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CREDIT OPINION
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Richmond Community Schools, MI

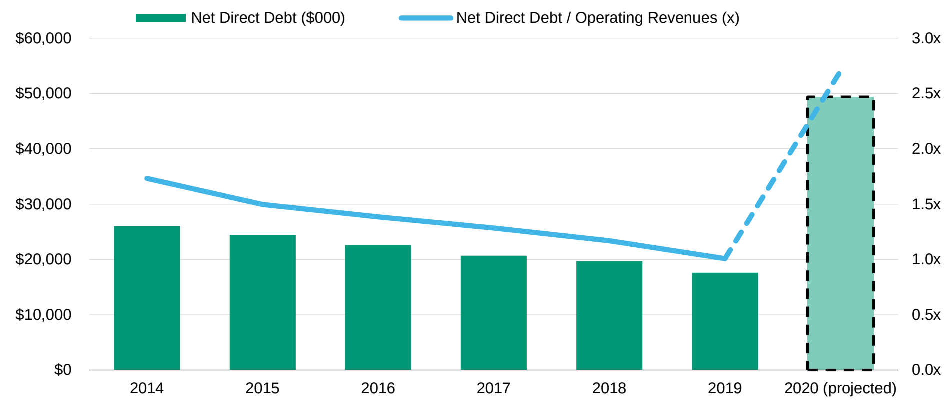
Update to credit analysis

Summary

Richmond Community Schools, MI's (A3) credit profile is characterized by elevated leverage, an improved but below average financial position and a modestly sized tax base with strong wealth and income levels. Both the debt and pension burdens are high because of a significant issuance planned for February 2020 and participation in an underfunded state cost-sharing plan (see Exhibit 1). The district's reserves have stabilized but are still below similarly rated peers and remain narrow on a nominal basis. While the district's tax base has grown steadily over the past seven years, enrollment has declined, but recent trends and residential development point to future growth.

Exhibit 1

Following several years of moderation the district's debt burden will more than double in fiscal 2020



Source: Richmond Community Schools audited financial statements and offering documents

Credit strengths

» Rebounding tax base valuation

» Steady growth in reserves and liquidity

Credit challenges

» Limited revenue raising flexibility and historic enrollment declines

» Narrow operating fund balance and liquidity

» Elevated debt burden and exposure to an underfunded state cost-sharing pension plan

Rating outlook
Outlooks are usually not assigned to local governments with this amount of debt.

Factors that could lead to an upgrade

» Enrollment gains that support substantial revenue growth

» Improved fund balance and liquidity

» Moderated debt and pension burdens

Factors that could lead to a downgrade

» Continued enrollment declines that limit revenue growth

» Further narrowing of fund balance or liquidity

» Additional material growth in the district's debt or pension burdens

Key indicators

Exhibit 2

Richmond Community Schools, MI	2015	2016	2017	2018	2019
Economy/Tax Base					
Total Full Value ($000)	$1,123,565	$1,190,217	$1,261,476	$1,305,565	$1,381,878
Population	12,360	12,714	12,817	12,817	12,817
Full Value Per Capita	$90,903	$93,615	$98,422	$101,862	$107,816
Median Family Income (% of US Median)	105.1%	108.1%	108.8%	108.8%	108.8%
Finances					
Operating Revenue ($000)	$16,313	$16,307	$16,151	$16,858	$17,480
Fund Balance ($000)	$1,295	$1,241	$949	$1,113	$1,207
Cash Balance ($000)	$534	$877	$287	$623	$644
Fund Balance as a % of Revenues	7.9%	7.6%	5.9%	6.6%	6.9%
Cash Balance as a % of Revenues	3.3%	5.4%	1.8%	3.7%	3.7%
Debt/Pensions					
Net Direct Debt ($000)[1]	$24,425	$22,585	$20,710	$19,690	$17,605
3-Year Average of Moody's ANPL ($000)	$41,759	$42,524	$45,304	$47,307	$48,934
Net Direct Debt / Full Value (%)	2.2%	1.9%	1.6%	1.5%	1.3%
Net Direct Debt / Operating Revenues (x)	1.5x	1.4x	1.3x	1.2x	1.0x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	3.7%	3.6%	3.6%	3.6%	3.5%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	2.6x	2.6x	2.8x	2.8x	2.8x

[1] Following a planned issuance in February, the net debt burden will grow to $51.7 million, equivalent to 3.7% of full value and 3x operating revenue.
Sources: Richmond Community Schools audited financial statements, US Census Bureau, Moody's Investors Service

Profile
Richmond Community Schools is approximately 40 miles north of Detroit (Ba3 stable), encompassing 71 square miles in northeast Macomb County (Aa1 stable) and southwest St. Clair County (Aa2). The district provides prekindergarten through twelfth grade education to residents of the City of Richmond and four surrounding townships. The district's fall enrollment count was 1,466.

