

Rationale

S&P Global Ratings assigned its 'AAA' rating to St. Louis County School District C-2 (Parkway), Mo.'s series 2017 general obligation (GO) refunding bonds. At the same time, we affirmed our 'AAA' long-term rating and underlying rating (SPUR) on the district's outstanding GO debt. The outlook is stable.

We rate St. Louis County School District C-2 (Parkway) higher than the sovereign because we believe the district can maintain better credit characteristics than the U.S. in a stress scenario based on its predominantly locally derived revenue base and our view that pledged revenue supporting debt service on the bonds is at limited risk of negative sovereign intervention. In 2016, local property taxes generated 86.1% of combined operating fund revenue, demonstrating a lack of dependence on central government revenue.

We understand officials intend to use series 2017 refunding bonds to crossover refund the series 2010A taxable general obligation bonds (Build America Bonds – Direct Pay), and pay interest on the bonds for the life of the bonds, including March 1, 2020 (the crossover date). We understand that the GO security applies to the series 2017 bonds for the life of the bonds, and as such, we do not believe there is any dependency on the escrow.

The rating reflects our opinion of the following factors for the district, specifically its:

- Access and participation in the broad and diverse St. Louis metropolitan statistical area (MSA);
- Very strong income and extremely strong market value per capita levels;
- Strong financial position, supported by positive budgetary performance and strong reserve levels;
- Strong management, with "good" financial policies and practices under our financial management assessment (FMA) methodology; and
- Low debt levels, including low overall net debt as a percentage of market value and low debt service carrying charges.

Economy

St. Louis County School District C-2 (Parkway), a grade K-12 district, is approximately 20 miles west of the city of St. Louis and serves an estimated population of 141,251. It encompasses about 70 square miles. The median household effective buying income (EBI) in the district is 149% of the national average, and the per capita EBI is 159% of the national average, both of which we consider very strong. At \$150,535 per capita, the 2017 estimated market value totaling \$21.3 billion is, in our opinion, extremely strong.

The district hosts a diversified local employment base across various sectors, including education and health care services, professional services, commercial retail, and manufacturing, as well as finance, insurance, and real estate. Notably, the local economy is anchored by health care service providers St. John's Mercy Medical Center (approximately 8,900 employees), St. Luke's Health Corp. (3,100), and Missouri Baptist Medical Center (2,878). Other leading employers are Schnuck's Market Inc. (approximately 15,600 employees), Dierberg's Markets Inc. (4,000), Coldwell Banker Gundaker (3,600), and Solutia Inc. (3,400). The tax base is very diverse, in our view, with the 10 largest taxpayers accounting for approximately 4.2% of assessed value (AV).

Interstate highways 64 and 270 traverse the district, connecting residents with regional employment centers. The city and county anchor the broad and diverse St. Louis MSA and serve as the cultural, financial, health care, and

educational center for nearly 3 million people in seven counties in Missouri and eight in Illinois. In 2016, St. Louis County's unemployment rate averaged 4.2%, which was below the state's 4.5% and the nation's 4.9% unemployment rates.

The district's AV grew by a total of 14.5% since 2015 to \$4.8 billion in 2017. Outmigration from the city of St. Louis has slowed in recent years, but district officials anticipate that AV in the district will continue to grow in-line with recent trends, as it remains an attractive destination for new commercial and residential development. Furthermore, the district has seen interest from residential developers, who are either planning or constructing three new housing subdivisions and luxury residential complexes.

According to management, the district returned more than \$8 million in protested tax settlements during fiscal years 2014 and 2015. The county has processed the remainder of protested tax settlements, leading to a decrease in property tax collections, but management anticipates AV growth will outpace future settlements.

In addition, the district has a voluntary rollback in its operating levy, and if it were to levy at the maximum levy rate, it could generate roughly \$12 million of additional annual revenue for ongoing operations or to fund capital projects. Subsequently, it can remove the rollback in reassessment years, and it has the ability to recuperate this over three years. The district will consider recuperating \$4 million annually over the next three years. We view this additional revenue-raising flexibility as a credit positive.

