

# **FITCH UPGRADES WASHOE COUNTY SCHOOL DISTRICT, NV'S \$9.2MM LTGOS TO 'AA-'; OUTLOOK STABLE**

Fitch Ratings-San Francisco-12 December 2019: Fitch Ratings has upgraded the following Washoe County School District, NV (the district) ratings to 'AA-' from 'A+':

- \$1.7 million outstanding general obligation limited tax (LTGO) school improvement bonds, series 2009;
- \$7.5 million outstanding LTGO school improvement bonds (taxable recovery zone economic development bonds), series 2010A; and
- Issuer Default Rating (IDR).

The Rating Outlook is Stable.

In addition, Fitch Ratings has withdrawn the 'A+' rating on the following bonds as they did not sell.

Washoe County School District (NV) general obligation limited tax school improvement bonds (taxable) (Build America Bonds) series 2010C. Previous rating: A+/Rating Outlook Stable:

## **SECURITY**

The bonds are direct and general obligations of the district backed by its full faith and credit for the payment of principal and interest, subject to state constitutional and statutory limitations on the aggregate amount of ad valorem taxes.

## **ANALYTICAL CONCLUSION**

The rating upgrade reflects the district's return to balanced operations in fiscal 2019 and 2020 and expectations for sustained balanced operations. The 'AA-' rating also reflects expectations for slow revenue growth, moderate long-term liabilities and strong gap-closing capacity through economic cycles. The district's capital needs are now being met by a sales tax and bond measure adopted by the voters in 2016, which alleviates pressure on the general fund to finance capital needs.

## **Economic Resource Base**

Washoe County School District is Nevada's second largest district, with an enrollment of about 64,000 students in fiscal 2019. The district's boundaries are coterminous with those of the county and include the cities of Reno and Sparks, as well as Incline Village on Lake Tahoe.

## **KEY RATING DRIVERS**

### **Revenue Framework: 'bbb'**

Fitch expects the district's revenue growth to be slow, about in line with inflation as the state increases per pupil funding and district enrollment remains flat. The district has no ability to independently increase revenues.

### **Expenditure Framework: 'aa'**

Fitch expects the natural pace of expenditures to be above slow growing revenues as pension and salary costs rise. Carrying costs are moderate and likely to remain so despite planned debt issuance and increasing pension contributions. The district has some flexibility to increase class sizes and reduce the number of teachers.

#### Long-Term Liability Burden: 'aa'

Long-term liabilities including the debt and pension burdens are currently low, but likely to increase to the moderate range with additional debt plans.

#### Operating Performance: 'aa'

The district's gap closing ability is very strong relative to low historical revenue volatility and midrange budget flexibility. The district adopted a 'balanced budget by fiscal 2021 resolution' and achieved structural balance in fiscal 2020. The resolution includes requirements for replenishing its reserves should they fall below 8% of spending.

#### RATING SENSITIVITIES

Structural Balance/Revenue Growth: The IDR is sensitive to material change in the district's prudent expenditure and financial management. Continued balanced operations and reserve levels if coupled with solid revenue growth could result in positive rating action.

#### CURRENT DEVELOPMENTS

After three years of deficits, the district ended fiscal 2019 with a surplus, as a result of both revenues and expenditures performing better than conservatively budgeted. Despite these recent deficits, the district maintained available fund balance above its 8% of spending policy. The fiscal 2019 surplus of \$833,000 brought available fund balance to \$40.5 million, equal to about 8.7% of spending. The district's fiscal 2020 budget is balanced and conservatively includes flat enrollment, and reserve levels slightly higher compared to fiscal 2019. The district passed a resolution in fiscal 2018 requiring it to have a balanced budget by fiscal 2021. This year's budget accomplished that target a year ahead of the requirement.

#### CREDIT PROFILE

The area has recovered from the economic recession, which hit it particularly hard. The tax base experienced an overall decline of 28.6% from fiscal 2010-2013 but has increased each year since, including gains of over 9% in fiscals 2017 and 2019 and smaller increases in fiscal 2018. The top taxpayers remain diverse representing just 3% of assessed value (AV) but the tax base and economy are somewhat concentrated in hotel/casinos.

The county unemployment rate has improved every year since 2012, reaching a recent low of 4.1% in 2018. The county's largest employers are in government, health care, and leisure including the district and Washoe County, the University of Nevada, Reno, the Renown Medical Center and St. Mary's Regional Medical Center, and the Peppermill Hotel and Casino, Grand Sierra Resort/Reno Hilton, Silver Legacy Resort, and Atlantis Casino as well as International Game Technology.

#### Revenue Framework

The Nevada legislature recently adopted legislation which will revise statewide K-12 education. However, the existing Nevada Plan will still govern school funding over the biennium (2020-2021) as the state studies how the new plan would impact revenues for various districts in the state. The new plan will generally collapse categorical funding into a weighted per pupil amount, which will take into account certain student characteristics such as being an English language learner, needing special education or being in a gifted and talented program. The new plan is expected to generally increase per pupil funding by roughly inflation and provide for a decrease in per pupil funding if state revenues are expected to decline.