Detailed credit considerations

Economy and tax base: rebounding, rural tax base north of Detroit

We expect Richmond's tax base and economy will remain stable given renewed valuation growth and moderation of area unemployment. Currently valued at $1.4 billion, the district's tax base grew at a compound annual rate of 5.5% since reaching a low of $952 million in 2012. Taxpayer concentration is moderate with the top 10 taxpayers accounting for 15.4% of 2019 taxable value. Six of the top 10 taxpayers are either utilities or pipelines.

The broader employment base remains heavily tied to the auto industry and many residents commute to auto and auto parts manufacturing jobs in the northern Detroit metro area. While the industry stabilized in recent years, long-term economic challenges negatively impacted income and unemployment metrics in the district. After reaching a high of 15.7% in 2009 that was well above the national rate of 9.3%, the Macomb County unemployment rate has dropped to 3.3% as of November 2019 and is equivalent to the national rate. Although the district's most recent estimate for median family income remains sound at 108.8% of the US median, it has fallen from an estimated 130.7% in 2000. Additionally, the population demographics, while still skewing older than the national averages, are getting younger. The median age has declined to 41 years in 2017 from 44 years in 2013 while the number of residents under 18 grew.

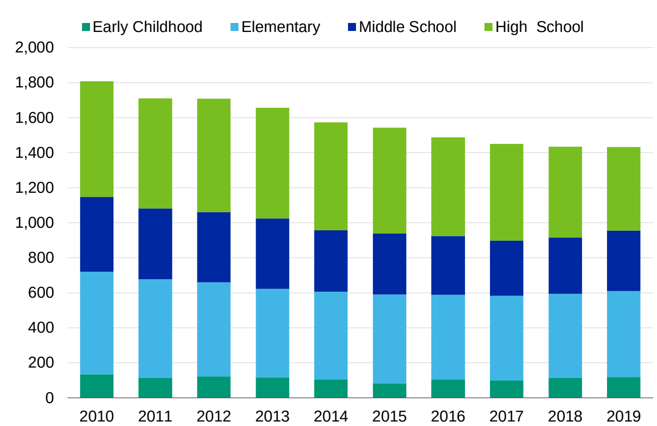
Financial operations and reserves: stable but narrow financial position

The district's reserves will remain stable and limited on a nominal basis. The district has closed each of the last three years with approximately $800,000 in available general fund balance, representing around 6% of general fund revenue. The fiscal 2020 budget projects a modest operating deficit in the general fund, although management expects positive variance that will yield balanced operations. The positive variance will come from reduced expenditures because fewer students are attending outside programs than was initially projected for this fiscal year.

Enrollment is the single largest factor in the state's funding formula for school districts. The district's fall enrollment has declined to 1,466 in 2019 from 1,710 in 2011. This decline pressured finances and necessitated expenditure cuts in previous years, but through effective budgeting the district has maintained balanced operations for the past several years. Despite long term enrollment declines, incoming kindergarten classes have trended upward since 2015 which limited recent overall declines and drives projections of enrollment increases over the next several years (see Exhibit 3). Residential housing demand and development in the district further supports these projections. The district has net losses in open enrollment, although those losses have also softened through a combination of fewer students enrolling out through schools of choice, more students enrolling in and fewer students enrolling in private or charter schools. Future enrollment growth would directly lead to increased revenue, barring major cuts in per pupil state aid foundation amounts.

