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Boone County School District, KY

Update following assignment of Initial Aa2 Issuer and Aa3 Underlying Ratings

Summary

Boone County School District, KY's sizeable tax base benefits from the presence of the Cincinnati/Northern Kentucky International Airport, which continues to be a driver of economic growth for the region. The district also benefits from above average resident wealth levels and a healthy, albeit slightly below average, reserve and liquidity position supported by prudent fiscal practices. Due to ongoing modest enrollment growth, the district's debt burden is somewhat above average given the need for additional school facilities, but will remain manageable due to future tax base growth and conservative budget management.

On December 14, we assigned an initial long-term issuer rating (implied general obligation rating) of Aa2 as well as an initial underlying rating of Aa3 to the district's School Building Refunding Revenue Bonds, Series 2017B.

Credit strengths

» Sizeable tax base experiencing continued growth

» Above average resident wealth levels

Credit challenges

» Above average debt burden

» Slightly below average reserves and liquidity relative to similarly rated districts

Rating outlook

Outlooks are not typically assigned to local governments with this amount of debt outstanding.

Factors that could lead to an upgrade

» Significant increase in the tax base and socioeconomic indices

» Sustained trend of surpluses resulting in increased reserves and liquidity

Factors that could lead to a downgrade

» Substantial increase in debt burden beyond current projections

» Trend of structural imbalance resulting in deteriorated financial position

» Material contraction in tax base and weakened wealth levels

Key indicators

Exhibit 1

Boone County School District	2013	2014	2015	2016	2017
Economy/Tax Base					
Total Full Value ($000)	$12,527,247	$12,519,676	$12,664,487	$13,179,554	$13,559,010
Population	115,017	117,040	118,619	118,619	118,619
Full Value Per Capita	$108,916	$106,969	$106,766	$111,108	$114,307
Median Family Income (% of US Median)	121.4%	121.1%	119.1%	119.1%	119.1%
Finances					
Operating Revenue ($000)	$172,673	$180,677	$187,690	$196,294	$199,806
Fund Balance ($000)	$25,268	$30,084	$33,810	$34,932	$37,836
Cash Balance ($000)	$24,909	$33,300	$36,129	$32,525	$35,676
Fund Balance as a % of Revenues	14.6%	16.7%	18.0%	17.8%	18.9%
Cash Balance as a % of Revenues	14.4%	18.4%	19.2%	16.6%	17.9%
Debt/Pensions					
Net Direct Debt ($000)	$204,838	$196,612	$184,452	$182,359	$200,813
3-Year Average of Moody's ANPL ($000)	N/A	$116,616	$105,443	$96,564	$91,283
Net Direct Debt / Operating Revenues (x)	1.2x	1.1x	1.0x	0.9x	1.0x
Net Direct Debt / Full Value (%)	1.6%	1.6%	1.5%	1.4%	1.5%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	N/A	0.6x	0.6x	0.5x	0.5x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	N/A	0.9%	0.8%	0.7%	0.7%

Source: Boone CSD KY Audited Financial Statements; Moody's Investors Service

Profile

Boone County School District is located in Northern Kentucky (The Commonwealth of Kentucky, Aa3 stable), across the Ohio River from the City of Cincinnati, OH (Aa2 stable). The district is the third largest in the commonwealth has and estimated enrollment of 18,588 (average daily attendance for the 2016-17 school year).

Detailed credit considerations

Economy and Tax Base: Growing Tax Base Benefitting from the Presence of the Cincinnati/Northern Kentucky International Airport

Boone CSD's sizeable and diverse $13.6 billion tax base is largely based in services, trade, transportation, and manufacturing and will continue to expand in the near term given ongoing development. The district is located along the Ohio River, immediately south of the City of Cincinnati and within the Cincinnati Metropolitan Statistical Area (MSA). The Cincinnati/Northern Kentucky International Airport is a large hub for DHL, a subsidiary of Deutsche Post AG (long-term issuer rating A3 stable), Germany's incumbent provider of mail services and the world's largest logistics service. Over the last five years, the district's total assessed value has grown at an average annual rate of 1.5%. The top ten taxpayers account for just 5.1% of 2017 assessed values.

Notable developments include DHL's recent $108 million expansion, which is expected to create 900 new jobs, and Amazon's (Amazon.com, Inc., Baa1 positive) planned $1.49 billion investment in a new worldwide cargo hub at the airport, which is expected to bring 2,700 jobs to the region. Additionally, Kroger (Kroger Co. (The) Baa1 stable) is developing a $60 million replenishment center that will service the company's direct-to-store distribution centers across the eastern half of the country. The district has also seen continued residential growth, such as the 800 home residential development in Union known as Ballyshannon.

Resident wealth levels are comparable to the national medians for the Aa2 rating category, with a 2015 median family income equivalent to 119.1% of the US according to the most recent American Community Survey. Boone CSD's unemployment rate of 3.5% in October 2017 is favorably below the state (4.3%) and national (3.9%) rates for the period.

