

RatingsDirect®

Summary:

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

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Credit Profile

US\$18.125 mil GO facs maint bnds ser 2024A due 02/01/2045

<i>Long Term Rating</i>	AAA/Stable	New
<i>Underlying Rating for Credit Program</i>	BBB/Negative	New
Hennepin Cnty Indpt Sch Dist #281 (Robbinsdale Area Schs) GO State Credit Enhancement		
<i>Long Term Rating</i>	AAA/Stable	Current
<i>Underlying Rating for Credit Program</i>	BBB/Negative	Downgraded

Credit Highlights

- S&P Global Ratings lowered its underlying rating to 'BBB' from 'A-' on Hennepin County Independent School District No. 281 (Robbinsdale Area Schools), Minn.'s existing general obligation (GO) debt.
- The outlook on the underlying rating is negative.
- At the same time, S&P Global Ratings assigned its 'AAA' long-term rating (based on credit enhancement), with a stable outlook, and its 'BBB' underlying rating, with a negative outlook, to the district's anticipated \$18.125 million series 2024A GO facilities maintenance bonds, based on the application of its "Methodology For Rating U.S. Governments," published Sept. 9, 2024, on RatingsDirect.
- The rating downgrade and negative outlook reflect our view of the district's rapid financial deterioration. The district's recent and projected financial performance, which is much weaker than previous district estimates, stems in part from weak financial management practices and governance as well as inadequate controls over financial reporting. We expect the significant use of reserves in fiscal years 2023 and 2024 will weaken the district's available general fund balance to a negative level and reduce its cash position. Another sizable deficit is projected for fiscal 2025 that, if realized, would further deplete the district's reserves and introduce liquidity risk in our view.

Security

The district's full faith and credit unlimited ad valorem tax GO pledge secures the series 2024A bonds. Bond proceeds will finance deferred maintenance projects identified in the district's 10-year long-term facilities maintenance plan.

Credit overview

The underlying rating incorporates our forward-looking view of the district's quickly deteriorating financial performance that is expected to weaken its available fund balance to negative levels in fiscal years 2024 and 2025 and deplete its cash position. In our opinion, the district's financial management has weakened considerably, with budget planning and monitoring practices that have not been sufficient to support fiscal balance, and weak internal control and governance oversight that could exacerbate its financial uncertainty. We believe the district's healthy economic

indicators and manageable debt burden support its general creditworthiness.

Following a period of positive financial performance, the district posted an unexpected \$2.2 million deficit (equal to -1.7% of revenues, draft audit) in fiscal 2023. It underperformed the budgeted \$1.2 million surplus due to lower-than-expected special education revenues and higher transportation and capital costs.

Subsequently, the district settled a new labor contract that involves significant salary increases over fiscal years 2024 and 2025 (including salary increases of 8.25% for cabinet-level management, 12.8% for principals, 20.8% for teachers, and 20.3% for assistants) without consideration for structural balance, in our view. Driven by the compensation cost increases, management anticipates a \$11 million general fund deficit (or -5.5% of budgeted revenues) in fiscal 2024 compared to the \$795,000 surplus originally budgeted. The large deficit is projected to reduce available reserves to negative \$3.1 million, and the weak reserve level could be exacerbated by a similar sizable deficit projected for fiscal 2025. We attribute the recent history and projections of deteriorating operations to unrealistic budgeting assumptions and lack of structural adjustments over the course of the year.

Despite management's expectation of increased state aid in fiscal years 2024 and 2025, we'll monitor whether the increased revenue is sufficient to offset the district's ongoing enrollment declines (15% since fiscal 2019 and 7% projected through fiscal 2030). The district welcomed its new superintendent in May 2024 and its new chief financial officer in August 2024. We'll monitor how the management team transitions the district's financial performance as it settles in. We believe further material deterioration in operations and reserves could pressure the rating.

In fiscal 2023, the district's auditor issued material weakness and significant deficiency findings on internal control, as reflected in its failure to comply with state and federal deadlines for the submission of audited financial data and annual financial statements. We also note that following recent complaints filed by several board members against each other, an external investigation of the district board found six of the seven members responsible for violating its values and norms agreement. We believe if these findings are not addressed in a timely manner, they could have long-lasting negative financial and operational implications for the district.

