S&P Global
Ratings

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Summary:

Milwaukee Public Schools, Wisconsin; Appropriations

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Summary:

Milwaukee Public Schools, Wisconsin; Appropriations

Credit Profile		
Milwaukee Pub Schs federally taxable redev lse rev bnds (Qualified Zone Academy Bonds)		
Long Term Rating	A+/Stable	Affirmed
Milwaukee Redev Auth, Wisconsin		
Milwaukee Pub Schs, Wisconsin		
Milwaukee Redev Auth (Milwaukee Pub Schs) taxable pension fdg bnds ser 2003 C-D dtd 12/23/2003 due 04/01/2026-2041 & 10/01/2043		
Unenhanced Rating	A(SPUR)/Stable	Downgraded

Rationale

S&P Global Ratings lowered its long-term rating and underlying rating (SPUR) to 'A' from 'A+' on Milwaukee Public Schools (MPS), Wis.'s the series 2003C and 2003D taxable pension funding bonds, issued by the Redevelopment Authority of the City of Milwaukee (RACM), reflecting the district's recent substantial decline in available reserves. In addition, the ratings on the series 2003C and 2003D bonds are based on the application of S&P Global Ratings' criteria, "Issue Credit Ratings Linked to U.S. Public Finance Obligors' Creditworthiness", published Jan. 22, 2018 on RatingsDirect. At the same time, S&P Global Ratings affirmed its 'A+' long-term rating on MPS' series 2016A and 2017A redevelopment lease revenue bonds and series 2015A, 2016B, and 2016C taxable redevelopment lease revenue bonds, issued by RACM based on the application of our criteria. The outlook is stable.

The authority is a component unit of the city of Milwaukee. S&P Global Ratings does not rate any of the district's unlimited-tax general obligation (GO) debt. The ratings are based on the district's implied general creditworthiness.

In December 2017, S&P Global Ratings placed MPS' ratings on CreditWatch with negative implications reflecting our view that MPS' financial position likely weakened in fiscal 2017 (year-ended June 30, 2017), given preliminary financial information provided to us by district officials. Since that time, we have received and reviewed the final 2017 audit. These rating actions resolve the previous CreditWatch placement.

The district's series 2003C and 2003D bonds are special obligations of the city, secured by annually appropriated legally available funds. The district's pledge to make debt service payments, subject to annual appropriation, is supported by the district's arrangement with the state to intercept state aid funds to make up for any debt service deficiencies. We rate these obligations one notch lower than the district's general creditworthiness to reflect the appropriation risk associated with annual payment. We view these bonds as having a strong relationship to the obligor and provide funding for a purpose that is significantly important to it. The district has pledged to annually appropriate from its operating revenues for debt service. In our opinion, there is no unusual political, timing, or administrative risk related to debt payment.

The series 2015A, 2016A-C, and 2017A bonds are secured by the district's rental payments to the authority as lessor in accordance with an amended and restated lease. The lease is not subject to annual appropriation or renewal. Rent is payable from any legally available funds of the city without a dedicated debt service levy, and the city's rental payments are not subject to annual appropriation. Bond proceeds funded improvements to a number of school buildings covered under the lease agreement. The buildings are owned by MPS and have or will be conveyed to the authority through a ground lease. The authority will then lease the buildings and improvements to MPS, which has the option of purchasing the buildings from the authority for a nominal amount after the bonds are paid. Although the rental payments are not subject to annual appropriation, they are only payable from legally available funds without a debt-service levy, and the district is able, but not required, to cancel the lease if it does not have "quiet enjoyment" of the leased properties in the event of a "material disturbance". In the event the lease is terminated, the bonds are subject to redemption, according to the trust indenture, and the district will have to vacate all the buildings under the lease. MPS' ability to terminate the lease and refuse to make lease payments is optional, not mandatory.

The ratings reflect our view of the district's:

- Position at the center of the broad and diverse economy of the Milwaukee metropolitan statistical area (MSA);
- Close relationship with the city of Milwaukee, which issues general obligation (GO) debt for the district, holds the school operations fund, and has a history of providing MPS with liquidity; and
- Financial management policies and practices that we consider good under our financial management assessment (FMA) methodology.

