S&P Global Ratings

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Summary:

Dexter Community Schools, Michigan; School State Program

Primary Credit Analyst:
Matthew T Martin, New York + 1 (212) 438 8227; Matthew.Martin@spglobal.com

Secondary Contact:
Jennifer Boyd, Chicago + 1 (312) 233 7040; jennifer.boyd@spglobal.com

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Credit Profile		
US$15.555 mil rfdg bnds (unltd tax GO) (taxable) ser 2021 due 11/01/2026		
Long Term Rating	AA/Negative	New
Underlying Rating for Credit Program	AA-/Stable	New
Dexter Comnty Schs GO State Credit Enhancement		
Long Term Rating	AA/Negative	Affirmed
Underlying Rating for Credit Program	AA-/Stable	Affirmed
Dexter Comnty Schs GO State Credit Enhancement (AGM)		
Unenhanced Rating	AA(SPUR)/Negative	Affirmed
Underlying Rating for Credit Program	AA-/Stable	Affirmed

Many issues are enhanced by bond insurance.

Rating Action

S&P Global Ratings assigned its 'AA' state-enhanced long-term rating and 'AA-' underlying rating to Dexter Community Schools, Mich.'s approximately $15.555 million series 2021 unlimited-tax general obligation refunding bonds. At the same time, S&P Global Ratings affirmed its 'AA-' underlying rating on the district's existing GO debt. The outlook on the underlying rating is stable and the outlook on the state-enhanced long-term rating is negative.

The district's full-faith-and-credit pledge and power to levy unlimited ad valorem taxes against all taxable property within its boundaries secure the bonds. Officials intend to refund borrowings under the School Loan Revolving Fund (SLRF) Program for interest-cost savings.

The 'AA' long-term rating reflects our view of the bond's participation in the Michigan State School Bond Qualification and Loan Program. Section 16 of Article 9 of the Michigan Constitution of 1963 created the program to provide districts access to funds to meet principal and interest payments on qualified bonds. Under the program, if a school district cannot meet debt service, it may borrow from the state's SLRF. In addition, under the program, the state treasurer can pay required debt service if notified of a deficiency by a paying agent for qualified bonds. If the balance in the state's loan fund is insufficient to cover obligations, the state is required to use its full-faith-and-credit pledge to make funds available. We rate bonds in this program on par with the state GO rating. The negative outlook on the state-enhanced rating reflects that of Michigan and moves in tandem with that of the state.

Credit overview

The 'AA-' underlying rating reflects our view of the district's:

- Access to a diverse employment base and the Ann Arbor, Mich. economic area;
- Extremely strong market value per capita and very strong income levels;

- Good management under our Financial Management Assessment (FMA) framework; and
- Very strong general fund reserves, including committed portions which can be made available, that are expected to grow in fiscal 2021.

We believe the district's relatively high fixed-cost profile offsets these strengths. Future issues may exacerbate the district's debt profile. In addition, stabilization in enrollment trends are key as the district has a high reliance on state aid revenue to fund operations.

Environmental, social, and governance factors

As the state provides the enhancement for the program rating, we view the environmental, social, and governance factors applicable to the enhancement rating as consistent with those of the State of Michigan. Absent the implications of COVID-19, we consider the school district's social risks to be in line with those of the sector. We also view the school district's governance and environmental risks as in line with those of the sector. The district's geographic location does not leave it overexposed to extreme weather or long-term climate changes.

Stable Outlook

Downside scenario

Factoring in the district's high fixed cost profile, if enrollment decreases were to pressure operations, and the district cannot maintain reserves at levels we consider very strong and commensurate with similar-rated peers, we could lower the rating.

Upside scenario

If the district is able to continue positive budget performance while maintaining reserves at a level commensurate with that of peers at a higher rating level, coupled with stabilized enrollment and a material moderation in its fixed cost profile, we could raise the rating, all else being equal.

Credit Opinion

Economy

Dexter Community Schools serves an estimated population of 21,673. At 162% and 156% of national averages, respectively, the district's median household and per capita effective buying income are very strong, in our view. Market value totaled $3.7 billion, which we consider extremely strong at $170,763 per capita, measured for 2021. Taxable value has grown by a total of 15% since 2018 to $1.5 billion in 2021. Roughly 6.7% of taxable value comes from the 10 largest taxpayers, representing a very diverse tax base, in our opinion.

The district is about 10 miles northwest of Ann Arbor, primarily in Washtenaw County. Residents benefit from the district's access to the Ann Arbor metropolitan area. Significant Washtenaw County employers include the University of Michigan and its medical center, which, in our view, lend stability to the local economy. Unemployment in the county averaged 2.9% in 2019, below the state and national averages. At the onset of the COVID-19 pandemic, Washtenaw County saw its unemployment rate spike to 14.8% in April 2020 before moderating significantly to 3.6% as of December 2020. In terms of the ongoing pandemic, management reports that residential development continues to remain strong as the district's boundaries include a significant amount of farmland that could facilitate further development. From an economic standpoint, the broader impacts of COVID-19 have been relatively minimal aside from service sector shutdowns similar to those seen throughout the nation, and that is illustrated by the significant moderation in the unemployment rate over the course of 2020.