Exhibit 3

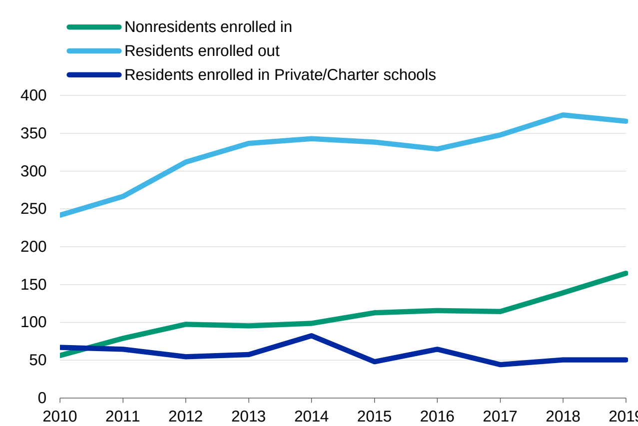
After long term enrollment declines, incoming classes are growing and have led to enrollment stabilization



Source: Michigan Department of Education

Exhibit 4

Recent open enrollment trends have been positive, with net increases through schools of choice and fewer students lost to private/charter schools



Source: Michigan Department of Education

LIQUIDITY

The district closed fiscal 2019 with a net operating cash balance of $644,000, inclusive of the general and debt service funds, or a narrow 3.7% of revenue. Many school districts in Michigan with narrow cash balances like Richmond Community Schools borrow for short term liquidity through state aid anticipation notes (SANs). Richmond Community Schools issued $1 million in notes in fiscal 2019 and $1.3 million for the current fiscal year of 2020. Management expects to continue this practice and issue notes for similar amounts in the future.

Debt and pensions: elevated leverage from debt and unfunded retirement liabilities

The district's above average leverage is likely to remain a credit constraint as the district slowly pays off bonded debt and meets minimum contribution requirements to stem growth in retirement liabilities. At the close of fiscal 2019 the district had $17.6 million in general obligation (GO) debt with plans to issue $34 million in February 2020. This issue will bring the district's net debt burden to $51.7 million, equivalent to an above average 3.7% of full value and 3x fiscal 2019 operating revenue.

The district's leverage from pensions and other post employment benefits (OPEB) will remain elevated given the district's history of contributions insufficiently large to decrease liabilities. Our Moody's three-year adjusted net pension liability (ANPL) stands at $48.9 million, representing 3.5% of full value and 2.8x operating revenue, while the district's adjusted net OPEB liability is an additional $10.9 million, equivalent to 0.8% of full value and 0.6x operating revenue.

Since the district's total leverage is high, fixed costs for debt service and pension and other retirement benefits consume an above average proportion of the budget. Total fixed costs for fiscal 2019 were $5.6 million, representing 31.8% of operating revenue (inclusive of general and debt service fund revenue). Debt service and pension contributions were the two largest shares at $2.8 million and $2.2 million, respectively. Following the planned issuance in February, debt service will climb to $4 million in fiscal 2021 and increase by about 3% annually through 2026, after which it descends.

DEBT STRUCTURE

All of the district's debt is fixed rate and long term. The rate of principal repayment is below average with 51.5% scheduled to be retired within 10 years.

DEBT-RELATED DERIVATIVES

The district is not a party in any derivative agreements.

PENSIONS AND OPEB

Retirement costs comprise most fixed costs for Michigan school districts. Growth in retirement costs has historically been a source of operating pressure with statutory contributions for Michigan school districts because the Michigan Public School Employees Retirement System (MPSERS) increased district contributions significantly from 16.5% of payroll in 2009 to approximately 27% of payroll in 2013. It has remained relatively stable since then because the state adopted legislation in 2012 to cap the share of payroll contributed by school districts to MPSERS related to the system's unfunded actuarial accrued liabilities (UAAL) and shifts any increase in costs to the state. However, growth in those costs may result in the state reducing funding for school district operations to pay for pension funding.

As of the plan's most recent 2018 measurement date, total contributions equaled 108% of its tread water payment, indicating that the plan provided sufficient funding to forestall growth to its unfunded liabilities given its actuarial assumptions.[1]

While recent reform legislation has been enacted to slow the growth of accrued liabilities, weak investment returns by MPSERS could be a source of cost growth in the future. Through fiscal 2017, the traditional defined benefit plan discounted its accrued liabilities at 8%. More recently, the plan reduced the assumed rate of return on investments to 7.5% in fiscal 2018 and 7.05% in fiscal 2019. The reduction in the discount rate will have little effect on our calculation of the plan's or district's ANPL, but will nonetheless necessitate growth in contributions to the plan. We view higher contributions as a positive development for funding pensions because they reduce the risk of future contribution growth. However, the higher contribution requirements that follow the changes in the discount rate could add near-term stress to Michigan school district budgets because growth in contributions by the state could negatively impact the amount of general aid it appropriates to districts.