Meanwhile, the existing Nevada Plan provides a statewide, formula-based framework. State aid provides the difference between the funding generated through local taxes, including the local school support tax (LSST, a sales and use tax equal to 2.6% of taxable sales) and one-third of a 75-cent per \$100 property tax, and a minimum guaranteed per pupil funding amount determined for each district. As such, approximately 75% of the district's budgeted revenue is set by statute. The

legislatively guaranteed state funding rate for fiscal 2018 was about \$5,900 per student and \$5,967 for fiscal 2019. The biennial budget just adopted will raise this to \$6,153 in fiscal 2020 and \$6,244 in fiscal 2021. These compare to \$5,582 per student in fiscal 2015. The largest revenue source is the LSST at over 40% of general fund revenues, followed by state aid at about 30% and property taxes at about 23%.

Despite these recent increases, the district's revenue growth in the last decade ending fiscal 2018 increased just 1.1% on average annually. However, Fitch expects per pupil revenue growth going forward to be at about the level of inflation. The state's most recent biennium budget (fiscal years 2020 and 2021) includes 2% raises for teachers and a 3% COLA in fiscal 2020, which combined with flat enrollment and assuming continued modest raises and COLAS suggests future revenue growth may be at the level of inflation. Despite new development in and around Reno due in part to the new Tesla Motors battery factory, the district expects relatively flat enrollment as the new development has fewer K-12 students per household.

The district does not have independent legal ability to increase revenues.

#### Expenditure Framework

The largest category of spending is salaries and benefits at over 80% of expenditures.

Fitch expects the natural pace of spending to be about the level of inflation, consistent with expected salary increases and moderate pension costs and a stable to declining number of staff.

Spending flexibility is solid, with carrying costs, including debt and retiree costs equal to about 15% of fiscal 2019 governmental spending. The district's post-employment benefits (OPEB) trust has a balance of about \$60 million at the end of fiscal 2019 that it could use to make its annual pay as you go cost of about \$6.5 million in fiscal 2019. In addition, the increase in the sales tax to support capital spending will relieve some pressure on the general fund. Fitch's supplemental pension metric, which assumes a 20-year level payoff of the Fitch-adjusted liability, indicates that even contributions at the current level would likely be insufficient to reduce pension liabilities, meaning that contributions are likely to continue to rise. For more information see "Revised Pension Risk Measurements (Enhancing Pension Analysis in U.S. Public Finance Tax-Supported Rating Criteria)," dated May 31, 2017.

The state's fiscal 2020 and 2021 budget includes a 2% raise and 3% COLA for fiscal 2020 and the district's recently settled contracts with most associations include just the 3% COLA.

#### Long-Term Liability Burden

The district's long-term liabilities are comparatively low at about 9% of personal income, most of which is attributable to unfunded pensions. Approximately 51% of direct debt (30% of the total liability) will be retired within 10 years.

The district has significant capital needs due in part to many years of deferred spending. In the absence of new capital funding since expiration of the prior bond rollover program in 2012, the district had experienced overcrowding and required year-round scheduling and increased use of portable facilities.

Voters approved a permanent increase in the county sales tax (WC-1) for school facilities in November 2016 (effective April 2017), which is expected to generate about \$781 million in bonding authority in its first decade. The district issued \$200 million GO bonds (additionally secured by the sales tax revenues) in November 2017, \$85 million in November 2018, and \$69 million in September 2019 and another \$100 million will be issued in December 2019. The district expects to issue about \$215 million over the next few months. The district may also issue LTGO's

payable only from the existing property tax rate. Fitch expects the district's long-term liability burden to increase but remain moderate.

The district participates in the Nevada Public Employees Retirement System, which reports a 75% assets to liabilities ratio based upon a 7.5% discount rate assumption. The system has an estimated ratio of assets to liabilities of 62% when adjusted by Fitch to a standard 6% rate of return. The net liability related to OPEB is a low \$158 million, equal to 0.6% of personal income.

#### Operating Performance

The district's board-approved policy is maintenance of 8%-10% of total appropriations. As of the end of fiscal 2019, the district's unrestricted fund balance totaled \$40.5 million, equal to about 8.7% of spending. The policy also requires the board to adopt a plan to replenish available reserves if it fails to meet the minimum policy. Relative to budget flexibility and Fitch's expectation that the district's revenue would decline about 1% in a moderate recession, Fitch expects the district to maintain very strong gap-closing capacity throughout economic cycles.

In March 2018, the board also passed a policy requiring the district to maintain a structurally balanced budget for the general fund beginning no later than the fiscal 2020-2021 budget year. This policy also requires the district to adopt a long-term financial plan (starting in fiscal 2021) including revenue forecasting. The district performs monthly and quarterly reporting of cash balances and revenues and expenditures.

The district's 2019 budget included about \$12.2 million in cuts relative to the preliminary budget, reducing the gap between ongoing revenues and expenditures to \$7.2 million. This was ahead of the district's policy established in fiscal 2018 to reduce the then \$40 million structural gap by 1/3 each year. The district cut 45 positions but did not require layoffs due to attrition and vacancies. For the fiscal 2020 budget, the district balanced the budget, which originally had an estimated deficit of about \$18 million through various cost-saving actions; including reducing health insurance costs and other staff/operating efficiencies.

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

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## Applicable Criteria

U.S. Public Finance Tax-Supported Rating Criteria (pub. 03 Apr 2018)

<https://www.fitchratings.com/site/re/10024656>

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