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Colorado School Finance Project

Moody’s K-12 School District Methodology Change

Background

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- On January 26, 2021, Moody's published a new rating methodology for US K-12 Public School Districts.
  - Moody's previously rated school districts using their US Local Government General Obligation Debt rating methodology. This is the same methodology used to rate counties, cities, and special districts.
  - Other rating agencies still rate school districts using the same GO methodology that they use for local governments.

- The methodology change resulted in two major adjustments to the way that school districts will be rated.
  - **Issuer Credit Rating** – The new methodology formally establishes an Issuer Credit Rating. This rating is not assigned to a particular financial obligation but is meant to rate the underlying credit worthiness of a district. Ratings for financial obligations such as general obligation bonds and certificates of participation are now 'notched' off this rating.
  - **Rating Methodology & Credit Factors** – The new methodology also changed the actual scorecard used to assess school districts. Importantly, the new methodology removed tax base, added enrollment trends, and increased the weighting on pensions from the scorecard.

Issuer Credit Rating

- Under the prior methodology, school districts were assigned a rating for their general obligation bonds which was effectively considered the district's issuer credit rating.
  - Ratings for COPs or lease obligations were typically one 'notch' lower than a district's general obligation bond rating due to appropriation risk.

- The new methodology establishes criteria for a district's Issuer Credit Rating, which would include similar factors to the prior rating methodology. Under this methodology, a financial obligation issued by a district will now be notched from this Issuer Credit Rating.
  - All Colorado school districts now receive one positive notch to their Issuer Credit Rating for their general obligation bond rating based on the lockbox and other security features established in statute.
  - However, this may mean a district's COP rating is one notch lower than it was under the prior methodology.

Hypothetical Rating Scenario		
	Prior Methodology	New Methodology
General Obligation Bond Rating	Aa2	Aa2
Issuer Credit Rating	n/a	Aa3
Certificates of Participation	Aa3	A1

Rating Methodology

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- The new methodology includes several changes to the scorecard methodology that was previously used to rate school districts.

- Primary changes include:
  - Removing tax base size;
  - Adding enrollment trends;
  - Removing fund and cash balance trends;
  - Increased weighting on debt and pensions.

	Prior Methodology		New Methodology	
Factor	Sub-Factor	Sub-Factor Weight	Sub-Factor	Sub-Factor Weight
Economy	Tax Base Size	10%	Resident Income (MHI)	10%
	Full Value per Capita	10%	Full Value per Capita	10%
	Wealth (MFI)	10%	Enrollment Trend	10%
Finances / Financial Performance	Fund Balance	10%	Available Fund Balance Ratio	20%
	Fund Balance Trend	5%		
	Cash Balance	10%	Net Cash Ratio	10%
	Cash Balance Trend	5%		
Management	Institutional Framework	10%	Institutional Framework	10%
	Operating History	10%		
Debt & Pensions / Leverage	Debt to Full Value	5%	Long-term Liabilities Ratio (Debt + ANPL + Adjusted Net OPEB) / Operating Revenue	20%
	Debt to Revenue	5%		
	Moody's Adjusted Net Pension Liability to Full Value	5%		
	Moody's Adjusted Net Pension Liability to Revenue	5%	Fixed-Costs Ratio Adjusted Fixed Costs / Operating Revenue	10%

Reduced total factor weighting by 10%

Increased total factor weighting by 10%

Pension Note: Moody's performs their own calculation to determine a district's pension liability and does not just incorporate the amount shown in a district's audited financial statements.

Pensions are now factored into 30% of a district's overall rating; previously included in just 10%

PERA and Moody's Ratings

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- Over the last several years, PERA's unfunded liability has been a common focus for Moody's in their evaluation of Colorado school districts.
  - The change in methodology increases the amount of focus on pensions in a district's scorecard rating.

- Press releases and credit opinions from Moody's for Colorado school districts frequently identify the above-average leverage statistics, led by the higher pension liabilities, as a credit negative.

- The two sub-factors in the Leverage category reflect two different pension statistics.
  - The long-term liability ratio reflects a district's current pension liability and outstanding debt compared to operating revenue. This is a more standard 'leverage' calculation.
  - The fixed-cost ratio is meant to capture what percentage of a district's operating revenue would be potentially impacted to improve funding levels by fully funding the actuarially required contribution (also referred to as their "Tread Water" statistic).
    - It is generally viewed as a credit negative that State statute does not require plan participants to fund this contribution amount.

Impact to Colorado School Districts

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- In general, the change in methodology was beneficial to most Colorado school districts.
  - The methodology change resulted in the immediate upgrade of general obligation bond ratings for 42 school districts in Colorado.

- In addition, 11 school districts were put under review for a potential downgrade and seven districts were put under review for a potential upgrade.
  - Of those districts that were under review for a downgrade, only one school district had their general obligation bond rating downgraded. All others had their general obligation bond rating affirmed at the existing rating level.
  - Of those districts that were under review for an upgrade, six districts had their general obligation bond rating upgraded at least one notch. Four of those districts had their bond rating upgraded two notches and one district's bond rating was upgraded three notches.

- For those districts that were placed under review for a potential downgrade and had their general obligation bond rating affirmed, their COP rating was downgraded one notch.

- Moody's currently rates 60 school districts in Colorado, 59 of which have general obligation bond ratings.
  - 47 school districts now have a rating of Aa3 or higher.
  - Three districts now have a bond rating of Aaa.

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Questions & Discussion