Finances

Funding for Missouri school districts is mostly based on a mix of local property taxes and state aid. Basic state aid funding is set by average daily attendance, and is then reduced by a local effort in the form of a look-back tax levy. The district can increase the annual tax levy by the lesser of inflation or 5% (not accounting for new construction, which is separately fully realized in the levy), as long as the resulting tax rate remains below the maximum voter-approved amount.

In our view, the district's finances are very strong; management has maintained very strong reserves by implementing a sound budgeting framework, including conservative expenditure assumptions with strong fiscal oversight and instituting long-term planning for changes to tax base growth, enrollment, and state aid. The district derives a majority of its general fund revenue from local and intermediate revenue sources, including property taxes. For fiscal 2016, the district's local and intermediate sources accounted for 86.1% of combined operating fund revenues, followed by state aid sources (accounting for 4.8%).

The district operates 30 educational facilities: 18 elementary schools, five middle schools, five high schools, an early childhood center, and an alternative instructional center. Following a period of declining enrollment in the 2012-2013 and 2013-2014 school years, it experienced slight growth over the past three school years. During the 2016-2017 school year, enrollment reflects 17,436 students, a nearly 1.7% increase from the 2013-2014 school year. Primarily due to new residential development in the district, management projects enrollment will continue to increase by approximately 100 students per year, or by a cumulative 2.56%, through the 2019-2020 school year. Furthermore, according to management, the district has capacity to manage an increase in enrollment, but officials continue to monitor trends and address capacity as part of their long-term facilities planning.

The district posted four consecutive positive operating results from fiscal years 2013 to 2016. In fiscal 2016, it realized a combined general and teachers' fund operating surplus of \$7.74 million, or 3.5% of combined operating fund expenditures. Management attributes the result to the better-than-budgeted revenue—due mainly to an increase in local tax receipts, which totaled \$4.8 million—over the original budget. At the same time, the district's expenditures were under budget, due largely to significant expenditure savings from its energy efficiency and sustainability efforts facility operational savings, reduced fuel and utility costs, and unexpended departmental appropriations from instruction and the district's business and central services. The district's available fund balance of \$38.68 million is strong, in our view, at 17.3% of general fund expenditures at fiscal year-end June 30, 2016.

For fiscal 2017, the approved an operating budget with a projected \$1.02 million combined operating funds surplus. At the same time, the operating budget includes salary increases of 2.8%, but officials expect this increase to be partially offset by savings from unfilled staffing vacancies. Although management reports a decline in revenue due to payment of tax settlements, the district expects to realize a better-than-budgeted surplus of approximately \$1.7 million at fiscal year-end due to unexpended departmental appropriations.

For fiscal 2018, the district projects another operating surplus. The budget includes appropriations to upgrade or replace a portion of the district's bus fleet. Furthermore, the district has a voluntary rollback in the operating levy, and if it were to levy at the maximum levy rate, it could generate up to \$4 million of additional annual revenue to support ongoing operations or to fund capital projects. Over the next two years, management indicates that it will monitor changes to out-of-district enrollment and tuition, taxpayer protests, and other economic and employment trends on future budgets.

Management

We consider the district's management practices "good" under our FMA methodology, indicating financial practices exist in most areas, but that governance officials might not formalize or monitor all of them on a regular basis.

We believe management's budget management framework—which includes the adoption of conservative revenue estimates and close monitoring of monthly budget activities—remains one of the key elements supporting the district's historically strong financial performance. In formulating its annual budget, the district uses five years of historical information to forecast its revenue and expenditure assumptions. Management revised its property tax collection rate assumptions upward to 97% from 96% given the limited number of tax settlements outstanding. At the same time, the district consults a data scientist to project enrollment trends and the county assessor to estimate new growth. Furthermore, management monitors year-to-date revenues and expenditures regularly, and the finance director delivers a monthly budget report to the school board, discussing budget variances and proposing budget amendments when necessary.

