

CREDIT OPINION

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 Rate this Research

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Will & Kankakee Counties Community Unit School District 207-U (Peotone), IL

Update to credit analysis following upgrade

Summary

[Will & Kankakee Counties Community Unit School District 207-U \(Peotone\), IL's](#) (Aa3) credit profile is characterized by a healthy financial position despite recent reserve draws. The district's debt burden is modest, though fixed costs are high due to a rapid repayment schedule. The tax base is moderately-sized and wealthy, with recent growth pointing towards stabilization. Primary credit challenges include contingent liability risk associated with participation in the Illinois Teachers Retirement System (TRS), the costs of which are predominantly covered by the [State of Illinois](#) (Baa3 stable) and ongoing enrollment losses.

On November 1, 2018 we upgraded the district's issuer and general obligation limited tax (GOLT) rating to Aa3 from A1.

Credit strengths

- » Moderately-sized tax base with above average resident wealth levels
- » Healthy operating reserves despite recent draws
- » Modest debt burden with rapid principal amortization

Credit challenges

- » Persistent enrollment declines
- » High fixed costs
- » Exposure to sizeable pension liabilities associated with the state's teachers pension system

Rating outlook

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

Factors that could lead to an upgrade

- » Sustained tax base growth and improvement of resident income levels
- » Further bolstering of operating reserves

Factors that could lead to a downgrade

- » Tax base contraction or weakening of resident income levels

- » Weakening of operating reserves
- » Material growth in the debt or pension burdens

Key indicators

Exhibit 1

Will & Kankakee Counties Community Unit School District 207-U	2013	2014	2015	2016	2017
Economy/Tax Base					
Total Full Value (\$000)	\$1,045,133	\$986,571	\$985,715	\$1,002,817	\$1,053,387
Population	10,679	10,749	10,858	11,049	11,049
Full Value Per Capita	\$97,868	\$91,783	\$90,782	\$90,761	\$95,338
Median Family Income (% of USMedian)	137.1%	135.5%	134.6%	134.6%	134.6%
Finances					
Operating Revenue (\$000)	\$22,354	\$21,363	\$22,996	\$24,269	\$22,319
Fund Balance (\$000)	\$13,639	\$11,843	\$8,891	\$11,882	\$10,602
Cash Balance (\$000)	\$13,639	\$11,843	\$8,891	\$11,882	\$10,602
Fund Balance as a % of Revenues	61.0%	55.4%	38.7%	49.0%	47.5%
Cash Balance as a % of Revenues	61.0%	55.4%	38.7%	49.0%	47.5%
Debt/Pensions					
Net Direct Debt (\$000)	\$28,614	\$25,478	\$22,109	\$22,815	\$18,699
3-Year Average of Moody's ANPL (\$000)	\$6,960	\$6,881	\$6,591	\$7,602	\$9,435
Net Direct Debt / Full Value (%)	2.7%	2.6%	2.2%	2.3%	1.8%
Net Direct Debt / Operating Revenues (x)	1.3x	1.2x	1.0x	0.9x	0.8x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	0.7%	0.7%	0.7%	0.8%	0.9%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	0.3x	0.3x	0.3x	0.3x	0.4x

Source: Moody's Investors Service, the district's audited financial statements, US Census Bureau

Profile

Peotone Community Unit School District 207-U is located approximately 45 miles southwest of the [City of Chicago](#) (Ba1 stable) and 15 miles southeast of the City of Joliet. It provides pre-K through twelfth grade education to 1,413 students within the villages of Peotone, Manhattan, Frankfort and surrounding unincorporated areas.

Detailed credit considerations

Economy and tax base: moderately-sized, wealthy tax base with declining enrollment

The district's tax base continues to recover with three consecutive years of growth, though valuations remains below its pre-recession peak. Currently valued at \$1.1 billion, the tax base is predominantly residential (61.3% of assessed value) with a significant agricultural presence (25.9%). While residential development is currently minimal, district officials report that the village of Peotone is advertising vacant farmland for development, and anticipate assessed values will continue to increase modestly in the near term. Resident wealth levels are strong with median family income estimated at 135.9% of the US.

Enrollment trends remain negative. Between 2009 and the current year, the student population contracted by a third, driven largely by stagnant population trends and little housing turnover within the district. Based on the size of kindergarten enrollment versus graduating classes, management anticipates annual declines of 50 students for the foreseeable future.

