

RESEARCH

Sector Review:**Only 21 School Districts Make The 'AAA' Grade**

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(This is Standard & Poor's Ratings Services' first sector review of 'AAA' rated school districts.)

There are only 21 school districts whose GO debt is rated 'AAA'. The list has expanded a bit from 2004 when there were 14, and represents a very exclusive club, with less than 1% of all uninsured ratings falling into this category. This category includes five community college districts and one technical college district. Enrollment varies greatly, ranging from 208 to over 58,000.

Why The Concentration In Illinois And Lake County?

The 'AAA' school districts are concentrated in the Midwest, with the most in Illinois. In fact, Illinois also has the highest number of 'AA+' rated school districts in the nation, reflecting pockets of very high wealth and income in the Chicago suburbs, a very low reliance on state aid, and the districts' success in getting the electorate to go along with tax increases. (For more information regarding Illinois School districts, see "Illinois School Districts 2006 Ratings Comparison".)

'AAA' Rated School Districts by Region

As of September 2006

Midwest	Southwest	Northeast	Far West
Illinois 8	Texas 3	New York 2	California 1
Nebraska 2		Massachusetts 1	
Kansas 1			
Missouri 1			
Ohio 1			
Wisconsin 1			

General Characteristics Of 'AAA' School Districts

When examining the credit quality of these districts, certain strengths are evident. In general the gilt-edged credit derives from:

- Location in or proximity to major economic centers;
- Very high wealth indicators;
- Strong financial management practices with a focus on multi-year planning; and
- Manageable debt burden.

Typically, 'AAA' rated school districts demonstrate the ability to manage through all economic cycles, to accommodate enrollment changes, and are either not dependent on or have demonstrated the ability to adjust to changing levels of intergovernmental aid.

Growing tax bases and proximity to economic centers

A 'AAA' school district either has its own strong economic base or is in an affluent residential area that is close to a metropolitan area with a dynamic economy. Many of the 'AAA' school districts are near highly rated cities with dynamic, diverse, job producing economies, such as Chicago, Dallas, New York, Boston, and San Francisco. Within 'AAA' districts, tax base valuation is strong as measured by rising market appreciation and market value per capita. But unlike municipalities and counties that can control growth and development within their borders, school districts have no direct control over development. However, they do play a role in development in a different way: school districts with highly regarded academic reputations enhance market values, and contribute to strong tax base growth.

Very high wealth indices

We also examine income and wealth levels, weighed against local and national trends, for each of the communities served by the district. The 21 'AAA' school districts exhibit high and in many cases exceptionally high wealth levels with income in some instances more than three times the national average.

Strong management practices with a focus on multi-year planning

While they naturally focus on current year operations, management of 'AAA' districts typically plan over a three- to five-year horizon. Conservative budgeting is a common trait. Many of the districts have strong fiscal policies, providing guidelines for spending, debt, and finances. Reserve levels tend to be high, especially when compared nationally to all school districts. Some school districts, as is the case for the eight Illinois 'AAA's, have successfully managed within a property tax cap levy. Highly rated school districts have strong management teams that have a proven track record through all economic cycles, dealing with cuts in intergovernmental aid, and adapting to changing enrollment.

Financial position is key

The degree of financial control a district exerts correlates to a sound financial position. It is this quality that is intrinsic to higher-rated school districts.

The general fund balance provides one measure of financial flexibility. A strong and liquid fund balance, built up with surpluses generated during periods of growth and through careful budgeting, provides an ample cushion against the unanticipated. A sizeable fund balance is also a resource the district can tap between payments of state aid or property taxes. Credit is given when management's financial strategy includes a formal fund-balance policy or an internal, targeted level, and adheres to it. Highly rated school districts establish fund balances with the expectation that certain circumstances will prompt use of reserves while also containing a mechanism to replenish if drawn on.

Almost every school district relies on a combination of property taxes and state aid. Districts reliant mostly on property taxes control their destinies to the extent that they have solid tax-base growth, and thus a growing, highly predictable revenue source. In highly rated school districts, property taxes comprise the largest revenue source, with state aid playing a minor role. As a result, the stability of and reliance on stable tax revenues shields districts from fluctuations in revenue from the state, which tends to get cut during economic slowdowns. No district, however, is immune to fiscal pressures such as rising health care and other personnel-related costs, which in some cases outpace or have the potential to outpace revenue growth. Managing these costs requires good management, which 'AAA' school districts have demonstrated.

