FitchRatings

RATING ACTION COMMENTARY

Fitch Rates Granite School District, UT's $20.7MM GO Refunding Bonds 'AAA'; Outlook Stable

Thu 07 Mar, 2024 - 5:25 PM ET

Fitch Ratings - San Francisco - 07 Mar 2024: Fitch Ratings has assigned a 'AAA' rating to the following Granite School District, Utah (the district) general obligation (GO) bonds:

--$20.7 million GO refunding bonds (Utah School Bond Guaranty Program), series 2024.

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 Guaranty Program, which is rated 'AAA' with a Stable Rating Outlook by Fitch.

In addition, Fitch has assigned an underlying rating of 'AAA' to the bonds, reflecting the district's credit quality without consideration of the guaranty.

Fitch has also affirmed the following ratings:

--The district's Issuer Default Rating (IDR) at 'AAA';

--The underlying rating for $210 million in outstanding GO bonds at 'AAA'.

The Rating Outlook is Stable.

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
Granite School District (UT)	LT IDR	AAA Rating Outlook Stable	Affirmed	AAA Rating Outlook Stable
Granite School District (UT) /General Obligation - Unlimited Tax/1 LT	LT	AAA Rating Outlook Stable	Affirmed	AAA Rating Outlook Stable

VIEW ADDITIONAL RATING DETAILS

The series 2024 bonds will sell competitively on March 26, 2024. Bond proceeds will refund currently outstanding GO refunding bonds, series 2012 and 2013 for savings.

SECURITY

The bonds are general obligations of the district, payable from the proceeds of unlimited ad valorem property taxes levied on all taxable properties within the district. Payment of principal and interest 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 'AAA' IDR and underlying rating on the GO bonds and the Stable Outlook reflect the district's strong financial operations, flexible labor environment and low liability burden. The district benefits from midrange inherent budget flexibility and superior gap-closing capacity.

Economic Resource Base

The district covers approximately 300 square miles in the northern half of Salt Lake County, placing it centrally within Utah's economic hub. It is Utah's third-largest school district based on a student population of just under 58,312 and the district operates 87 elementary, junior high and high schools, including six special purpose schools..

KEY RATING DRIVERS

Revenue Framework: 'aa'

Solid general fund revenue growth prospects will likely reflect both increasing state funding support and gradually declining student enrollment. The district has satisfactory independent legal ability to raise revenues.

Expenditure Framework: 'aa'

Spending growth will likely remain in line with, to marginally above, anticipated revenue growth driven by increases in state funding. The district enjoys solid expenditure flexibility.

Long-Term Liability Burden: 'aaa'

The district's combined debt and its share of the state's unfunded pension liability is low relative to its resource base. Fitch expects the long-term liability burden to remain low given rapid amortization of outstanding direct debt, no new debt plans, and annual actuarially required pension system contributions.

Operating Performance: 'aaa'

The district has superior gap-closing capacity, supporting financial resilience during economic downturns and demonstrated sound fiscal management.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to a positive rating action/upgrade:

--Not applicable, as the district's IDR is currently at the highest rating level.

Factors that could, individually or collectively, lead to a negative rating action/downgrade:

--Allowing reserve levels to decline to less than 60% of historical five-year average of 26% of general fund expenditures

--Failure to make use of available policy measures that offset revenue loss from declining enrollment resulting in consecutive years of operating deficits exceeding an average of 4% signaling the erosion of the district's gap-closing capacity;

--Severe economic weakness exceeding cyclical US downside economic scenarios, with indications that the district will not recover its prior level of economic and financial strength for an extended period.

CURRENT DEVELOPMENTS

The district is the third largest school district in the state and has exhibited strong financial performance for the past five years, notwithstanding a steady decline in enrollment. The anticipated revenue loss as a result of enrollment declines has been offset by steady increases in per pupil state aid funding. Overall, the state school funding climate in Utah has been positive. In 2024 the legislature provided state schools with an additional $700 million of one-time funding for district programs and capital projects.

The district's own policy actions have also enabled it to manage declining enrollment. District management anticipates further enrollment declines of roughly 1% annually. In response, the district's board took decisive action, closing three schools in 2023-2024 school year and an additional school is scheduled to close in the upcoming 2024-2025 academic year, producing expected annual savings of about $2 million to $3 million. Additionally, management continues to plan for additional school closures as needed to keep expenditures in line with revenues.

The district has already received almost $107 million in ESSER and ARPA funds through Salt Lake County and the state office of education, which helped stabilize the general fund in fiscal 2020 and is now almost fully spent. The Fiscal 2024 Budget includes approximately $60 million in remaining ESSER spending. The district intends to use those moneys to offset leaning loss, providing intensive interventions for high need families and financing capital projects to upgrade air filtration in schools. A portion of the ESSER funds will also be used for capital projects.

The district's Fiscal 2024 Budget is balanced and assumes total general fund revenues of $715.4 million which includes approximately $27.2 million of new funding over 2023's budget and expenditures of $711.9 million. The largest revenue components of the new funding include approximately $15.8 million in state funding as a result of a 6% increase in weighted pupil unit funding, state property tax guarantees and new local property tax revenue growth of roughly $1.5 million.

CREDIT PROFILE

The district is located at the center of the large and resilient Wasatch Front region's economy, which supports around 1.2 million people. The district's tax base has more than full recovered from the national housing downturn and resulting 20% taxable assessed valuation (TAV) decline between fiscal years 2009 and 2013. The tax base remains diverse with the largest taxpayers representing a variety of employment sectors. Due to the growing tax base, taxpayer concentration is diminishing. The top 10 property taxpayers accounted for only 8% of fiscal 2020 TAV, with the largest property taxpayer, Kennecott Utah Copper, representing less than 4% of the tax base.