Finances

The district's financial operations are strong, with consistently positive results over the last five fiscal years that continue to bolster its already very strong reserves. State aid funding, determined by enrollment, is the primary operating revenue source for most Michigan school districts. Therefore, increases or decreases in enrollment can lead to corresponding increases or decreases in revenue. In fiscal 2020, state aid accounted for approximately 69% of general fund revenue, with property taxes making up an additional 11.4%. The district offers its services across three elementary, two middle/intermediate, and two high schools with several other school facilities to accent programming or activities. In school year 2020-2021, student enrollment across the district totaled 3,388, a decrease of 6.6% over the prior year; management attributes the notable decrease in enrollment this year to pandemic-related factors. Historically, enrollment has fluctuated somewhat but has largely held stable. Officials expect a return to growth to, at least, its typical headcount range based on historical rates as well as the superintendent being heavily involved in community outreach in order to ascertain parent and student sentiment.

The district has operated with positive general fund performance for five straight fiscal years, increasing the size of said surpluses each year from fiscal 2016's 0.1% to the latest fiscal 2020 surplus of 4.7% of expenditures. As of fiscal year-end 2020, the district's reserves have grown to approximately $9.8 million, including committed amounts (set aside for instructional materials, technology, and facilities) that can be made available, or a very strong 23.5% of expenditures. Management notes that the district received some one-time revenues of approximately $1.9 million related to a liability it had been maintaining on its balance sheet which was released and received in fiscal 2020; that said, given the state mandate to continue paying all employees in addition to negative variance given pandemic-related expenditures, the district essentially posted a breakeven budget year that was aided by the one-time receipt of released revenues.

The district's finances are stable, in our view, moving forward through fiscal 2021 given recent surpluses and significant committed general fund reserves. The fiscal 2021 adopted budget totals $45.4 million with a slight draw on reserves of approximately $76,000. The district typically budgets conservatively, and therefore actual results tend to show positive variances relative to the budget in the range of $500,000 to $900,000. Officials project outperforming the budget on the strength of overall positive variances, which we view as a reasonable assumption given historical results as well as an anticipated, unbudgeted estimation of $800,000 as part of the latest stimulus relief package. Altogether management anticipates an operating surplus of approximately $1 million come year end fiscal 2021. We understand that the district has no plans to spend down reserves and, despite the fluid nature of the ongoing pandemic, anticipate that the total available fund balance will remain very strong.

Management

We consider Dexter Community Schools' financial management practices good under our Financial Management Assessment (FMA) methodology, indicating our view that practices exist in most areas, although not all may be formalized or regularly monitored by governance officials.

The FMA was revised to good from standard as a result of our understanding that the district has a formal fund balance policy to maintain an unassigned general fund balance of 3% to 5% of expenditures, which it is meeting. Officials refer to historical data in setting the budget, and use an outside consultant for enrollment projections. The school board receives monthly budget-to-actual updates and annual investment reports. Officials maintain a long-range financial plan that goes out three years beyond the budget year, and update it annually. The district completed a facilities study in connection with prior bond issuance, which includes estimated costs for maintenance and repair needs. The district has its own investment policy but does not have a debt management policy.

Debt

We consider overall net debt moderate to high at 4.1% of market value and $7,068 per capita, respectively. Amortization is fairly rapid, with 68% of the district's direct debt scheduled to be retired within 10 years. The debt service carrying charge was 20.1% of total governmental fund expenditures excluding capital outlay in fiscal 2020, which we consider elevated.

We understand the district plans to issue approximately $17.7 million of voter-authorized debt in the 2022-2023 timeframe but otherwise has no additional debt plans. Neither does the district have alternative financings such as variable-rate or direct purchase debt.

Pension and other postemployment benefit (OPEB) liabilities

Pension and OPEB costs are a source of credit pressure for Dexter Community Schools, as the district's plans are poorly funded and annual costs already represent an above-average portion of total spending, although a portion of contributions are reimbursed by the state.

The school district's costs related to OPEB will likely escalate but, given the size of the liability relative to budget, we expect costs to remain affordable.

The district participates in the following plans:

- Michigan Public School Employees' Retirement System (MPSERS): 60.1% funded, with a proportionate share of the plan's net pension liability of $88.5 million.
- MPSERS OPEB: 48.7% funded, with a proportionate share of the plan's net OPEB liability of $19.0 million.

Combined pension and OPEB carrying charges totaled $9.2 million, or 13.9% of total governmental fund expenditures, in 2020.

The plan made funding progress in the most recent year, with contributions in excess of static funding, but less than our minimum funding progress metric. There is an actuarial plan in place to reach full funding, and contributions are expected to increase by approximately 2.75% each year as a result of the level-percent-of-pay amortization basis. The plan is scheduled to be fully funded within 21 years. Considering the discount rate of 6.80%, we see a risk of budgetary stress in response to market volatility, as well as cost deferrals resulting from a static mortality assumption and the requirement to maintain payroll growth.

Related Research

Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020