S&P Global Ratings

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Summary:

Indiana Bond Bank; Appropriations

Primary Credit Analyst:
Anna Uboytseva, Chicago (1) 312-233-7067; anna.uboytseva@spglobal.com

Secondary Contact:
Oscar Padilla, Dallas (1) 214-871-1405; oscar.padilla@spglobal.com

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Credit Profile		
US$87.51 mil common sch fd advancement purch funding bnds ser 2019A due 01/15/2023		
Long Term Rating	AA+/Stable	New

Rationale

S&P Global Ratings assigned its 'AA+' long-term rating to the Indiana Bond Bank's series 2019A taxable common school fund (CSF) advancement purchase funding bonds. The outlook is stable.

The bonds are secured by loan repayments from up to 69 individual school corporations, each of which has agreed to have state aid (subject to appropriation by the state of Indiana) withheld to repay the loans.

Factors contributing to the 'AA+' rating include:

- Appropriated state aid that is withheld from participating school corporations (advancement payments) to pay advancement agreements;
- Very strong coverage of loans for each participant by its appropriated state aid;
- The state's long-standing commitment to school funding, demonstrated by a history of stable and predictable state aid payments to schools; and
- Indiana's strong creditworthiness ('AAA' issuer credit rating [ICR]).

The individual school corporation loans are in the form of advancement agreements, and are payable from advancement payments, which have been pledged to the series 2019A bonds. Each school corporation has agreed to have its school tuition support payments (and any other funds appropriated by the state for distribution to the school corporation) withheld by the state to directly pay its advancement agreement--this withholding is considered the advancement payment. Given that the state is directly making these advancement payments from revenues appropriated out of its general fund, and that repayment of each school corporation's semi-annual loan amount depends on its appropriated state aid being sufficient to cover its loan amount, we consider each of these advancement agreement obligations to be the equivalent of an appropriation pledge of the state of Indiana. Therefore, we rate the series 2019A bonds one notch off the state ICR), reflecting annual appropriation risk. For more information on the state ICR, please refer to the full analysis on Indiana published Dec. 21, 2018, on RatingsDirect.

Section 20-49-4 of the Indiana Code permits the Indiana State Board of Education (SBOE) to advance money from the state CSF to school corporations to finance school building construction and education technology programs. These loans are evidenced by advancement agreements entered into between the school corporation and the state treasurer, acting on behalf of SBOE and the state Board of Finance (BOF). These agreements authorize the SBOE and BOF to withhold state aid that has been appropriated by the school corporation to repay the loans. The loan repayment schedules are established in the advancement agreements.

The statute also authorizes the state BOF to sell these advancement agreements to the Indiana Bond Bank, in whole or in part, through an advancement acquisition and administrative agreement, thereby affording the bond bank the right to receive the withheld state aid payments (advancement payments). The bond bank is issuing the series 2019A bonds to purchase from the state the advancement agreements securing the loans issued by up to 69 individual school corporations. The state will then use the proceeds from selling the agreements to the bond bank to make future additional loans to school corporations from the CSF.

The advancement acquisition and administrative agreement requires the SBOE, BOF, and state treasurer to take all actions necessary to execute and deliver the advancement payments to the trustee for the benefit of the bondholders. The bond bank has assigned its rights under the advancement acquisition and administrative agreement to the trustee for the benefit of the bondholders. We also note that if advancement payments for an individual school corporation do not cover that school corporation's loan amount, there is no step-up provision or requirement for increased advancement payments from other school corporations. In addition, there is no debt service reserve fund for the series 2019A bonds.

The bond bank is only purchasing CSF loans made for school building construction.. The loans are generally limited to the greater of $15 million or the product of $15,000 multiplied by the number of students accommodated by the improvements unless the school corporation has sustained a loss caused by fire, wind, cyclone, or other disaster, in which event such limitation may be waived by the BOE after consulting with the Department of Education and the budget agency. Advancements for educational technology programs are not limited in amount other than the availability of funds in the CSF set aside for this purpose and the ability of the school corporation to repay the advancement. The loan terms for construction projects cannot exceed 25 years; the loan terms for education technology programs cannot exceed five years. All agreements purchased by the bond bank with 2019A bond proceeds will be limited to advancements previously made for construction programs only.