Partly offsetting these credit factors, in our view, are the following:

- Significant decline in available general fund reserves in fiscal 2017;
- Adequate-but-below-average income levels;
- Recent history of declining enrollment, which is linked to state aid; and
- Moderate-to-moderately high debt burden.

Economy

MPS serves an estimated population of 597,802. The median household effective buying income (EBI) in the district is 67% of the national average, and the per capita EBI in the district is 65% of the national average, both of which we consider adequate. The district's total $26.9 billion equalized value in 2018 is adequate, in our view, at $45,005 per capita. Equalized value grew by a total of 3.6% overall from 2016 to $26.9 billion in 2018, but in 2018 it decreased slightly by 0.5%. Roughly 5.3% of equalized value comes from the 10 largest taxpayers, representing a very diverse tax base in our opinion.

MPS provides early childhood and pre-kindergarten through grade 12 (K-12) education to Milwaukee and is the largest school system in the state. MPS' financial powers are limited to budget adoption authority, while the city of Milwaukee levies and collects MPS' property taxes, issues GO debt and revenue anticipation notes for school purposes, and holds the school-operations fund on MPS' behalf. The city also provides the school system with short-term liquidity for operations as needed.

Finances

A three-year moving enrollment average is a key factor in Wisconsin school district per-pupil revenue, which is subject to a cap that the state determines. Although annual student count fluctuations do not have a material effect on finances, a trend of increasing or decreasing enrollment could lead to an increase or decrease, respectively, in revenue. Enrollment totaled 78,652 students in 2017 and decreased overall from 2013 to 2017.

MPS' enrollment has been in decline for years due to outmigration to the suburbs, charter-school growth, and the state-mandated parental choice program. The state expanded the Milwaukee Parental Choice program in 2011 by eliminating the enrollment cap and increasing the family income limitation.

After experiencing declines for more than a decade, the district experienced a slight increase in enrollment of 0.6% in fiscal 2017. Despite this increase, enrollment in fiscal 2018 declined, in part, due to a decrease in non-instrumentality charter school enrollment. Management indicates that it expects enrollment to stabilize after the decline in fiscal 2018. Future stable enrollment would help the district maintain balanced operations, because most general fund revenue consists of state equalization aid and property taxes that are subject to the state's per-pupil revenue limit.

After posting a slight surplus in its general fund in fiscal 2016, in audited fiscal 2017 MPS reported a substantial decline in its general fund of approximately $10.3 million, leaving it with $31.2 million in available reserves. This available fund balance represents approximately 2.9% of general fund expenditures in 2017, a level that we consider still adequate, though substantially lower than reserves in fiscal 2016, when it held $41.5 million and 3.9%. Contributing to this result was the district's early implementation of Governmental Accounting Standards Board (GASB) Statement No. 86, Certain Debt Extinguishment Issues in fiscal 2017, which required it to reclassify certain debt service transfers that were previously designated as prepaid items. The district also experienced higher general fund expenditures in 2017 that weakened budgetary performance. Specifically, the district incurred $10.0 million in increased health care expenses and $7.5 million in additional facilities costs, among other increased expenditures. With regard to fiscal 2018, the district's budget calls for a break-even result after transfers. District officials report that they are currently on track with its budget.

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.

Management provides the board with monthly budget-to-actual reports, and plans each year's budget with the help of five-year enrollment projections, historical trending of revenues and expenditures, six-year financial projections, and a 10-year capital plan. The district's cash is held by the city according to the board's investment policy; management does not provide routine portfolio reports to the board. Although MPS does not have a formal debt management policy, management abides by some written practices when issuing debt. The board approved a formal fund balance policy that calls for MPS to maintain a "fiscally responsible" unassigned general fund balance for cash flow and to cover contingencies.

Debt

Overall net debt is moderately high, in our opinion, as a percent of market value at 7.6%, but moderate on a per capita basis at $3,413. With 64% of the district's direct debt scheduled to be retired in 10 years, amortization is fairly rapid.