Manageable Debt Burden

The debt burden and capital planning profiles of the 'AAA' school districts are strong. This is to be expected given their high wealth levels and generally large tax bases. Most of the 'AAA' school districts have well-developed multi-year capital plans that focus on future capital needs, measuring the effect of borrowing on future budgets. Funding sources, whether through pay-as-you-go financing, intergovernmental aid, or long-term borrowing, are also articulated. The multi-year capital plans are reviewed and modified annually. Funding usually consists of a combination of bond proceeds and pay-as-you-go financing. A comprehensive plan encompassing these characteristics is yet another characteristic of sophisticated management, and is a sign of credit strength.

Ratios And Rankings

Standard & Poor's uses several ratios as part of the credit review process. Among them are overall net

debt per capita, per capita market value, and unreserved general fund balance as a percentage of expenditures (see Glossary). A high overall net debt ratio is an indication of a heavy debt burden, which is theoretically borne in equal measure by each resident. In some cases, we make distinctions between direct debt, for which the issuer itself is responsible, and overlapping and underlying debt, which is not a direct obligation of the issuer. If the issuer's direct debt is low, less weight may be given to overlapping and underlying debt than will be the case if the issuer's own debt burden is high.

Overall debt per capita for the 21 'AAA' school districts ranges from \$85 to \$6,666; the districts with the highest debt per capita have populations much smaller than the median of 63,000. Average overall net debt per capita is \$3,197 and the median is \$2,691.

Per capita market value measures property wealth. The average is \$176,927, the median is \$179,208 and the highest is \$474,639.

When examining a school district's financial position we also review reserves levels, both in terms of policies and trends. We examine the unreserved general fund balance as a percentage of operating expenditures to determine the size of reserves available in relation to the total budget. While we do not advocate an ideal reserve level, our report dated March 7, 2005, "State and Local Government Credit Analysis By The Numbers", sets forth ranges for cities, school districts and counties based on population segments with descriptors that range from high to low. However, each situation is considered on its own merits. The ratio for the 'AAA' school districts for unreserved general fund balance as a percentage of general fund operating expenditures varies. The average unreserved general fund balance is 26.5% of operating expenditures, while the median is 20.1%.

Economic Assessment

Areas of economic activity that affect credit quality include:

- Growth over time of the labor force;
- Diversification of employment sectors;
- Unemployment rates;
- Wealth and income indicators;
- Construction and retail activity;
- Population growth;
- Attraction of new businesses; and
- Tax base and employment expansion.

We examine several economic indicators to determine the vibrancy and strength of an entity. Among the most important are income levels and unemployment rates. We compare several income indicators to U.S. averages. As measured by Claritas Inc. ratios, per capita effective buying income (EBI) as a percentage of the U.S. average ranges from 98% to a very high 432% among the 'AAA' districts. The sheer wealth and buying power of these districts is evident when looking at the median per capita EBI (220% of the U.S. average) and median household EBI (199% of U.S. average). On average, the 'AAA' school districts' per capita income was a strong 227% of the U.S. average, while the median was also very strong at 220%. Unemployment rates for the jurisdictions that the districts are located in are well below the U.S. rates, and many are significantly below the U.S. average.

More 'AAA's Expected

While the 'AAA' universe of GO school districts remains small, Standard & Poor's expects to see additions to this list over time. To achieve this coveted rating, potential 'AAA' candidates must meet all of the credit characteristics outlined in this article and compare well within this peer group's ratios. Also critical for consideration for a 'AAA' rating is a demonstrated ability to manage through all economic cycles, accommodate enrollment changes, and demonstrate the ability to adjust to changing mandates and fluctuations in intergovernmental aid.

