. The evolution of the crisis remains highly uncertain and the full extent of the economic costs will be unclear for some time.

Modest annual expansion of the district's tax base will likely continue over the near term primarily driven by ongoing residential development, reassessment of existing property, and minor commercial development. The district's tax base expanded 3.7% on average over the past five years, including a 9.7% increase for fiscal 2020 to a sizable $10.5 billion. Since the recessionary trough of $8.0 billion in fiscal 2013, the district's base has expanded nearly 32%.

Resident incomes are average with median family income equal to 99.9% of the US median. District residents benefit from access to employment opportunities throughout the greater Kansas City area. Similar to the rest of the nation, the unemployment rate in Clay County skyrocketed in response to the economic shutdown due to the coronavirus pandemic. The county's May 2020 unemployment rate of 12.4% exceeded the state rate of 9.8% but was in line with national rate of 13%. Management expects district enrollment growth to continue over the near term, in line with the 1.3% average annual growth over the past five years.

Financial operations and reserves: trend of conservative fiscal management and maintenance of healthy operating reserves expected to continue

As a result of the pandemic impact on state revenues, Missouri's governor announced a $459 million reduction in the state's fiscal 2021 budget, including a $123.4 million reduction in the basic foundation formula that funds Missouri schools. Consequently, the district's state aid revenues are expected to decline somewhat in fiscal 2021; however, the full extent of these cuts is unknown as additional cuts could occur if the pandemic continues to pressure state resources. Still, the district's operating reserves are expected to remain stable and healthy given the district's conservative budgeting and growth in local source revenues driven by taxable value growth. The district's revenues were primarily derived from local property taxes (64.8%) and state aid (27.6%) in fiscal 2019.

The district's operating funds (general, special revenue (teachers'), and debt service funds) posted a $5.5 million drawdown in fiscal 2019, attributable to the defeasance of debt with reserve contributions added to a crossover refunding. The drawdown reduced available operating reserves to $73.1 million, representing a healthy 26.1% of operating revenues. The district's fiscal 2020 budget included a $3 million drawdown though management projects the drawdown will be closer to $750,000, inclusive of approximately $2.5 million in state aid reductions resulting from the coronavirus. The district's debt service fund is projected to add more than $4 million with taxable value growth driving revenues and reduced debt service expenditures.

LIQUIDITY

The district closed fiscal 2019 with $78.1 million in general fund liquidity, representing 31.2% of general fund revenues. Inclusive of debt service reserves, operating liquidity closed at $109.2 million, representing 39.1% of operating revenues.

Debt and pensions: debt burden to remain elevated

The district's debt burden will remain elevated, though manageable, given additional near term issuance plans and slow principal amortization. In June 2020, voters approved the issuance of $155 million to construct new and improve existing school facilities along with the purchase of school buses and other transportation equipment. Following the issuance of the Series 2020 bonds, the district will have $315 million of GO debt outstanding and $20 million in lease appropriation debt, representing a net direct debt burden of 3.4% of fiscal 2020's full value, which is elevated for the rating category. However, the district's outstanding debt represents a manageable 1 times operating revenues. Additionally, the district plans to issue the remaining $60 million of the authorization within the next 12-14 months.

Notably, all of the district's general obligation unlimited tax debt is enrolled in the Missouri Direct Deposit Program (MDDP) which sends intercepted state aid directly to the trustee for payment of outstanding debt enrolled in the program. The district can issue additional debt under the program if state aid provides 1.5 times coverage of maximum annual debt service (MADS) post sale. The district remains obligated to pay debt service on the bonds if the amounts of intercepted state aid is insufficient. State aid received under the basic foundation formula (from which intercepted funds are derived) totaled $65.3 million in fiscal 2020, providing 2.02 times MADS coverage, inclusive of the current issuance.

DEBT STRUCTURE

All of the district's debt is fixed rate and matures over the long-term (final maturity in fiscal 2040). Principal amortization is below average with 61.3% of principal repaid within ten years.

DEBT-RELATED DERIVATIVES

The district is not party to any interest rate swaps or other derivative agreements.

PENSIONS AND OPEB

The district's elevated pension burden is growing and outsized compared to peers in the rating category. Moody's has allocated liabilities of two state cost-sharing plans in proportion to the district's contributions for the Public Education Employee Retirement System (PEERS) and Public School Retirement System (PSRS). Budgetary pressure related to previous underfunding of the pension plans will remain manageable in the near-term as the annual statutory increase in the total contribution rate may not exceed 1% of pay for PSRS and 0.5% of pay for PEERS.

