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Ratings

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Summary:

Boone Community School District, Iowa; Sales Tax

Primary Credit Analyst:
Coral Schoonejans, Centennial + 1 (303) 721-4948; coral.schoonejans@spglobal.com

Secondary Contact:
Andrew J Truckenmiller, Chicago + 1 (312) 233 7032; andrew.truckenmiller@spglobal.com

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US$3.1 mil sch infrastructure sales, svcrs and use tax rev bnds ser 2022 due 07/01/2032		
Long Term Rating	A/Stable	New

Rating Action

S&P Global Ratings assigned its 'A' long-term rating to Boone Community School District, Iowa's anticipated $3.1 million series 2022 school infrastructure sales, services, and use tax revenue bonds. The outlook is stable.

A first lien on annual state-collected retail sales and service tax revenue, for school infrastructure purposes, secures the bonds. The rating reflects our priority-lien tax revenue debt criteria, published Oct. 22, 2018, on RatingsDirect, which factors in, among other aspects, pledged revenue strength and stability and the general credit quality of the district where taxes are collected and distributed, also known as the obligor's creditworthiness. A change in either component could lead to a revision of the priority lien rating.

Bond proceeds will be used for various capital improvements.

Credit overview

The district serves an estimated population of 14,291 in central Iowa, approximately 40 miles northwest of Des Moines. Its financial profile is very strong after consecutive surplus operating results. Total enrollment has declined over the past decade but has been relatively stable in recent years, and management expects stability hereafter. We base the stable outlook on our view that pledged revenue, supported by Iowa's very strong economy, would likely be sufficient and less prone to significant fluctuations during normal economic cycles. However, under our criteria, there is a link between the priority lien pledge and the obligor's general creditworthiness. Therefore, rating pressures on the obligor's general creditworthiness could lead to a lower priority lien rating. For S&P Global Economics' latest U.S. economic forecast, see "Economic Outlook U.S. Q1 2022: Cruising At A Lower Altitude," published Nov. 29, 2021.

Key credit considerations include our opinion of the district's:

- Very strong economic fundamentals, as reflected by a statewide revenue base and distributions to districts based on certified enrollment, and
- Low-to-very-low revenue volatility because of the funding mechanism, as demonstrated by pledged revenue growth.

Partly offsetting the above strengths, in our view, are the district's low additional bonds test of 1.2x and its lack of a debt service reserve fund.

Environmental, social, and governance

Our rating accounts for the health and safety risks related to the COVID-19 pandemic, which we consider social risks greatly affecting all sector peers. While the health and safety social risks of the pandemic temporarily weakened sales tax collections nationally, sales tax collections in Iowa have predominantly withstood pandemic-related volatility. An additional mitigating factor is the district's stable certified enrollment, which supports at least stable revenue in upcoming years. However, we note that certified enrollment has declined over the past decade. We also analyzed environmental and governance risks and determined that all are in line with our view of the sector standard.

Stable Outlook

Downside scenario

Although such a scenario is unlikely, we could lower the rating if statewide sales tax collections were to decrease beyond projections, coupled with enrollment falling to such a degree that year-over-year revenue also deteriorates, leading to lower-than-expected debt service coverage (DSC) payments, or if the obligor's general creditworthiness were to weaken by multiple notches.

Upside scenario

We could raise the rating with stronger bond provisions and sustained stronger coverage, while all other credit characteristics improve or remain unchanged.

Credit Opinion

The Secure an Advanced Vision for Education program

In May 2008, the Iowa Legislature passed the Secure an Advanced Vision for Education (SAVE) program; effective July 1, 2008, it replaced the school infrastructure local option tax. SAVE establishes a statewide one-cent sales tax for infrastructure, collected through Dec. 31, 2029, and since extended to Jan. 1, 2051. SAVE requires the deposit of 2.1% of funds collected through the sales tax, before distribution to individual school districts, into Iowa's property tax equity relief fund, which provides property tax relief through the general school aid formula, particularly to districts with additional levy rates higher than the statewide average. The district deposits the remainder of one-cent sales tax revenue into the state-held SAVE fund, which the Iowa Department of Revenue distributes to individual school districts on a per pupil basis.

The per-pupil calculation compares a district's actual, in-district certified enrollment with total statewide enrollment. Districts receive 95% of the state's projected taxes in monthly payments with a final payment in November; this payment reconciles the difference between actual and estimated receipts. After 2013, all 99 counties made the transition to the statewide SAVE program. All districts receive the same level of per pupil revenue, most recently $1,112 for fiscal 2021 and an estimated $1,116 for fiscal 2022.

Districts can use their individual share of SAVE revenue for school infrastructure purposes or property tax relief; they cannot use funds for general operations. The district's electorate has adopted a broadly written revenue purpose statement that directs the school board to use sales tax revenue first for sales tax debt service and then for purposes that the SAVE Act permits, including property tax relief. Absent a revenue purpose statement, state statutes require districts to use SAVE funds for property tax relief first, essentially subordinating revenue bonds.

Recent legislation extends the 2029 sunset on the tax to 2051. The other significant change was an increase to the initial 2.1% set-aside of sales tax revenue into the property tax equity relief fund, which could increase by 1% annually should SAVE revenue increase by 2% or more, capped at 30%. Two-thirds of revenue in the property tax relief fund would benefit districts above the statewide average, with the remaining one-third raising foundation levels and benefiting all districts equitably.

Economic fundamentals: Very strong

For SAVE-backed revenue bond transactions, we have assessed the state economy in our analysis given the collection of sales tax revenue at the state level, coupled with a specific distribution formula for each district.