MPSERS also provides OPEB to eligible retirees and beneficiaries. Similar to pensions, legislation requires districts to contribute 100% of the state's required annual contribution amounts.

Management and governance: weak institutional framework

Michigan school districts have an Institutional Framework score of "Baa," which is weak. The primary revenue source is the state per-pupil foundation allowance, which is moderately predictable. The allowance, adopted annually in the state budget, is funded through local property taxes generated by 18-mills, with the state contributing the balance. Districts have a low ability to raise revenue as they cannot individually seek voter approval for millage increases above the 18-mill cap. Expenditure reduction ability is moderate. Many districts have already significantly reduced personnel and negotiated contract concessions. Low expenditure predictability reflects a declining school-age and competition from charter schools.

Management at Richmond Community Schools has a strong record of budgeting conservatively and outperforming expected results. The district budgeted for draws in the general fund every year since 2012, but ended each year with an operating surplus. Due to the variable amount of per pupil funding set by the state and enrollment volatility, accurately projecting revenue driven by enrollment is the primary challenge for Richmond. In fiscal 2019, the vast majority of Richmond's per pupil allowance was provided by the state, with 70.9% of general fund revenue derived from state sources while local property taxes provided 22.6% of general fund revenue. The district faces limited pressure from charter and private school competition, but historically loses students through the state's School of Choice program. In the 2018-2019 school year Richmond lost 50 students to private or charter schools, which is consistent with previous years. The district also had a net loss of 201 students through open enrollment, improved from a net loss of 235 the previous year. While the state has not published figures yet for the 2019-20 school year, the unofficial fall enrollment count showed an increase of 41 students over the previous year.

Rating methodology and scorecard factors

The US Local Government General Obligation Debt methodology includes a scorecard, a tool providing a composite score of a local government's credit profile based on the weighted factors we consider most important, universal and measurable, as well as possible notching factors dependent on individual credit strengths and weaknesses. Its purpose is not to determine the final rating, but rather to provide a standard platform from which to analyze and compare local government credits.

Exhibit 5

Richmond Community Schools, MI

Rating Factors	Measure	Score
Economy/Tax Base (30%) [1]		
Tax Base Size: Full Value (in 000s)	$1,381,878	A
Full Value Per Capita	$107,816	Aa
Median Family Income (% of US Median)	108.8%	Aa
Finances (30%)		
Fund Balance as a % of Revenues	6.9%	A
5-Year Dollar Change in Fund Balance as % of Revenues	-1.6%	Baa
Cash Balance as a % of Revenues	3.7%	A
5-Year Dollar Change in Cash Balance as % of Revenues	-1.0%	Baa
Notching Factors:[2]		
Other Analyst Adjustment to Finances Factor: Small nominal fund balance		Down
Management (20%)		
Institutional Framework	Baa	Baa
Operating History: 5-Year Average of Operating Revenues / Operating Expenditures	1.0x	A
Debt and Pensions (20%)		
Net Direct Debt / Full Value (%)	3.7%	A
Net Direct Debt / Operating Revenues (x)	3.0x	A
3-Year Average of Moody's Adjusted Net Pension Liability / Full Value (%)	3.5%	A
3-Year Average of Moody's Adjusted Net Pension Liability / Operating Revenues (x)	2.8x	A
	Scorecard-Indicated Outcome	A2
	Assigned Rating	A3

[1] Economy measures are based on data from the most recent year available.
[2] Notching Factors are specifically defined in the US Local Government General Obligation Debt methodology.
Sources: US Census Bureau, Moody's Investors Service

Endnotes

1 Employer contributions that tread water equal the sum of current year service cost and interest on reported net pension liabilities at the start of the year, using reported assumptions. If plan assumptions are met exactly, contributions equal to the tread water indicator will prevent the reported net pension liabilities from growing.

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