S&P Global Ratings

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Summary:

Hennepin County Independent School District No. 281 (Robbinsdale Area Schools), Minnesota; School State Program

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Summary:

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Credit Profile		
US$17.085 mil GO facs maintenance bnds ser 2020A due 02/01/2041		
Long Term Rating	AAA/Negative	New
Underlying Rating for Credit Program	A-/Stable	New
US$14.38 mil GO alternative facs rfdg bnds ser 2020B due 02/01/2032		
Long Term Rating	AAA/Negative	New
Underlying Rating for Credit Program	A-/Stable	New
Hennepin Cnty Indpt Sch Dist #281 (Robbinsdale Area Schs) GO State Credit Enhancement		
Long Term Rating	AAA/Negative	Affirmed
Underlying Rating for Credit Program	A-/Stable	Affirmed

Rating Action

S&P Global Ratings assigned its 'AAA' long-term (based on credit enhancement) rating, with a negative outlook, and 'A-' underlying rating, with a stable outlook, to Hennepin County Independent School District (ISD) No. 281 (Robbinsdale Area Schools), Minn.'s series 2020A general obligation (GO) facilities maintenance bonds and series 2020B GO alternative facilities refunding bonds.

The district's full faith and credit unlimited ad valorem tax GO pledge secures the bonds. Series 2020A bond proceeds will be used to finance deferred maintenance projects across the district's existing facilities. Series 2020B bond proceeds will be used to refund the district's series 2011A and 2012A GO alternative facilities bonds for expected interest cost savings.

The 'AAA' long term rating reflects the additional security provided by the district's eligibility for and participation in Minnesota's School District Credit Enhancement Program, a state standing appropriation program to prevent a default on the district's bond issues as authorized by Minnesota State Statutes, Section 126C.55. Under the program, the state will pay debt service on behalf of the district from the state's general fund if the district fails to meet its debt service obligations for the qualified debt. Payments from the state represent a standing appropriation from the state's general fund. We view this standing appropriation pledge as equivalent to a general fund pledge because the standing appropriation does not require adoption of a budget or any action of the legislature to make payment. Furthermore, the standing appropriation is not subject to executive unallotment authority. Additionally, the credit enhancement program supports projects that are central to the state of Minnesota's operations and purpose. In our opinion, there is no unusual political, timing, or administrative risk related to the debt payment. The rating on obligations that have received enhancement under the program is on par and moves in tandem with the rating on the state. The negative outlook on the long-term credit enhancement program rating reflects that of the State of Minnesota and moves in tandem with the state GO rating and outlook (see "Minnesota Credit Enhancement Program Outlooks Revised To Negative After State GO Outlook Revision," published Aug. 3, 2020, on RatingsDirect).

Credit overview

The district's finances have improved marginally after a period of structural imbalance leading to a negative available fund balance as recently as fiscal 2018. Management attributes the deficits to declining enrollment and rising costs--especially given the district's heavy reliance on enrollment-based state funding. However, in our view, in addition to slow revenue growth, the district had not been successful in controlling expenditures. It is no longer in compliance with its fund balance policy, and given the lack of other formal policies and practices, the Financial Management Assessment (FMA) is vulnerable. The district corrected its structural imbalance through a voter-approved operating referendum and cost-control measures that precluded further rating deterioration. The district's economy could support a higher rating. Given lingering effects from the recession and the ongoing pandemic, we believe additional effects could materialize on the district's finances and economy in the next six to 12 months (see: "The U.S. Economy Reboots, With Obstacles Ahead," published Sept. 24, 2020).

Credit factors include the district's:

- Favorable location and participation in the broad and diverse Minneapolis-St. Paul (Twin Cities) metropolitan statistical area (MSA), though this has not prevented enrollment declines;
- Strong incomes and nearly extremely strong market value per capita that suggest the rating could be higher but for the weak financial position; and
- Management debt burden with moderate overall net debt burden with rapid amortization.

Environmental, social, and governance factors

Our rating incorporates our view of the COVID-19 pandemic, which is a social risk affecting all sector peers. Absent the implications of the pandemic, we have analyzed the district's environmental, social, and governance (ESG) factors and have concluded that all are in line with sector peers.

Stable Outlook

Downside scenario

If the district is unable to continue to rebuild its reserves and returns to structural imbalance, we could lower the underlying rating. However, we do not expect to change the rating within the two-year outlook timeframe.