Overall, Iowa's population (estimated at 3.2 million) in 2020 lagged that of the nation; the state's population is relatively older. Iowa's per capita effective buying income has remained somewhat under national levels historically. The state regained its pre-Great Recession employment in mid-2013, and the unemployment rate remained among the nation's lowest at 2.7% in 2019. Iowa's unemployment rate through the recent pandemic-related recession stayed below the nation's rate at 5.3% in 2020. We think that although employment growth might lag that of the nation in the next few years, the area's slower population and labor force growth will allow the state's unemployment rate to remain low compared with the national level.

Iowa remains more concentrated in agriculture and manufacturing than does the nation, particularly manufacturing related to agricultural processing. IHS Markit estimates that two of every nine jobs in the state are agricultural. Other nonfarm employment sectors, in general, show similar concentration to that of the nation, with below-average concentration in professional and business services. Iowa is home to many financial and insurance companies; it has the nation's highest concentration of insurance and financial services employment, according to IHS.

Volatility: Low-to-very-low

We assess revenue volatility to determine the likelihood of revenue availability during different economic cycles. We have two levels of volatility assessments: macro and micro.

Our macro volatility assessment begins with an assessment of the historical volatility of economic activity taxed, including an analysis of societal, demographic, political, and other factors that could greatly affect these activities.

We have analyzed revenue distribution to schools from 2008 to 2021, the start of the SAVE program; we note less revenue volatility compared with national trends given the formula used for distributing revenue to districts, reflecting the percentage of each district's actual enrollment compared with total state enrollment. Statewide disbursements to schools have increased since SAVE's inception in 2008, apart from decreases of 1.0% in fiscal 2009 and 1.2% in fiscal 2021.

Fiscal 2021 actual statewide disbursements were $544.8 million, or $1,112 per pupil. They rose by a net $100 million, or 25%, during the previous 10 years compared with statewide enrollment, which has been relatively flat and increased by only a net 16,600, or 3.5%. Therefore, revenue from Iowa's distribution formula has seen comparably lower volatility than the nationwide average.

On a micro volatility level, we see no external influence that weakens the macro assessment of low volatility. Under the funding formula, even districts with decreasing enrollment, if the decrease is not significant, have experienced flat-to-growing year-over-year revenue; therefore, these districts report stable DSC.

Debt service coverage and liquidity: Weak-to-adequate

The stipulation that SAVE revenue cannot be used to support general operations typically results in weak-to-adequate coverage and liquidity. Districts tend to structure bonds with weak ABTs, typically in the range of 1.2x to 1.3x DSC, providing a greater ability to issue bonds and fund capital projects. ABT on the series 2022 bonds is 1.2x. We note most districts eventually issue additional debt to the ABT's fullest extent. We factor this into our analysis and our expectation of future DSC, and anticipate that coverage will remain close to adequate.

The series 2022 bonds lack a debt service reserve, which we view as meaningful to credit quality, in light of the additional borrowing limitations.

After the issuance, the district will have $10.16 million in sales tax revenue bonds outstanding. With use of $599,000 of pledged revenue in fiscal 2021, historical coverage was approximately 1.3x. With use of projected per pupil revenue of $1,116, or $2.26 million, for fiscal 2022 (and stable enrollment of 2,021) and MADS of $1.35 million in 2023, MADS coverage is approximately 1.7x.

In our view, in most cases, revenue distribution based on enrollment lends stability to DSC and liquidity. Districts can sustain modest enrollment decreases and still generate positive revenue growth because of historically increasing per pupil revenue.

Certified enrollment has declined in the past decade, but management projects that enrollment will stabilize based in part on healthy preschool and kindergarten enrollment expectations for the upcoming school year after a temporary decline in fiscal 2021 primarily resulting from the pandemic, when several families opted to participate in the home school assistance program. The district has historically lost students through its open-enrollment component, but this does not factor into pledged revenue on the bonds. For the October 2020 count, which is used for fiscal 2022 revenue collections, certified enrollment was 2,021. Enrollment is expected to remain relatively stable.

We applied two stress tests to assess DSC under scenarios of enrollment and sales tax revenue declines. Using the statewide per pupil revenue estimate of $1,116 for fiscal 2022, we determined that the district would still have 1x MADS coverage with 1,206 pupils, or a loss of 815 (a 40% decline). In addition, if enrollment remains constant at 2,021, we calculate per pupil revenue could decline to $666, and the district would still have 1x MADS coverage.

We expect DSC will likely be stable but remain weak-to-adequate. The district has no formalized plans to issue additional debt.

Obligor linkage: Close

Under our criteria, the priority lien rating links with the obligor's general creditworthiness because we view overall creditworthiness as a key determinant of an obligor's ability to pay all obligations, including special-tax-secured bonds. In our opinion, rated debt bond provisions are less restrictive with respect to revenue collection and distribution. The districts directly receive SAVE revenue from the Iowa Department of Revenue, and are responsible for paying debt service. In our opinion, pledged revenue flow is not substantially removed from the district's direct control.

Income levels, measured by median household and per capita effective buying income, are adequate, in our view, at 88% and 86% of the national levels, respectively. In our view, finances are very strong, with an available general fund balance of $5.7 million, or 21.8% of expenditures, in fiscal 2021 after a large $1.1 million surplus. Boone CSD expects to post around break-even results for fiscal 2022. Management has an informal reserve target minimum of 15%. We expect reserves will remain at least strong.

For more information on the district's general creditworthiness, see our report published Jan. 12, 2022.

Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020
- Criteria Guidance: Priority-Lien Tax Revenue Debt, Oct. 22, 2018