

RATING ACTION COMMENTARY

Fitch Rates Nebo School District, UT's GO Bonds 'AAA'; Outlook Stable

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Fitch Ratings - San Francisco - 29 Jul 2022: Fitch Ratings has assigned a 'AAA' rating to the following Nebo School District, Utah General obligation (GO) and refunding bonds:

--\$111.495 million GO school building and refunding bonds (Utah School Bond Guaranty Program), series 2022.

The 'AAA' rating is based on the state's full faith and credit guarantee provided as credit enhancement to the district's GO bonds under the Utah School Bond Default Avoidance Program, which is rated 'AAA' with a Stable Rating Outlook.

In addition, Fitch has assigned an underlying rating of 'AAA' to the bonds, reflecting the district's credit quality. The bonds are also backed by the state's full faith and credit guarantee provided as credit enhancement under the Utah School Bond Default Avoidance Program, which is rated 'AAA' with a Stable Outlook.

In addition, Fitch has affirmed the following ratings of the district:

--Issuer Default Rating (IDR) at 'AAA'

--\$167.98 million outstanding GO bonds at 'AAA';

--\$33.8 million outstanding Lease Revenue bonds at 'AA+'.

The Rating Outlook is Stable.

The bonds are scheduled to sell via competitive bid on Aug. 9, 2022. Bond proceeds will be used to fund construction and purchase buildings and school sites as well as to refund certain outstanding GO bonds for debt service savings.

SECURITY

The series 2022 general obligation school building and refunding bonds are general obligation bonds, payable from the proceeds of ad valorem taxes to be levied without limitation as to rate or amount on all of the taxable property in the district. In addition, payment is guaranteed by the full faith and credit and unlimited taxing power of the state under the provisions of the Utah School Bond Guaranty Act.

ANALYTICAL CONCLUSION

The district's 'AAA' rating reflects its strong revenue growth prospects within the state school funding framework, solid expenditure control, low long-term liability burden including well-funded pensions, and its superior gap-closing capacity. Its revenue framework is supported by a growing tax base and protected by automatic tax levy adjustments during periods of taxable assessed valuation (TAV) decline. While the growing student population generates capital and operational cost pressures, it also results in increased state funding.

Economic Resource Base

Nebo School District is the state's sixth-largest district by enrollment with more than 35,000 students. It serves a rapidly developing suburban area at the southern edge of Utah's economically dynamic Wasatch Front region. The district's growth has been largely driven by the availability of land and relatively affordable housing within commuting distance of very strong job markets in northern Utah County and farther north in Salt Lake County.

KEY RATING DRIVERS

Revenue Framework: 'aaa'

Long-term general fund revenue growth is expected to outpace U.S. economic growth, reflecting a strong tax base, steady enrollment gains and increasing state per pupil funding. The district has substantial independent legal ability to raise revenues if needed with local property tax rates well below the legal limit.

Expenditure Framework: 'aa'

The rate of spending growth is expected to be in line with to marginally above strong revenue growth, as rising enrollment drives increases to teaching staff. The district enjoys solid expenditure flexibility, with moderate carrying costs and a flexible labor environment.

Long-Term Liability Burden: 'aaa'

The district's debt and net pension liabilities are low relative to its resource base. Future debt plans are manageable.

Operating Performance: 'aaa'

The district has superior gap-closing capacity, with limited historical revenue volatility and superior inherent budget flexibility, accompanied by sizable reserves. Budget management in times of recovery is also strong, with rapid rebuilding of financial flexibility after downturns and conservative budgeting to maintain structural balance.

RATING SENSITIVITIES

For the IDR and underlying ratings, factors that could, individually or collectively, lead to negative rating action/downgrade:

- A sustained slowdown in revenue growth to less than the rate of nominal U.S. GDP;
- A sustained increase in the long-term liability ratio to above 10% of personal income;
- Material erosion of fund balance, resulting in weakened financial resilience.

For the enhanced rating, factors that could, individually or collectively, lead to negative rating action/downgrade:

- A weakening of the credit quality of the state of Utah that leads to a downgrade of the Utah School Bond Default Avoidance Program rating.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a

worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit <https://www.fitchratings.com/site/re/10111579>.

CREDIT PROFILE

The district's economic resource base provides strong fundamental support for operations. Utah County's unemployment rate runs well below that of the nation, and employment growth has been strong. Utah County is regularly among the fastest job creators among U.S. counties.

Strong TAV growth is expected over the near term; TAV has risen by more than 10% in each of the last three years.

Revenue Framework

Funding for schools in Utah is a shared responsibility between the state, which has a constitutional responsibility for public education, and local school districts. Funding is provided from a combination of property taxes imposed by the local school district, state-imposed personal income taxes and corporate franchise taxes and federal sources. The WPU (weighted pupil unit) is the statutory allocation methodology for equalized school funding across the state. The state provides close to three quarters of Nebo's general fund revenues, and local property taxes provide about 19% of revenues.

State revenues have grown rapidly due to moderate increases in per pupil funding and strong enrollment growth, while property tax revenues have risen with development activity. For fiscal 2022, the Utah legislature provided an increase in WPU of about 5.92% over the previous year and for fiscal 2023, an increase of 6.01% in WPU is expected. The district has seen strong revenue gains over the past 10 years with the compound annual growth rate of 5.5% through fiscal 2021, which was higher than national GDP performance over the same period.