Financial operations and reserves: solid financial position with modest exposure to state aid

The district's financial profile is expected to remain a credit strength given a modest dependence on state funding and sound fund balance. Despite four consecutive deficits, the district closed fiscal 2017 with an available operating fund (educational, operations and

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maintenance, working cash, transportation, Illinois Municipal Retirement and debt service funds) balance of \$10.6 million, or a strong 47.5% of operating revenue. The declines were largely attributed to a decline in revenue correlating to enrollment losses, as well as delayed state aid. Positively, draft results for fiscal 2018, which closed on June 30, reflect a surplus of \$435,000 and an estimated fund balance of \$11 million, or 50.2% of revenue.

Property taxes, the district's largest revenue source, comprised 68.1% of operating fund revenues in fiscal 2017. State operating aid, including on-behalf pension payments, accounted for 21.7% of the district's 2017 revenues. Excluding on-behalf pension payments, state operating aid comprised a more moderate 10% of operating revenues. Designated as a tier 3 district under the state's new evidence-based funding (EBF) model, Peotone is expected to receive \$34,000 in additional aid in fiscal 2019.

LIQUIDITY

As the district's financial audits are reported on a cash basis, the district's liquidity is equivalent to the fund balance figure cited above.

Debt and pensions: high fixed costs due to rapid debt repayment; exposure to underfunded pension plan

Long term leverage is expected to remain manageable given rapid repayment and limited borrowing needs. The district's net debt burden is a modest 1.2% of full value and 0.6x operating revenue. Management reports no plans for additional debt as the district has ample capacity at its facilities and have absorbed a portion of capital and maintenance costs into its annual budget.

The district's pension burden is low, solely due to heavy state support. The Moody's three year adjusted net pension liability (ANPL) for the district, our measure of a local government's pension burden is \$9.4 million or a low 0.9% of full valuation and 0.4x operating fund revenue. The district's fixed costs, inclusive of debt service pension and other post employment benefit contributions were equivalent to an elevated 24% of operating revenue in fiscal 2017. This figure is primarily comprised of debt service, which accounts for 22.3%, given the district's aggressive debt repayment schedule.

DEBT STRUCTURE

All of the district's debt is fixed rate. Amortization is rapid with 100% of principal retired within five years.

DEBT-RELATED DERIVATIVES

The district is not a party to any debt-related derivatives.

PENSIONS AND OPEB

The state currently assumes responsibility for funding the majority teacher pensions on behalf of local school districts. Given the large unfunded liabilities for teacher pensions across the state, a reduction in this support by the state represents a contingent risk for all local school districts. District teachers participate in the Teachers Retirement System (TRS) of Illinois, while other staff participate in the Illinois Municipal Retirement Fund (IMRF), an agent multiple-employer plan. Very high unfunded pension liabilities are a significant drag on the state's credit quality, and TRS represents a material portion of the state's total pension burden.

Like its other pension systems, the State of Illinois contributes to TRS using a very back loaded and annually rising payment schedule. These rising costs have played a significant role in the state's ongoing budget challenges. Certain state legislators and the past two governors have considered shifting pension costs to Illinois schools and universities for a number of years, but to date have shown no inclination toward forcing local districts to pay for accumulated unfunded liabilities. Typically the proposals call for shifting current year benefit accruals to local districts, called "normal cost" or "service cost," over the course of anywhere between the next four years to over a decade. In 2017, we estimate that the district's share of TRS employer service cost totaled \$538,000, or 2.4% of operating revenue.

Management and governance: moderate institutional framework

The district's historically strong reserves partially mitigate the risks associated with uneven state aid distributions and pension support. Management has an informal target to maintain 180 days cash on hand.

Illinois school districts have an Institutional Framework score of A, which is moderate. Institutional Framework scores measure a sector's legal ability to increase revenues and decrease expenditures. School districts have moderate revenue-raising ability since they are subject to tax caps, but districts can seek voter approval for additional local property tax funding. Revenue predictability is disparate across the state: revenue for property tax dependent districts are very stable, while revenue for state aid dependent districts are less stable. Strong public sector unions somewhat limit districts' expenditure reduction ability. Still, districts have some cost-cutting ability

given manageable fixed costs, as the state currently assumes most pension costs. Expenditures consist primarily of personnel costs, which are highly predictable.

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