Upside scenario

A higher underlying rating would most likely be predicated on the district's enrollment stabilizing and reserves being at a level more commensurate with those of higher-rated peers. Additionally, the formalization, and adherence to, policies and practices is necessary for upward rating movement.

Credit Opinion

Favorable location adjacent to Minneapolis with strong incomes

The district is in northwestern Hennepin County and encompasses all or parts of Robbinsdale and some surrounding communities.

Economic market value grew an average annual rate of about 8% between 2015-2016 and 2019-2020, reflecting a strong local housing market, along with some new multiresidential development. The mostly residential tax base will likely continue to grow into the near future as property values increase at a faster rate than the area population.

Weak financial position that showed some improvement due to new revenue sources

The state's basic general education revenue funding, which is determined by pupil count, is the primary source of operating revenue for Minnesota school districts. As a result, increases or decreases in enrollment can lead to corresponding movements in revenue. The district is mostly state aid funded (72%), and property taxes (21%) are the next-largest revenue source.

Despite its favorable location, the district's enrollment is declining. Between 2016-2017 and 2020-2021, it lost 709 students, or 5.8%. Enrollment in the most recent year declined more than expected likely due to the COVID-19 pandemic. Management expects some of these students to return in the near term. Over the long term, management is projecting stable-to-slight declines. We note that historical drops in enrollment have not been addressed with corresponding expenditure adjustments.

Cash-flow borrowing is currently not required given that the total general fund balance is positive and the district has available cash for liquidity outside the general fund. Should the state hold back funding, liquidity could be pressured.

We understand past deficits were due primarily to declining enrollment and lower-than-anticipated special education funding, coupled with some cost pressures stemming from contract negotiations. For fiscal 2019, the district faced a budget gap of $10 million and made cuts to curriculum, technology, classroom support staff, and supplies, all of which contributed to an adopted balanced budget. However, negative variances persisted and expenditures exceeded revenues before transfers. The district made a one-time transfer of $4.75 million from its other postemployment benefit (OPEB) trust for catch-up expenditures over the past decade. After the transfer, the fiscal 2019 audit included a $1.075 million addition to reserves--its first in four years.

Voters approved (by over 60%) a 10-year, $6.7 million operating levy that will grow with inflation. With the new operating revenue, the fiscal 2020 budget included a $1 million surplus with a $1.3 million contingency. The audit is not yet complete; however, early estimates indicate the surplus was realized but some of the contingency may be used for food service-related expenditures.

For fiscal 2021, the budget is similar to fiscal 2020--with a $1 million surplus and a $1.3 million contingency. Enrollment-based revenues are likely to be short given the negative enrollment variance. Management indicates that this shortfall could be covered by CARES Act revenue. We also recognize that given the thin available reserves, there is little room for unfavorable variances.

Relatively new financial management that has implemented necessary adjustments, but with a vulnerable FMA and no adherence to its fund balance policy

The current finance director started in July 2018 and has begun to turn around a depleting financial position.

The district uses at least three years of historical trends, internal and external sources, and line-by-line budgeting when preparing its budget each year. However, in our view, unfavorable budget-to-actual variances and inaccurate projections are common. Management has not provided a long-term plan, but the district maintains a 10-year long-term facilities maintenance plan that is tied to a state funding source and that it is required to update annually. It has a formal investment policy, though it does not report investment holdings to the board during the year. The district also has a formal fund balance policy to maintain a minimum unassigned general fund balance of 6.5% of annual expenditures, though it has fallen out of compliance with its policy. The school board does not receive regular budget-to-actual reports during the year, and the district lacks a formal debt management policy.

Moderate overall debt burden including the 2020 issues

Overall net debt is $3,579 per capita, which we consider moderate. With 80% of the district's direct debt scheduled to be retired within 10 years, amortization is rapid.

The district has no formalized additional debt plans this year. Additional facility maintenance bonds are likely to be issued annually. Management indicates it has no direct-purchase or private-placement debt obligations.

Manageable pension costs, despite potential for future cost acceleration

- We do not believe that pension and OPEB liabilities represent a medium-term credit pressure given that contributions are only a modest share of the budget, though pension plan actuarial assumptions and methods and plan funding practices introduce long-term risk of cost acceleration.
- The district participates in two multiple-employer, defined-benefit pension plans that cover teachers and general employees. Both plans have recently improved their funded status, though plan statutory contributions have regularly fallen short of actuarial recommendations. Along with certain plan-specific actuarial assumptions and methods, this introduces some long-term risk of funding volatility and cost acceleration.
- The district's single-employer OPEB plan provides health and dental insurance to eligible employees and their spouses. It pays for all OPEB costs on a pay-as-you go-basis. We expect that medium-term costs will remain only a small share of total spending and, therefore, not a significant budgetary pressure.