Enrollment levels are expected to experience continued growth in the near term. Over the past five years, enrollment has averaged a modest annual growth rate of 0.9%. Enrollment for the 2016-17 school year (average daily attendance) is estimated at 18,588, which represents a 0.8% increase from the prior year.

Financial Operations and Reserves: Healthy Reserve Position Supported By Conservative Budgetary Practices

The district's fiscal performance will remain stable given conservative budgetary practices, despite a planned use of fund balance, demonstrated by the district's history of conservative budgetary management. Fiscal 2017 ended with a with a $2.9 million increase in total general fund balance to $37.8 million, or a healthy 21.3% of general fund revenues, which is comparable to the national medians for the Aa2 rating category. The district has posted consecutive surpluses in the general fund driven by increases in local revenues related to tax base growth, increases in state revenues due to enrollment growth, and conservative expenditure management. Total general fund balance has averaged 19.4% of revenues over the past five years. The district has strategically set aside $6.6 million in the general fund that they plan to use over time to offset future capital costs related to planned new school openings. Management anticipates using approximately $2 million for an elementary school within the next three years. Despite the planned use of reserves for one-time capital projects, the district's reserve and liquidity position will remain adequate.

General fund revenues consist primarily of state aid (51% of 2017 general fund revenues) and property taxes (36%). The district also receives occupational license and utilities taxes, which accounted for 7% and 5% of 2017 revenues, respectively.

LIQUIDITY

Boone CSD's liquidity will also remain healthy given conservative budgeting practices. General fund cash and investments totaled $35.7 million at fiscal year-end 2017 or a healthy 20.1% of revenues, which is comparable to the national medians for the Aa2 rating category. The district has a history of maintaining strong cash levels, averaging operating cash at 19.1% of general fund revenues over the past five years.

Debt and Pensions: Slightly Above Average Debt Burden with Moderate Future Borrowing Plans; Manageable Pension Liabilities

Despite moderate additional borrowing plans over the next several years, the district's debt burden (1.5% of 2017 full value) will remain manageable given future tax base growth. The district's net direct debt burden, while manageable, is slightly elevated compared to the national medians for the Aa2 rating category. Future borrowing plans include the issuance of approximately $18 million in lease revenue bonds in the Spring of 2018 to finance the renovation of an office building that was donated to the district. The debt, along with $6 million in grants from the commonwealth, will transform the office building into a technology center with a robotics lab. The district has also identified a need for a new elementary school within the next three years that will be financed with a combination of fund balance reserves and additional debt issuance.

DEBT STRUCTURE

All of the district's outstanding debt is secured by lease rental payments subject to annual appropriation. The lease revenue debt is fixed rate and amortizes over the long term.

The lease agreement automatically renews for the life of the bonds, unless the board provides written notice of termination 60 days prior to the automatic renewal date (July 1). Debt service payments are made directly to the paying agent no less than 15 days prior to the debt service due date. Additional bondholder security is derived from a leasehold interest in the projects financed with bond proceeds.

DEBT-RELATED DERIVATIVES

The district is not party to derivative agreements.

PENSIONS AND OPEB

The district participates in the Kentucky Teachers' Retirement System (KTRS) and the Kentucky County Employees' Retirement System (CERS) pension plans. Boone CSD's pension burden will remain manageable in the near term despite anticipated contribution rate increases due to the fact that on-behalf payments from the Commonwealth of Kentucky cover the full amount of the district's annual pension costs to KTRS. The district will be able to absorb contribution rate increases to CERS given conservative budgeting practices and expenditure-reduction flexibility.

Boone CSD's annual required contribution to CERS was $4.8 million in fiscal 2017, or a modest 2.42% of fiscal 2017 operating fund revenues. The district's 3-year average adjusted net pension liability, under Moody's methodology for adjusting reported pension data, is $91.3 million, or 0.46 times operating fund revenues, which compares favorably to the national medians for the Aa2 rating category. Moody's uses the adjusted net pension liability to improve comparability of reported pension liabilities. The adjustments are not intended to replace the city's reported liability information, but to improve comparability with other rated entities.

Total fixed costs, including debt service and pension contributions, totaled approximately 14% of 2017 operating fund revenues.

Management and Governance

Boone CSD has strong management as evidenced by conservative budgeting and stable operating reserves and liquidity. While the district does not maintain formal policies surrounding reserve levels, historical trends present a demonstrated ability to manage reserves at sound levels.

Kentucky School Districts have an Institutional Framework score of A, which is moderate compared to the nation. Institutional Framework scores measure a sector's legal ability to increase revenues and decrease expenditures. The sector's major revenue sources are subject to a cap which can be overriden with voter approval only. However, the cap of 4% still allows for moderate revenue-raising ability. Unpredictable revenue fluctuations tend to be minor, or under 5% annually. Across the sector, fixed and mandated costs are generally greater than 25% of expenditures. Kentucky is a Right to Work state, providing significant expenditure-cutting ability. Unpredictable expenditure fluctuations tend to be moderate, between 5-10% annually.

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