The district's contributions of $16.9 million to PSRS and $3.4 million to PEERS totaled $20.3 million for fiscal 2019, representing 7.3% of operating revenues. Moody's three-year average adjusted net pension liability (ANPL) for the district, under our methodology for adjusting reported pension data, is $851 million representing an elevated 3.0 times operating revenues and 8.9% of the estimated market value.

While the pension burden is elevated relative to peers, the district's contributions have exceeded “treadwater” each of the past five years. In fiscal 2019, the contribution exceeded “treadwater” by roughly 13.3% which represented less than 1% of operating revenues. The “tread water” indicator is the annual government contribution required to prevent the reported net pension liability from growing, under reported assumptions including the above average 7.5% discount rate. Contributions above the tread water level cover all net pension liability interest plus pay down some principal, making them stronger from a credit perspective than contributions below this level.

The district's fixed costs (inclusive of $33.8 million for debt service (of which $6.5 million was provided for by a crossover refunding), $20.3 million for pension contributions, and $960,000 in OPEB contributions) totaled $55.2 million in fiscal 2019, representing a manageable 19.7% of operating revenues. Amortization of the unfunded pension liability will result in increased future pension contributions and higher fixed costs in the future. Failure to earn the assumed rate of return on pension assets would compound the need for higher future pension contributions.

ESG considerations

ENVIRONMENTAL

Environmental considerations do not present material risks to the district's credit profile. The district's location along the Missouri River puts it at medium risk for flooding resulting from extreme rainfall events which are also typically accompanied by state and federal assistance, further mitigating environmental risk.

SOCIAL

Social considerations including demographic and economic trends along with the recent coronavirus pandemic and its resulting effect are discussed above in the summary and economy and tax base sections.

GOVERNANCE

The district is governed by a seven member board of directors elected at large to three year staggered terms. The board appoints the district's superintendent who is responsible for the day-to-day operations of the district. Conservative budgeting practices, including maintaining operating reserves at 16% of budgeted expenditures, have contributed to stable financial performance.

Missouri School Districts have an Institutional Framework score of A, which is moderate. The sector's major revenue sources are subject to a cap via the Hancock Amendment which can be overridden with voter approval only. Unpredictable revenue fluctuations tend to be minor, or under 5% annually. Across the sector, fixed and mandated costs are generally less than 25% of expenditures. Unpredictable expenditure fluctuations tend to be minor, under 5% annually. We anticipate the district will maintain balanced operations while incorporating rising pension contributions and additional near term debt issuance.

Rating methodology and scorecard factors

The US Local Government General Obligation Debt methodology includes a scorecard, a tool providing a composite score of a local government's credit profile based on the weighted factors we consider most important, universal and measurable, as well as possible notching factors dependent on individual credit strengths and weaknesses. Its purpose is not to determine the final rating, but rather to provide a standard platform from which to analyze and compare local government credits.

Exhibit 2

North Kansas City School District 74, MO

Scorecard Factors	Measure	Score
Economy/Tax Base (30%) [1]		
Tax Base Size: Full Value (in 000s)	$10,546,415	Aa
Full Value Per Capita	$76,776	Aa
Median Family Income (% of US Median)	99.9%	Aa
Finances (30%)		
Fund Balance as a % of Revenues	26.1%	Aaa
5-Year Dollar Change in Fund Balance as % of Revenues	6.9%	A
Cash Balance as a % of Revenues	39.1%	Aaa
5-Year Dollar Change in Cash Balance as % of Revenues	14.4%	Aa
Management (20%)		
Institutional Framework	A	A
Operating History: 5-Year Average of Operating Revenues / Operating Expenditures (x)	1.0x	A
Debt and Pensions (20%)		
Net Direct Debt / Full Value (%)	4.0%	A
Net Direct Debt / Operating Revenues (x)	1.5x	A
3-Year Average of Moody's Adjusted Net Pension Liability / Full Value (%)	8.1%	Baa
3-Year Average of Moody's Adjusted Net Pension Liability / Operating Revenues (x)	3.0x	A
Notching Factors:[2]		
Unusually Strong or Weak Security Features		
	Scorecard-Indicated Outcome	Aa3
	Assigned Rating	Aa2

[1] Economy measures are based on data from the most recent year available.
[2] Notching Factors are specifically defined in the US Local Government General Obligation Debt methodology.
[3] Standardized adjustments are outlined in the GO Methodology Scorecard Inputs publication
Source: North Kansas City SD 74's audited financial statements; US Census Bureau

REPORT NUMBER 1234942

CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454

MOODY'S
INVESTORS SERVICE