The rating and outlook further reflect the following:

- The district's favorable location in the broad and diverse Minneapolis-St. Paul (Twin Cities) metropolitan statistical area has resulted in robust county-level economic metrics.
- Negative operations in fiscal 2023 and a sizable deficit projected for fiscal 2024 led to rapid deterioration in available reserves to an anticipated negative level in fiscal 2024. The reserves remain low compared with those of peers and below the district's formal 6.5% fund balance policy.
- Weak financial management practices reflect unrealistic budgeting assumptions, untimely budgetary adjustments, and minimal board oversight in our view.
- The debt burden is manageable, with no debt plans in the next couple of years. Furthermore, we do not view pension benefits to be a credit pressure given the low contributions relative to budget.
- For more information on our institutional framework assessment for Minnesota school districts, see "Institutional Framework Assessment: Minnesota Local Governments," published Sept. 10, 2024.

Environmental, social, and governance

We view the district's transparency and reporting, governance structure, and risk management, culture, and oversight risks as negative given the delay in filing the fiscal 2023 audit and the external findings on board. Management has put together a corrective action plan, and we will monitor the progress during the outlook period. We also view the district's social capital risk as moderately negative given that the district's declining enrollment has led to budgetary imbalance that has pressured general fund operations and available reserves. We view environmental factors as neutral in our credit rating analysis.

Outlook

The negative outlook reflects the at least one-in-three chance we could lower the underlying rating over the outlook horizon if a large deficit materializes, as currently projected for fiscal 2025, with no sustainable structural adjustment plan to close future budget gaps and replenish available reserves.

Downside scenario

We could lower the rating if there is continued budgetary imbalance caused by rising expenditures, decreasing enrollment, or lower-than-budgeted state funding, leading to further available reserve declines.

Upside scenario

We could revise the outlook to stable if the district's fiscal 2025 results are significantly better than projected and if there is a clear path to restore structural balance and improve the available fund balance.

Credit Opinion

Economy

The district is in northwestern Hennepin County and encompasses all or parts of Robbinsdale and some surrounding communities. Although the district is mostly built out, its economic market value has grown at an average annual rate of about 9% over the past five years to \$15.1 billion in 2024, reflecting a strong local housing market, along with some new multifamily development. However, the net tax capacity is estimated to decrease slightly in 2025 due to a change in law that has increased the homestead market value exclusion. Benefitting from the diverse economy and access to job opportunities, the district has robust per capita gross county product and county-level per capita personal income, although its local income levels are weaker than the county's.

Financial performance, reserves, and liquidity

Beginning in fiscal 2019, the district reported four operating surpluses, aided by two voter-approved operating levies that grow annually with inflation. The two levies, which were approved in 2014 and 2019 and expire in 2026 and 2029, respectively, generated a total of \$21.6 million in operating revenue in fiscal 2023. In addition, the district was allotted a total of \$40.5 million in federal ESSER funding, of which \$18 million was spent in fiscal 2023, and the remaining \$4.5 million was spent in fiscal 2024. ESSER funds were used to fund temporary staffing, new technology, curriculum, and other one-time pandemic-related expenses.

However, in fiscal 2023, the district posted a \$2.2 million deficit (or -1.7% of revenues), which underperformed the

budgeted \$1.2 million surplus, due to lower-than-expected special education revenues and higher transportation and capital costs.

After fiscal year-end 2023, the district settled a new labor contract that involves significant salary increases over fiscal years 2024 and 2025, which led to a projected \$11 million deficit (or -5.5% of budgeted revenues) in fiscal 2024. The large deficit is projected to lower available reserve to negative \$3.1 million. For fiscal 2025, management currently projects another large deficit similar to fiscal 2024's, which could reduce the unassigned general fund balance to negative \$14 million to negative \$18 million if no further budgetary adjustments were made during the fiscal year.

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. The district is mostly state-aid funded (62%), followed by property taxes (23%), based on the fiscal 2023 draft audit. Despite its favorable location, the district's enrollment has declined, which has pressured the general fund performance because enrollment losses had not been addressed with corresponding expenditure adjustments in our view.

Management

We believe the district's budgeting and financial planning practices and policies are insufficiently robust to ensure expenditure control and support long-term fiscal balance. Also, we view the recent management turnover during financial instability, the contentious board relationship, and the investigation and its related findings of the board negatively. With the new superintendent and CFO who joined this year and three board members up for re-election, we'll monitor the ongoing effectiveness of management and governance in transitioning the district's financial performance.

Management uses at least three years of historical trends, internal and external sources, and line-by-line budgeting when preparing the annual budget. It does monthly budget-to-actual reporting to the school board beginning in fiscal 2023 and at least one annual revision to the budget. The district has a 10-year long-term facilities maintenance plan that is updated annually, but lacks long-term financial planning and formal debt policy. It maintains formal investment and fund balance policies but has not complied with the target of a minimum unassigned general fund balance of 6.5% of annual expenditures in recent years.