Management highlights include its strong focus on financial and capital planning, evidenced by district's rolling five-year capital improvement plan (CIP), which identifies interfund appropriations and debt financing of capital projects. The district also constructs a five-year financial forecast that management reviews semi-annually and shares with the school board during the annual budget process. In addition, the district adheres to its formal investment policy, which largely follows state guidelines and limits investment maturities to no more than 10 months. However, investment holdings and earnings are only reported as part of the annual audit.

Furthermore, management has a formal reserve policy, which calls for an available fund balance target of 17.3% of general, teachers', and capital projects fund expenditures. According to management, the district aims to increase fund balances by at least 0.25% per year until the target fund balance is reached. Its philosophy is that the target fund balance will provide a contingency in the occurrence of one-time events, and relieve its need to issue tax anticipation notes (TANs) in future. At this time, the district does not have formal debt management policy, but adheres to state debt limitations.

Debt

Overall net debt is 1.2% of market value and \$1,837 per capita, which we believe to be low. However, with 46% of the district's direct debt scheduled to be retired within 10 years, amortization is slower than average. Debt service carrying charges were 7.4% of total governmental fund expenditures (excluding capital outlay) in fiscal 2016, which we consider low.

Including this bond issue, the district has approximately \$197.1 million of total direct debt outstanding. Furthermore, its proportionate share of overlapping GO debt is about \$55.4 million, which includes St. Louis County, municipal, and fire district debt. In addition, according to management, the district also has short-term capital lease obligations for bus and copier machines, which totaled approximately \$2.38 million. In accordance with historical practice, the district expects to seek authorization annually for short-term TANs to meet annual cash flow needs; however, due to an overall build-up in reserves in recent years, management expects to reduce its short-term cash flow borrowing to approximately \$15 million from \$20 million.

Over the next two years, the district may seek voter approval for approximately \$110 million in additional debt, spread across multiple issuances, to finance maintenance, enhancements, and renovations at existing facilities or new facility construction. The district is currently working a long-range planning committee to prioritize capital needs for the next bond issuances, which will likely occur between fiscal years 2019 and 2021.

Pension and other postemployment benefit liabilities

The district participates in the Public School Retirement System of Missouri (PSRS) and the Public Education Employee Retirement System of Missouri (PEERS), both cost-sharing multiemployer defined-benefit pension plans.

The district's proportionate share of the net pension liability was approximately \$147.5 million for PSRS and nearly \$13.4 million for PEERS as of the most recent actuarial valuation, June 30, 2014. It contributed \$19.7 million combined, or 100% of its actuarially determined contribution (ADC), in fiscal 2015. As of June 30, 2015, the district's plan fiduciary net position as a percent of the total pension liability for the PSRS and PEERS were 85.8% and 88.3%, respectively. Historically, it has funded, and continues to fund, its ADC in full.

The district currently provides OPEB benefits on a pay-as-you-go basis, including a continuation of medical, dental, prescription drug, and vision insurance coverage for retirees. However, retirees who elect to participate must pay the premium in effect for the current plan year or a subsequent year at the premium rates, as determined by the district. Thereby, the district has an implicit rate subsidy for this liability. In fiscal 2016, it contributed nearly \$2 million, or 0.8% of total governmental expenditures. Combined pension and OPEB carrying charges totaled 8.2% of total governmental fund expenditures in fiscal 2016.

Outlook

The stable outlook reflects S&P Global Ratings' opinion of the district's ability to maintain strong budgetary performance and to sustain its strong combined fund reserves. It also reflects the district's very strong financial management practices and policies, sustained by its strong budget administration, monitoring framework, and long-term planning, which will likely allow it to make budget adjustments when necessary. In our view, its very strong wealth and income levels, coupled with its access to regional employment centers, are likely to support credit stability. For these reasons, we are unlikely to change the rating during our two-year outlook period.

While unlikely, we could lower the rating if the district were to experience a sustained or substantial weakening of budgetary performance, leading to a deterioration of reserves and constrained liquidity.