The district participates in the following pension and OPEB plans:

- Teachers' Retirement Association of Minnesota (TRA): 78.2% funded (as of June 30, 2019), with a district proportionate share of the plan's net pension liability (NPL) of $90 million
- Minnesota General Employees Retirement Fund (GERF): 80.2% funded (as of June 30, 2019), with a district proportionate share of the plan's NPL of $24 million
- A single-employer, defined-benefit OPEB plan: 181.5% funded, with a net OPEB asset of $6.325 million. The district issued OPEB bonds in 2009 (which were refunded with the series 2018B bonds).

The district's combined pension contributions were 3.6% of governmental fund expenditures in fiscal 2019. Plan-level contributions to GERF were in excess of our static funding metric in the most recent year, though TRA contributions were not, and both fell well short of minimum funding progress. Annual contributions are based on a statutory formula that has typically produced contributions less than the actuarially determined contribution, which we think increases risk of underfunding over time if future funding shortfalls are not met with offsetting adjustments by the state legislature. The plans' 7.5% investment rate of return assumption introduces substantial market risk and exceeds our 6.0% guidance, and their use of a lengthy 30-year amortization period based on a level-percentage of payroll significantly defers contributions into the future, which creates long-term risk of cost acceleration. Still, costs remain only a modest share of total spending and, we think, are unlikely to pressure the district's medium-term operational health.

Hennepin County Independent School District No. 281 (Robbinsdale Area Schools), MN -- Financial And Operating Statistics

	Characterization	Most recent	Historical information		
			2019	2018	2017
Economic indicators					
Population			105,410	104,284	103,908
Median household EBI % of U.S.	Good		110	112	109
Per capita EBI % of U.S.	Strong		113	112	113
MV per capita ($)	Very strong	98,846	98,846	92,301	86,814
Top 10 taxpayers as % of AV	Very diverse	4.2	3.9	4.0	4.2
Financial indicators					
Total adjusted available fund balance ($000)			796	(1,319)	8,836
Total adjusted available fund balance as % of operating expenditures	Adequate		0.5	(0.8)	5.2
Governmental funds cash as % of governmental fund expenditures			16.7	20.7	19.7
General fund operating result as % of general fund operating expenditures			0.6	(4.9)	(2.7)
FMA	Vulnerable				
Enrollment		11,616	12,280	12,011	12,325
Debt and long-term liabilities					
Overall net debt as % of MV	Moderate	3.6	3.6	3.9	3.1
DS as % of governmental funds expenditures	Moderate		10.6	10.2	10.2
Required pension contribution ($000)			8,304	8,114	7,956
OPEB contribution ($000)			0	0	0
Required pension plus OPEB contribution as % of governmental fund expenditures			3.6	3.5	3.1

EBI--Effective buying income. MV--Market value. AV--Assessed value. FMA--Financial Management Assessment. DS--Debt service. 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
- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020

Ratings Detail (As Of October 13, 2020)		
Hennepin Cnty Indpt Sch Dist No 281 Robbinsdale Area Schs GO cap facs bnds ser 2016A dtd 03/10/2016 due 02/01/2031		
Long Term Rating	AAA/Negative	Affirmed
Underlying Rating for Credit Program	A-/Stable	Affirmed
Hennepin Cnty Indpt Sch Dist No 281 Robbinsdale Area Schs GO facs maintenance bnds (Minnesota School District Credit Enhancement Prog)		
Long Term Rating	AAA/Negative	Affirmed
Underlying Rating for Credit Program	A-/Stable	Affirmed
Hennepin Cnty Indpt Sch Dist No 281 Robbinsdale Area Schs GO taxable OPEB rfdg bnds ser 2018B due 02/01/2025		
Long Term Rating	AAA/Negative	Affirmed
Underlying Rating for Credit Program	A-/Stable	Affirmed
Hennepin Cnty Indpt Sch Dist #281 (Robbinsdale Area Schs) GO State Credit Enhancement		
Long Term Rating	AAA/Negative	Affirmed
Underlying Rating for Credit Program	A-/Stable	Affirmed