Summary:
Denver City & County School District No. 1, Colorado; Appropriations; General Obligation; School State Program

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Credit Profile

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<td>Underlying Rating for Credit Program</td>
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Rationale

S&P Global Ratings assigned its 'AA' long-term rating to Denver City & County School District No. 1, Colo.'s series 2020A certificates of participation (COPs). At the same time, S&P Global Ratings affirmed its 'AA+' long-term rating and underlying rating on the district's existing general obligation (GO) bonds and its 'AA' long-term rating on the district's COPs outstanding. The outlook is stable.

Security and use of proceeds
The COPs represent an interest in lease payments made by the district as lessee, subject to annual renewal, to the lessor for the use and possession of the leased assets, which include essential assets of the district. The district has covenanted to budget and appropriate funds for the bonds' repayment, and has considered the affordability of the lease payment in its long-term plans. We considered the affordability and likelihood of the lease payment, which is reflected in the appropriation rating and in our view of the district's general creditworthiness. We rate these obligations one notch lower than our view of the district's general creditworthiness to account for the appropriation risk associated with the lease payment. In our view, the lease features and terms are standard, with no unusual risks regarding timely payment of debt. There will not be a debt service reserve for the COPs. The series 2020A COPs will be issued in a par amount of approximately $40.2 million, and proceeds will be used for various capital improvements to school facilities.

Revenue from an unlimited ad valorem property tax, collected by the city and county and dedicated to the bonds' repayment, secures the outstanding GO bonds. Revenue, once collected, applies to debt service payments and is not available for operations or other purposes.

Credit overview
The ratings further reflect our opinion of the district's:

- Broad and diverse local economy with good to strong income and extremely strong wealth indicators;
- Maintenance of a strong available fund balance position;
- Good financial management policies and practices;
• Increasing enrollment trend, which is expected to continue; and
• Significant revenue flexibility supported by several mill levy overrides and a substantial reserve for teacher compensation.

Partly offsetting the above strengths, in our view, are:

• The state funding formula, which limits the district’s further revenue-raising ability outside of its current levies and student enrollment, and
• The district’s moderate to high overall debt burden, with slow amortization and a carrying charge that we consider elevated.

The district benefits from its large and diverse tax base, serving the growing Denver metro area. As a result of the 2019 teacher strikes, the district granted an 11.7% pay increase to teachers with a guaranteed cost-of-living increase over the next two years, which increased expenditures beginning in fiscal 2020. While fiscal 2020 may result in a drawdown due to the salary increases, the district anticipates increased state revenues that will begin coming in over the next year and recent expenditure reductions to offset the costs and we believe the district will return to operational balance in the next year. Overall, the district anticipates stable operations in the coming years, maintaining its strong reserve position. Consequently, we anticipate stability in the district’s credit fundamentals throughout our outlook horizon.

Economy
Denver City & County School District No. 1 serves an estimated population of 717,341. The district encompasses 155 square miles and is coterminous with Denver City and County, making it the largest tax base of any Colorado school district. Denver serves as a service, trade, and transportation center for the greater Rocky Mountain region. Denver’s leading employment sectors are diverse, including professional services, government, education, health, and wholesale and retail trade. As a result of the district’s access to a broad and diverse regional economy and associated metropolitan statistical areas, we view the district’s median household effective buying income (EBI) as good, at 107% of the national level, but per capita EBI as strong, at 129%.

The district’s tax base has exhibited very strong growth since 2013, rising by more than 20% biannually, primarily driven by the rebounding real estate market and ongoing new development. From 2018 to 2020, actual value grew by 23% and totaled $167 billion in 2018, which is extremely strong, in our view, at $233,641 per capita. The district’s assessed value (AV) followed a similar trend, increasing by a total of 27% over the last two years to $22.2 billion in 2020. Roughly 8.6% of AV comes from the 10 largest taxpayers, representing a very diverse tax base, in our opinion.