'AAA' GO School District Ratios

District	St	Pop (000)	Enrol (000)	HH EBI	PC EBI	TMV (mil. \$)	PC MV (\$000)	GFB % OE	UFB % OE	DD (mil. \$)	OD % MV	OD PC (\$)
Hillsborough City Sch Dist	CA	11	1,421	345	432	5,560	475	17.4	16.2	40.5	2.0	9,485
DuPage & Cook Cntys Twp High Sch Dist #86 (Hinsdale)	IL	75	4,378	253	284	13,519	179	52.1	48.7	14.9	1.5	2,691
DuPage Cnty Comnty Coll Dist #502	IL	971	17,000	168	162	106,244	95	42.5*	N.A.	132.0	2.5	2,356
Lake Cnty Comnty High Sch Dist #115 (Lake Forest)	IL	30	1,667	329	350	7,514	250	18.2	18.2	17.9	1.1	2,802
Lake Cnty Cons High Sch Dist #125 Adlai E. Stevenson	IL	63	4,600	294	300	8,872	141	1.3	1.0	42.6	1.9	2,731
Lake Cnty Sch Dist #106 (Bannockburn)	IL	1	208	358	N.A.	526	368	125.1	125.1	3.2	1.8	6,666
Lake Cnty Sch Dist #112 (North Shore)	IL	31	4,383	199	260	6,368	208	19.0	15.8	47.7	2.4	4,995
Lake Cnty Sch Dist #113 (Deerfield - Highland Pk)	IL	59	3,500	251	314	10,610	179	22.1	22.1	59.3	2.1	3,752
Northfield Township High Sch Dist #225 (Glenview-Northbrook)	IL	79	4,760	180	210	15,367	194	33.7	33.6	44.7	2.6	5,017
Johnson Cnty Comnty Coll	KS	511	34,000	145	149	53,301	104	46.6*	N.A.	1.7	0.1	106
Lincoln-Sudbury Regional School District	MA	25	1,503	262	234	5,670	224	16.1	12.5	71.6	0.5	1,004
St Louis Cnty Sch Dist (Ladue)	MO	24	3,356	300	392	5,729	239	26.9	26.9	28.9	0.5	1,205
Douglas Cnty Sch Dist #1 Omaha	NE	390	46,549	95	100	14,919	38	23.6	23.1	288.3	4.4	1,696
Lancaster Cnty Sch Dist #1	NE	240	31,514	97	98	13,839	58	13.5	9.4	289.6	2.9	1,698
Cold Spring Harbor Cent Sch Dist	NY	9	2,045	298	311	2,792	321	16.7	5.5	38.2	2.1	6,508
Pelham Un Free Sch Dist	NY	12	2,510	176	207	1,759	148	19.1	5.0	33.2	2.0	2,797
Orange Sch Dist	OH	14	2,374	208	230	2,852	206	55.6	39.4	28.9	2.1	4,325
Collin Cnty Comnty Coll Dist	TX	680	18,300	159	161	56,268	83	54.8*	N.A.	57.6	0.1	85
Dallas Cnty Cmnty Coll Dist	TX	2,307	58,092	107	110	132,486	57	28.1*	N.A.	166.2	4.2	2,414
Tarrant Cnty Jr Coll Dist	TX	1,628	34,356	118	115	96,598	59	63.8*	N.A.	68.0	4.1	2,413
Madison Area Technical Coll Dist	WI	691	8,900	114	112	61,241	89	25.8	22.0	24.4	2.7	2,382
Average		374	13,591	212	227	29,621	177	30.4	26.5	71.4	2.1	3,197
Median		63	4,383	199	220	10,610	179	20.6	20.1	42.6	2	2,691

* These districts only report on a government-wide basis. Total unrestricted net assets/total net assets used. HH-Household; EBI-effective buying income; PC-per capita; TMV-total market value; GFB-general fund balance; UFB-unrestricted fund balance. OD-overall debt; DD-direct debt; N.A.-not available.

Glossary

General fund balance/expenditures	The annual dollar amount of reserves the municipality has in its general fund as a percentage of general fund expenditures at the end of the fiscal year. Source: Audits and Comprehensive Annual Financial Reports of the municipalities.
Household EBI % of U.S.	Effective buying income measures income after taxes. Household EBI measures income on a household basis, irregardless of the number of family members and compares it on a ratio basis to a national average. Source: Claritas Inc.
MV/capita	Total market value divided by population.
Overall net debt % of MV	Overall net debt to market value. A ratio of the dollar value of debt to the value of the underlying tax base. This number provides insight into how heavy or light the debt burden is on taxable property. Source: Official statements of municipalities and Comprehensive Annual Financial Reports.
Overall net debt per capita	This number generally includes underlying and overlapping debt, and indicates how heavy the debt burden is for residents. Source: Official statements of municipalities and Comprehensive Annual Financial Reports.
PC EBI % of U.S.	Per Capita Effective Buying Income measures after tax income on a per person basis as a ratio of the nation's PC EBI. Source: Claritas Inc.
Population	The number of residents in the community. Source: Bureau of the Census.
Total direct debt	The total amount of debt the issuer is directly responsible for repaying. It excludes overlapping and underlying debt.
Total market value	The value of the municipality's taxable property. Source: Official statements of the municipalities.
Unreserved general fund balance / expenditures	Similar to total general fund balance, but more restrictive because only those funds not reserved for some specific purpose are included. Source: Audits and Comprehensive Annual Financial Reports of the municipalities.

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