Pursuant to the advancement agreements, CSF loans are payable to the state on Jan. 1, and July 1, of each year. Each Jan. 1, and July 1, the state treasurer will make a payment from its general fund to the CSF in an amount equal to the scheduled CSF loan repayment amounts due on that date. These payments a made to a restricted CSF debt service subaccount, and on the same day, are transferred to the trustee for the series 2019A bonds, in amounts sufficient to fund the upcoming Jan 15 and July 15 debt service payments on the series 2019A bonds. To reimburse itself, the SBOE and BOF then withhold amounts from each of the next six months' scheduled state aid distributions to each school corporation equal to one-sixth of the previous Jan. 1, and July 1, CSF loan repayments.

The amount of revenue the state treasurer will transfer from its general fund to pay a CSF loan (as well as the amount the SBOE and BOF will, in return, withhold in the following six months to reimburse itself) is equal to an amount up to the total amount of state aid that has been appropriated and allocated for distribution to the school corporation during the current state fiscal year. Thus, CSF loan repayments are subject to appropriation risk of the state. There is also risk in that the size of the appropriation must be sufficient to cover the annual CSF loan repayments. For this reason, we also evaluate the level of appropriated, allocated state aid for distribution to a school corporation during the state's fiscal year against the size of the CSF loan payments that are due in the same period. Each of the school corporations with advancement agreements that may be purchased by the bond bank has very strong coverage of the maximum annual CSF loan payment by annual state aid.

We also note that, pursuant to Section 20-48-1-11 of the Indiana Code, the state treasurer could be obligated to intercept and advance appropriated, allocated state aid in an amount to cover a default on a school corporation's lease- and general obligation-backed debt. We understand that the state aid available to be intercepted pursuant to this statute would be net of amounts needed to repay semiannual CSF loans. While this effectively prioritizes CSF loans over other school corporation debt obligations, we still evaluate annual state aid against maximum annual debt service (MADS) on all school corporation debt, including CSF loans. MADS coverage on all obligations by annual state aid for each school corporation remains very strong. The lowest MADS coverage is 2.14x.

In addition, in the absence of a budget, we note that the state would not be able to make general fund transfers to pay the CSF loans, which introduces late budget adoption risk. However, given Indiana's history of on-time budget adoption and what we consider an incentive for timely budget adoption given no continuing appropriations, we do not view there to be significant risk of late budget adoption. We also expect that Indiana will continue to consider annual appropriations to the Department of Education for distribution to school corporations a high budget priority. CSF loans provide funding for education related projects we believe are significantly important to the state. The state has an established track record of appropriating for resources necessary to satisfy debt service, and, in our opinion, there is no unusual political, timing, or administrative risk related to the debt payment. We view the intended payment source as strong.

Outlook

The stable outlook reflects the strength of the CSF and advancement agreement structure, the state's commitment to funding school corporations and to adopting timely budgets, and our expectation that coverage for each participant will remain very strong.

It also reflects our stable outlook on the state, and specifically our view of Indiana's strong financial position and management's commitment to maintaining structural balance and a high level of reserves. In addition, we expect the state to make adjustments as necessary to restore budgetary balance if revenues do not come in as forecasted. We believe Indiana has demonstrated a strong commitment to strengthening budget and management controls and overall financial management, and base the outlook on our expectation that these practices will continue. A downside risk to the rating is the significant economic reliance on manufacturing and exports. If global economic conditions weakened and led to an appreciation of the dollar or if the manufacturing sector were to sharply decline in the medium term, it could weaken the state's economy, which could in turn weaken Indiana's credit profile if not actively managed. In addition, while we believe the state's pension liabilities remain manageable within the short-to-medium term, Indiana's liability associated with the state's pay-as-you-go plan (Pre-1996) could add budgetary pressure as resources in the pension stabilization fund are exhausted and appropriations fund annual contributions in their entirety.

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 S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.