The Mountain states continue to lead the country in net immigration from other states, and we expect most of these new residents to find work, with nonfarm employment growth expanding through 2021, although we expect the pace to slow to 1.3% in 2021 from 2.4% this year. As many of these new residents come with coastal-level buying power, we anticipate that median home price growth will continue to give developers incentive to build in a region with plenty of land but that the pattern will be uneven. Contrary to the national trend, in the Mountain region we continue to be pessimistic about housing starts in 2019, with every state but Arizona and Wyoming likely experiencing declines and an aggregate 5% slowdown. However, we have eased back on this pessimism slightly in the past quarter and for 2020 expect a 1% uptick for the region as a whole, albeit followed by a 2% decline in 2021. For additional information,
please refer to our report "In The Mist Of Mixed Economic Signals, U.S. State And Local Credit Quality Remains Strong," published Oct. 29, 2019, on RatingsDirect.

**Finances**

Student enrollment drives operating revenues under the state funding system. The pupil count for districts with declining enrollment is the greater of a two-year, three-year, four-year, or five-year average of the October counts. Therefore, while annual pupil count fluctuations do not have a material effect on finances, continuing declining enrollment could lead to a material decrease in revenue. The district's enrollment has experienced good growth year over year, increasing by an average annual rate of 1% to 3% in the past few years. The student headcount stood at 93,356 in fiscal 2019, a 0.4% increase from fiscal 2018. Preliminary estimates reflect flat enrollment in fiscal 2020 and management anticipates stability over the next three to five years, with some potential for modest declines in the out-years. Additionally, the district has 60 operating charter schools that serve roughly 20% of the district's enrollment. According to management, charter schools have become close to cost neutral through the implementation of facility charges, administrative fees, and charges for the charter's share of pension costs.

In fiscal 2018 (the most recent audit), the district posted an operating deficit of less than 1% of expenditures after transfers, reducing the available fund balance to $89.2 million, which is still strong in our view, at 8.8% of general fund expenditures. We note that our calculation excludes the statutorily required 3.0% Taxpayer Bill of Rights (TABOR) reserve. Management attributed the recent drawdown financial performance to an increase in transfers out of the general fund to the capital reserve fund to return funds that were inadvertently added to the general fund.

Overall, the district benefits from six mill levy overrides that, with electorate approval, allow a school district to generate local property tax revenue in excess of state funding. In general, a mill levy override is restricted to 25% of a district's total program funding. With the most recent override approval, the district's revenue flexibility will increase annually to allow the district to levy at the maximum 25% or higher if the state raises the maximum levy rate. We note that the district is one of a handful of school districts in the state to levy at the maximum amount. Of the district's other mill levy overrides, the district has a fixed mill levy override approved in 2005, which includes an annual inflation factor, to fund the district's professional compensation system, which is an independently governed trust dedicated to teacher merit pay. Electorate support for the district's capital improvement plan and mill levy increases have been strong, in our opinion, as all proposals have been approved since 1998, and only one measure has failed since 1988. The district indicated that it is evaluating additional mill levy overrides for dedicated purposes, which are not subject to the 25% maximum level.

Estimated actuals for fiscal 2019 report near-balanced operating performance, maintaining the available reserve. The fiscal 2020 budget reflects an operating deficit, due in part to an increase in teacher salaries as a result of the 2019 teacher strike, which resulted in an 11.7% pay increase with a guaranteed cost-of-living increase over the next two years. The district reports that the teacher contracts are now settled through 2022 and it continues to repair relationships with the bargaining units. Management expects the impact of the salary increases to be offset by increased revenue from the state and savings from administration staff reductions. According to multiple-year forecasts, the district is expecting modest deficits in the general fund through fiscal 2021, though management indicated that it will likely continue to outperform its budgets and maintain its available fund balance at levels to remain in compliance with the board policy of at least 10% of revenue, inclusive of the 3.0% TABOR reserve.
Management
We consider the district's management practices good under our Financial Management Assessment methodology, indicating financial practices exist in most areas, but that governance officials might not formalize or regularly monitor all of them. Highlights of the district's key policies and practices include:

- Realistic revenue and expenditure assumptions based on the use of an internal driver-based model and benchmarking against those of large neighboring districts;
- Quarterly review of budget-to-actual reports with board participation;
- An annually updated five-year, long-term financial plan for the general fund;
- The lack of a formalized capital improvement plan, but a robust planning and analysis process conducted by a specialized team and accountability committees;
- A formal board-approved investment management policy and annual review of investment holdings and earnings reports with board participation;
- A debt management policy that includes specific minimum swap collateral requirements, but lacks a policy on its level of desired variable-rate debt exposure; and
- A formal fund balance target of 10% of expenditures, inclusive of the 3% TABOR reserve, to which the district has historically adhered.