The district has benefited from strong enrollment trends for many years. Enrollment has grown by almost 20% since 2010. Given healthy state per pupil funding growth and solid demographic trends, Fitch expects the district's revenue growth prospects to be strong over the near term. The district saw an increase of about 122 students as of October 2021, reflecting a 0.3% increase over the previous year. For the current fiscal year, the district is

projecting an increase of 385 students (increase of 1.09% over the previous year.). The district expects its enrollment will continue to see growth of about 200 to 300 students each year over the next 3-5 years.

The district has a high independent legal ability to raise revenues relative to its expected revenue volatility. The main operating levy (board levy) is well below the maximum level providing the district with ample flexibility and the district could raise approximately \$21.9 million, if the board levy were increased to the maximum rate of 0.25%. While the board has no plans to raise the board levy, it does plan to raise the voted leeway levy (which has floated down over time) through the truth in taxation process.

Expenditure Framework

The expenditure framework is typical for a school district, with a majority of general fund spending dominated by teacher and staff salaries and benefits.

Fitch expects the natural pace of expenditure growth to be in line with to marginally above revenue gains, absent policy action. Personnel and operational costs will increase with enrollment growth and opening of new schools.

The district has solid expenditure flexibility. The fixed carrying costs of debt service, pensions and other post-employment benefits (OPEB) are at the higher end of the moderate range (approximately 17.5% of governmental expenditures in fiscal 2021). In part, this reflects the moderately rapid amortization of the district's direct debt over 10 years, which should help absorb any planned additional borrowings without materially increasing carrying costs. Debt service accounted for roughly 9% of governmental spending in fiscal 2021, with more volatile pensions contributions comprising about 8%.

The labor framework is also very manageable. About 55% of the district's workforce is subject to collective bargaining, but policymakers retain the authority to determine both staffing and compensation levels. The elected school board has the legal authority to impose terms in the rare instances when labor and management cannot agree to contract terms. While employees can strike, there is no recent history of strikes and district officials characterize management/labor relations as very good. The district negotiates contracts annually to maintain the flexibility to adjust costs to changes in state funding levels. The district will provide labor with a salary increase of 6.25% for fiscal 2023.

The district received close to \$8 million in ESSER II and about \$19 million in ESSER III funding and has used a portion of the funds to hire teachers to help students overcome learning gaps

caused by the pandemic. The district has plans to convert the positions to permanent teaching positions once the one-time federal funds are expended, the cost of which is expected to be covered through attrition.

The district also has the ability to adjust class sizes and the number of paid teacher days if needed in a period of financial stress. Given growth in enrollment, adjustments to class sizes can typically be achieved by slowing hiring without resorting to layoffs or other more disruptive means of expenditure control.

Long-Term Liability Burden

The long-term liability burden is low relative to the economic resource base at about 6.8% of personal income. Principal amortization is moderate with approximately 55% of principal repaid in 10 years. Overlapping debt is minimal. Net Fitch adjusted pension liabilities of \$163 million are equivalent to less than 2% of total personal income. Pensions are provided through the Utah Retirement System, which is adequately funded.

After this GO issuance, the district will have \$111 million remaining in its 2018 GO bond authorization of \$298 million, which it expects to issue over the next few years. The district has tentative plans to seek a new GO bond authorization in fiscal 2026 for capital projects, given rapid enrollment growth and the need for additional schools for about \$400 million (tentative). Further increases in debt are likely to be paired with growth in the tax base and personal income and moderate debt amortization muting the impact on the long-term liability metric.

Operating Performance

The district has superior gap closing capacity as compared with its revenue volatility. Fitch expects the district's unrestricted fund balance to remain considerably above levels supporting the 'aaa' operating performance assessment even as the district uses some of its reserves for planned purposes such as opening of new schools and implementation of its new employee benefit plan.

The district usually budgets conservatively and tends to beat its projections, and its last net operating deficit was in fiscal 2010 (equal to less than \$1 million or 1% of spending at the time). The district ended fiscal 2021 with a surplus of \$11.3 million and a total unrestricted fund balance of \$81 million (30.4% of spending & transfers out). The district projections show unrestricted general fund balance for fiscal 2022 at 21% of spending, with a planned spend down of about \$9.3 million related to costs for the two new middle schools that opened in August 2021 and a portion of the reduction is a result of budgeted funds that were

unspent in fiscal 2021. Projections for fiscal 2023 shows unrestricted ending fund balance at 24% of spending.

The district had committed \$14 million of its unrestricted general fund balance for economic stabilization (5% of general fund budgeted revenues) in fiscal 2021 and plans to increase this amount to reach \$16 million under the proposed budget for fiscal 2023. Federal and state one-time funding received by the district accounted for close to \$32 million, which it plans to spend within the required timeframe strictly on one-time expenses.

Budget management in times of recovery is strong, with rapid rebuilding of financial flexibility when needed, conservative budget planning and full funding of required spending such as pensions. The district has increased its financial cushion significantly since the Great Recession, adding to its unrestricted general fund balance each of the past several years. The district has strong financial practices and generally budgets conservatively.

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

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APPLICABLE CRITERIA

[U.S. Public Finance Tax-Supported Rating Criteria \(pub. 04 May 2021\) \(including rating assumption sensitivity\)](#)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

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Nebo School District Local Building Authority (UT)

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