Debt service carrying charges were 6.3% of total governmental fund expenditures excluding capital outlay in fiscal 2016, which we consider low.

In December 2017, the district privately placed two series of bonds with local banks totaling $34.9 million to finance capital improvements and deferred maintenance needs at schools within the district. We have reviewed the documents reflecting these obligations and they do not contain any nonstandard events of default or materially adverse acceleration terms, in our view, that could significantly affect the district's finances. The district does not expect to issue any additional new money debt in the near term, apart from its annual short-term borrowing in the fall.

With regard to MPS' existing interest-rate swaps, the $130.85 million series 2003D pension bonds bear interest at a floating index rate and are hedged by three floating-to-fixed interest-rate swaps with different counterparties. The swaps can be terminated if the bond rating falls below 'BBB+' for one of the swaps and below 'BBB-' for the others. Given the terms, we do not think the swaps pose a significant liquidity risk. The series 2003D pension bonds were purchased by a single buyer when the district converted the interest-rate mode from auction rate to the current index rate in 2005. According to the bond purchase agreement associated with the direct purchase, there are no events of default that lead to bond acceleration. For this reason, we do not think the direct purchase poses a significant liquidity risk. The series 2016C bonds were also issued to a local bank. We do not believe this obligation poses a significant liquidity risk to MPS, because the bonds are not subject to acceleration events of in the event of default and have a par amount of only $1.5 million.

Pension and other postemployment benefit liabilities

In fiscal 2017, the district paid $44.8 million toward its pension obligations, equal to 98.7% of the full required contribution. The district's full required pension contribution totaled 3.6% of total governmental expenditures. The district also contributed $33.7 million, or 2.6% of total governmental expenditures, toward its other postemployment benefits (OPEB) obligations in fiscal 2017. Combined pension and OPEB carrying charges totaled 6.2% of total governmental fund expenditures in 2017.

The district participates in the Wisconsin Retirement System (WRS) and the Employees' Retirement System (ERS) of the city of Milwaukee, in addition to providing two supplemental defined-benefit pension plans. The district's proportionate share of the net pension liability for WRS and ERS was $21.8 million and $56 million as of Dec. 31, 2016 and June 30, 2017, respectively, for each of the plans. The district contributes toward an OPEB trust fund, which reported actuarial assets of $128.8 million and an unfunded actuarial accrued liability of $868.6 million as of July 1, 2015.

Outlook

The stable outlook reflects our view that management will maintain balanced operations in most years through conservative budgeting, despite declining enrollment. We do not expect to change the ratings within the two-year outlook horizon. The district's participation in broad and diverse the Milwaukee MSA provides additional support for the rating.

Downside scenario

We may lower the ratings if MPS experiences fiscal stress resulting in a further weakening of its available reserves.

Upside scenario

We may consider raising the ratings if MPS' key economic indicators substantially improve and if the district were to significantly increase its reserves over the next few years to a level commensurate with higher-rated peers.

Related Research

Alternative Financing: Disclosure Is Critical To Credit Analysis In Public Finance, Feb. 18, 2014

Ratings Detail (As Of March 16, 2018)		
Milwaukee Pub Schs federally taxable redev lse rev bnds QECB-dir pymt subsidy		
Long Term Rating	A+/Stable	Affirmed
Milwaukee Pub Schs redev lse rev bnds		
Long Term Rating	A+/Stable	Affirmed
Milwaukee Redev Auth, Wisconsin		
Milwaukee Pub Schs, Wisconsin		
Milwaukee Redev Auth (Milwaukee Pub Schs) federally taxable redev lse rev bnds QSCB-dir pay subsidy (Milwaukee Pub Schs) ser 2015A due 05/15/2041		
Long Term Rating	A+/Stable	Affirmed
Milwaukee Redev Auth (Milwaukee Pub Schs) redevelopment lse rev bnds (Milwaukee Pub Schs) ser 2017A due 11/15/2036		
Long Term Rating	A+/Stable	Affirmed

Many issues are enhanced by bond insurance.

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.