Debt and liabilities

Robbinsdale Area Schools has a moderate debt burden, with per capita net direct debt and debt service carrying charge comparable with peers'. It doesn't plan to issue additional debt in the next couple of years. We do not believe that pension and other postemployment benefits (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 allows retirees to remain on its health insurance plan and pay active premium rates, reflected as an implicit subsidy liability.

Robbinsdale Area Schools participates in the following pension and OPEB plans:

- Teachers' Retirement Association of Minnesota: 76.4% funded, with the district proportionate share of the plan's net pension liability (NPL) of \$114.2 million as of June 30, 2023.
- Minnesota General Employees Retirement Fund: 83.1% funded, with the district proportionate share of the plan's

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NPL of \$21.4 million as of June 30, 2023.

- The district's OPEB trust, with a net OPEB asset of \$5.9 million as of June 30, 2022.

Minnesota State Standing Appropriation Program

The 'AAA' long-term rating reflects our view of the additional security provided by the district's eligibility for, and participation in, the Minnesota State Standing Appropriation 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 the district's behalf from the state's general fund if the district fails to meet debt service obligations for the qualified debt. Payments from the state represent a standing appropriation from Minnesota's general fund. We view this standing appropriation pledge as equivalent to a general fund pledge because it 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. In addition, the credit enhancement program supports projects that are central to Minnesota's operations and purpose. We see no unusual political, timing, or administrative risk related to the debt payment. The credit enhancement program rating reflects that on Minnesota and moves in tandem with the state GO rating and outlook.

Table 1

Hennepin County Independent School District No. 281 (Robbinsdale Area Schools), Minnesota--credit summary	
Institutional framework (IF)	2
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Financial performance	6
Reserves and liquidity	6
Debt and liabilities	2.75
Management	5.65

Table 2

Hennepin County Independent School District No. 281 (Robbinsdale Area Schools), Minnesota--key credit metrics				
	Most recent	2023	2022	2021
Economy				
GCP per capita % of U.S.	184	--	184	180
County PCPI % of U.S.	138	--	138	134
Market value (\$000s)	15,095,185	14,642,906	13,109,335	12,178,619
Market value per capita (\$)	144,202	139,881	122,281	114,862
Top 10 taxpayers % of taxable value	3.9	3.9	4.1	4.3
County unemployment rate (%)	2.6	2.6	2.5	3.8
Local median household EBI % of U.S.	105	108	109	112
Local per capita EBI % of U.S.	108	115	115	117
Local population	104,681	104,681	107,207	106,028
Financial performance				
Operating fund revenues (\$000s)	--	192,162	187,209	185,052

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Table 2

Hennepin County Independent School District No. 281 (Robbinsdale Area Schools), Minnesota--key credit metrics (cont.)				
	Most recent	2023	2022	2021
Operating fund expenditures (\$000s)	--	198,349	185,956	174,382
Net transfers and other adjustments (\$000s)	--	3,941	186	186
Operating result (\$000s)	--	(2,246)	1,439	10,856
Operating result % of revenues	--	(1.2)	0.8	5.9
Operating result three-year average %	--	1.8	2.5	2.5
Enrollment	--	10,946.0	11,081.0	11,354.0
Reserves and liquidity				
Available reserves % of operating revenues	--	3.8	4.9	5.1
Available reserves (\$000s)	--	7,380	9,115	9,385
Debt and liabilities				
Debt service cost % of revenues	10.0	10.0	9.9	9.6
Net direct debt per capita (\$)	2,151	1,960	1,862	1,766
Net direct debt (\$000s)	225,209	205,188	199,573	187,239
Direct debt 10-year amortization (%)	68.0	81.0	--	--
Pension and OPEB cost % of revenues	5	5	5	4
Net pension liabilities per capita (\$)	1,295	1,295	1,316	716
Combined net pension liabilities (\$000s)	135,595	135,595	141,085	75,932

GCP--Gross county product. PCPI--Per capita personal income. EBI--Effective buying income. OPEB--Other postemployment benefits.

Related Research

Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022

Ratings Detail (As Of October 17, 2024)		
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/Stable	Current
Underlying Rating for Credit Program	BBB/Negative	Downgraded
Hennepin Cnty Indpt Sch Dist No 281 Robbinsdale Area Schs GO facs maintenance bnds (Minnesota School District Credit Enhancement Prog)		
Long Term Rating	AAA/Stable	Current
Underlying Rating for Credit Program	BBB/Negative	Downgraded
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/Stable	Current
Underlying Rating for Credit Program	BBB/Negative	Downgraded

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