Revenue Framework

Funding for Utah schools is provided via a combination of property taxes imposed by the local school district, state-imposed personal income and corporate franchise taxes, and federal sources. The weighted pupil unit (WPU) is the statutory allocation methodology for equalized school funding across the state. In fiscal years 2021, 2022, and 2023, the state increased the WPU by 6% in each year. The state has typically provided about 59% of the district's general fund revenues, while local property taxes and other local sources provided a further 30%.

Given resilient state revenue performance, the state provided an additional 6% increase in WPU. Additionally, the district will also receive $6.1 million to pay stipends to educators, $6.6 million in one-time public education and technology funding and $2.7 million in full-time kindergarten and $4.4 million for programs for at-risk-students. Fitch believes that these additional state resources along with district's unfilled vacant positions will help offset the revenue impact of the ongoing decline in student enrollment.

Fitch believes student enrollment will eventually begin to grow once Kennecott Utah Copper releases land holdings suitable for residential and commercial development on the western side of the district. The district considers such development as highly likely given the state's persistent housing shortage and strong economy and property market.

The district has satisfactory independent legal ability to raise operating revenues. Additional revenues can be raised each year through a truth-in-taxation public hearing process. The district could increase the board local tax levy by up to $27.7 million in fiscal 2023. Such increases would also not result in a reduction of state funding. In response to the pandemic, the state legislature had enabled school districts to transfer revenues derived from the capital outlay levies to the school general funds for operating expenses specifically for fiscal years 2021 and 2022, under House Bill 5003. The district currently has the capacity to raise approximately $65.7 million under its capital outlay levy.

From fiscal 2022 onwards, the district expects to hold annual truth-in-taxation hearings to shift debt service capacity to the capital levy as debt is amortized and to maintain its capital tax levy rate in the face of TAV increases. The resulting capital funding increases should enable pay-as-you-go funding of the district's medium- to long-term capital needs.

Expenditure Framework

The majority of district spending is on instruction (67% of fiscal 2023 general fund spending). To control health care costs, the district operates an on-site medical clinic for employees and their families to access free urgent care, free basic health care, and prescriptions with no co-pays. District officials advise that it is proving so successful that the district will consider opening a second clinic in the future. The clinic is the first of its kind among school districts in Utah.

Based on the district's patterns of revenue and spending, Fitch expects the district's future general fund expenditures to be in line with, to marginally above, general fund revenue growth.

The district has identified rising personnel and inflation as near-term cost pressures. In order to continue offering competitive salaries, particularly for teachers in a still tight local job market, the district had committed to a remuneration increase and higher teacher starting salaries that were to have been funded by the 6% WPU increase originally approved by the state legislature. The district also sought the property tax increase noted above to cover additional costs of teacher and worker salaries. Fitch believes that the district's budgetary balance could over time require more stringent approaches including wage or hiring freezes or layoffs, should local property tax increases and enhanced state aid allocations not be available. The district does have the flexibility to implement layoffs at any point during the year if necessary.

In line with the district's standard practice, the next round of labor negotiations will commence after the state legislature finalizes its budget and has made its final decisions regarding the WPU level and other education funding. The tight labor market for teachers and rising health and pension expenses will continue to be a consideration in the negotiations.

The district's expenditure flexibility is solid. Carrying costs related to debt repayment and pension contributions, at 12% of fiscal 2023 spending, are low relative to the district's resources, although there is likely to be some upward pension contribution pressure.

Long-Term Liability Burden

The district's overall debt and pension liability burden is low at 3% of personal income. The district has utilized all its voter-approved GO bonding authorization and has no plans to seek new voter authorization for further GO bonds. The district confirmed its intention to move completely to pay-as-you-go capital funding, unless faster than expected growth on the district's western side spurs the need for new borrowing. The district's direct debt is heavily front-loaded, with 46% repaid within five years and 90% repaid within 10 years.

The district participates in several state-sponsored pension plans. The cumulative 82% ratio of assets to liabilities is based on Fitch's assumed 6% investment return. The district continues to fund its post-retirement obligations at 100%.

Operating Performance

The district has superior gap-closing capacity and reported operating surpluses in six out of the prior seven fiscal years from 2017 to 2023. Prior to this recent trend, however, there were three years of general fund draw downs in fiscal years 2012 to

2014. This occurred for a mix of reasons including planned textbook adoption, unexpected state funding shortfalls, one-time priority educational initiatives, and general fund structural imbalance.

At the close of fiscal 2023, the district reported an ending general fund balance of $163.2 million including approximately $147.8 million of unrestricted fund balance which equates to 26%, and 23.5% of general fund expenditures respectively. District officials expect to maintain the general fund balance at a level commensurate with historical norms. Fitch expects the district to maintain its high fund balance trend even during periods of economic stress given the district's satisfactory ability to increase tax revenues and solid ability to adjust spending

The district has significant policy tools at its disposal to ensure ongoing structural balance, including its ability to rebalance between tax levies, reduce its personnel costs, and draw down its reserves if necessary. Fitch expects this combination of solutions would leave the district well positioned to rebuild its financial resilience through the eventual recovery period.

Due to its high general fund balance, the district does not foresee any liquidity issues. In an unexpected general fund emergency, it could permanently transfer up to almost $3.2 million from its self-insurance fund. The unused portion of capital tax rate could also be a future source of funds to offset general fund pay-as-you-go funding of capital projects. The district continues to fund its undistributed reserve for contingencies at the maximum 5% of budgeted general fund expenditures allowed by state law, which prohibits use of the reserve in labor negotiations or settlements.

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.

ESG CONSIDERATIONS

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

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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).

FAST Econometric API - Fitch Analytical Stress Test Model, v3.0.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Granite School District (UT)	EU Endorsed, UK Endorsed

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