Over the last year, the district has hired a new superintendent and chief financial officer. Despite the recent staffing changes, the district's financial management policies and practices remain strong and consistent.

Debt
We consider overall net debt (including overlapping debt) to be moderate as a percentage of market value, at 3.2%, but high on a per capita basis, at $6,223. With 50% of the district's direct debt scheduled to be retired within 10 years, amortization is slower than average. Inclusive of the current issuance, the district will have approximately $2.8 billion in direct debt outstanding. Debt service carrying charges were 15.8% of total governmental fund expenditures excluding capital outlay in fiscal 2018, which we consider elevated. Management has confirmed that the district has no alternative financing obligations, which we find can represent a source of contingent liquidity risk, outstanding or under consideration. While the district does not have any established additional debt plans at this time, management indicated that it intends to return to voters in November 2020 for additional GO authorization.

Pension and other postemployment benefit (OPEB) liabilities
The district composes the Denver Public Schools (DPS) division of the Colorado Public Employees' Retirement Assn. (PERA). DPS is a single-employer defined benefit pension plan. The district paid its full statutorily required contribution of $31.6 million toward its pension obligations in fiscal 2018, or 2.0% of total governmental expenditures. Also the district paid $11.4 million, or 0.7% of total governmental expenditures, toward its other postemployment benefit (OPEB) obligations in fiscal 2018. Combined pension and OPEB carrying charges totaled 2.7% of total governmental fund expenditures in 2018, which we consider low.

Pension and OPEB highlights:

- The district's contribution rates have been relatively modest, largely due to the DPS plan merger with PERA in 2009,
which occurred after the district had issued pension obligation bonds that contributed to its strong funded ratio relative to the rest of the PERA schools division. When the funded ratio of the PERA divisions are equalized, we expect contributions to escalate as the poorly funded combined PERA Schools division works to improve its funded status.

• While the district has been meeting its annual statutorily required contributions, it has not been meeting its actuarially determined contribution due to budgetary relief adjustments from the plan merger. The statutory contributions made last year did not meet our minimum funding progress metric. Last year's contributions also did not meet static funding, which we expect will lead to contribution deferrals and increased annual costs for the medium-term as unfunded liability grows.

• The district offers OPEB on a pay-as-you-go (paygo) basis, which we view as poor funding discipline. However, liability is comparatively small and contained for the near-to-medium term.

The district reports a net pension liability of $896.5 million, and the district's PERA division GASB funded ratio was 79.5% as of Dec. 31, 2017 (the most recent valuation date), which remains better funded that the PERA school division level. Liability for PERA Divisions are measured using a GASB discount rate of 7.25%, which is based on the assumed asset return and we view as high compared to our 6.5% guideline. Contributions based on this discount rate may be volatile for the District's budget, which would indicate that the associated liability is underestimated if that is the case.

Since the merger, the district has been making its statutorily required contributions to the pension plan, which includes an allowed offset to the originally determined contribution rate as the district continues to pay off its 2013B pension COPs, which refunded the pension obligation bonds. We understand that the district will eventually begin to increase its contribution to PERA over the next 20 years as the pension COPs mature, increasing the contribution rate over time. When the pension COPs mature in 2037, the allowed offset will be eliminated and the district will be contributing the full statutorily required amount to PERA.

Outlook

The stable outlook reflects our expectation that the district's available fund balance will remain strong at above 8% of general fund operating expenditures over the next two years, supported by what we consider good financial management policies and practices. The stable outlook further reflects our expectation that the underlying tax base will remain at least stable over the outlook period, in line with regional economic trends. Therefore, we do not anticipate changing the ratings within our two-year outlook horizon.

Upside scenario

We could raise the ratings if the district's available fund balance position were to improve to, and we believe they would likely be maintained at, a level we consider very strong.

Downside scenario

We could lower the ratings if the district were to report sustained operational imbalance, reducing the available fund balance to a level that we no longer view as strong.

Ratings Detail (As Of December 30, 2019)
## Ratings Detail (As Of December 30, 2019) (cont.)

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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](http://www.standardandpoors.com) for further information. Complete ratings information is available to subscribers of RatingsDirect at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings’ public website at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column.