FitchRatings

RATING ACTION COMMENTARY

Fitch Rates Socorro ISD, Texas ULT Refunding Bonds *'AAA'* PSF/Underlying 'AA'

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Related Fitch Ratings Content:
Socorro Independent School District, Texas

Fitch Ratings - Austin - 09 Apr 2020: Fitch Ratings has assigned a AAA rating based on the Texas Permanent School Fund (PSF) guarantee and a AA' underlying rating to the following unlimited tax (ULT) bonds for Socorro Independent School District, Texas:

- -$94.4 million ULT refunding bonds, taxable series 2020A;

- $40.1 million ULT refunding bonds, taxable series 2020B;

- $10.8 million ULT refunding bonds, series 2020C.

In addition, Fitch has affirmed the district's Issuer Default Rating (IDR) and the underlying rating on approximately $847 million outstanding ULT bonds (pre-refunding) at 'AA'.

The Rating Outlook is Stable.

New Issue Details

The bonds are scheduled for negotiated sale the week of April 13. Proceeds from the sale will be used to refund outstanding debt for interest cost savings.

SECURITY

The bonds are payable from an unlimited property tax levy and are further backed by the Texas PSF bond guaranty program, rated ‘AAA by Fitch. A change in Fitch's assessment of the Texas PSF bond guarantee program would automatically result in a change in the rating of Socorro Independent School District's ULT school building bonds, series 2020A-C, but would not affect the underlying rating. For more information on the Texas PSF see 'Fitch Affirms Texas PSF Rating at ‘AAA’; Outlook Stable,' dated Nov. 25,2019.

ANALYTICAL CONCLUSION

The 'AA' IDR and ULT rating reflect the district's strong revenue growth prospects, strong gap-closing capacity, and moderate fixed costs. The district faces capital needs given its expectations of consistent, modest-to-moderate enrollment growth, elevating long-term liabilities but not to a level outside the moderate range.

Economic Resource Base

The district is located east of the city of El Paso (GO rated AA/Stable) in an arid ranching area that includes a portion of the Fort Bliss military installation and the Briggs Army Airfield. The district includes the city of Socorro, Horizon City, a portion of the city of El Paso and unincorporated areas of El Paso County

KEY RATING DRIVERS

Revenue Framework:

The district's revenue growth prospects are strong given Fitch's expectations of modest-to-moderate enrollment growth and state per pupil funding levels. The district's independent legal ability to raise revenues is limited by state law.

Expenditure Framework:

Fitch expects the natural pace of spending growth to be in line with to marginally above that of revenue growth. Solid expenditure flexibility incorporates management's control over headcount and salaries within the annual budget cycle and moderate carrying costs.

Long-Term Liability Burden:

Fitch expects the district's long-term liability burden to remain elevated relative to the economic resource base but still within the moderate range based on future debt issuance plans.

Operating Performance:

Fitch expects the district's finances to remain strong through an economic downturn based on sizable reserves and sound expenditure flexibility. Disciplined budget management practices support the district's history of consistently favorable operating performance.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--Sustained reduction in the long-term liability burden materially below 20% of the district's personal income.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--Weakening of the district's enrollment trend, leading to revenue growth gains at or below the rate of inflation.

—Diminished financial flexibility due to sustained structural imbalances stemming from the district's failure to adjust spending to changing enrollment trends, rising employee healthcare benefits, or the maintenance of additional facilities.

BEST/WORST CASE RATING SCENARIO

Ratings of Public Finance issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings visit https://www.fitchratings.com/site/re/10111579.

CURRENT DEVELOPMENTS

The recent outbreak of the coronavirus and related government containment measures worldwide creates an uncertain global environment for U.S. state and local governments and related entities in the near term. While the district's most recently available fiscal and economic data may not fully reflect impairment, material changes in revenues and expenditures are occurring across the country and likely to worsen in the coming weeks and months as economic activity suffers and public health spending increases. Fitch's ratings are forward-looking in nature, and Fitch will monitor developments in state and local governments as a result of the virus outbreak as it relates to severity and duration, and incorporate revised expectations for future performance and assessment of key risks.

For the state's fiscal 2020-2021 biennium, the state is increasing Texas Education Agency (TEA) funding by roughly 20% through the provisions of House Bill 3 (HB3), which was approved by the 2019 Texas legislature and signed into law by the governor. The increased funding is driven primarily by an increase in the per student basic allotment to $6,160 from $5,140. HB3 requires districts to apply 30% of annual increased funding to fulltime employee compensation increases (75% of which would go to teachers, counselors, nurses and librarians). In addition to the funding increase, HB3 calls for the compression of local operating tax rates and requires districts to limit annual operating tax revenue increases to 2.5% (by requiring a reduction in the M&O rate if TAV increases by more than 2.5%). The tax rate compression is designed to be offset by the increase in state revenues.

CREDIT PROFILE

The Fort Bliss army installation (currently the Army's second largest installation) and a sizable medical sector anchored by the downtown El Paso's Medical Center of the Americas, lend stability to the local economy. Economic activity has historically come from El Paso's position as a key international trade corridor near Mexico's maquiladora assembly plants. The bi-national region represents one of the largest manufacturing centers in North America, and trade and transportation is a key employment sector. On March 13,2020, the United States-Mexico-Canada Agreement (USMCA), which replaces the North American Free Trade Agreement (NAFTA), became effective upon the ratification of the agreement by Canada.

The USMCA should reduce key uncertainties for trade among the three countries and lead to positive economic implications for local economies along the U.S-Mexico border. For additional details, please see Fitch's press releases, "Fitch Ratings: US Tariffs on Mexico May Threaten USMCA, Corporate Cash Flow" dated June 3,2019, "NAFTA Replacement USMCA Settles Key Trade Uncertainties" dated Oct. 2,2018, and "NAFTA Termination Could Hit Upper Midwest, Border State Economies Hard" dated April 11,2018, available at www.fitchratings.com.

Revenue Framework

Revenue Framework Details

Funding for public schools in Texas is provided by a combination of local (property tax), state and federal resources. The state budgets the majority of instructional activity through the Foundation School Program (FSP), which uses a statutory formula to allocate school aid taking into account each district's property taxes, projected enrollment and amounts appropriated by the legislature in the biennial budget process. The Tier 1 component of the FSP provides districts a certain level of operational funding, and the basis for most Tier 1 allotments is called the basic allotment The basic allotment is a per pupil dollar amount that is multiplied by average daily attendance (and adjusted for specific circumstances) to produce a district's Tier 1 allotment. In fiscal 2019, the district received 71% of its total general fund revenues from state sources, and 26% from property taxes.

Revenue Framework Growth Prospects

The district's general fund revenues grew by a CAGR of 3.9% in the 10-year period ending fiscal 2019, in line with U.S. GDP growth. Anticipated growth patterns and recent school state funding increases are expected to continue yielding strong revenue growth prospects in the medium term.

Legal Ability to Raise Revenues

With the recent passing of HB3, the district's maintenance and operations (M&O) tax rate was compressed to $0.93 per $100 of taxable assessed value (TAV) from $0.98 in fiscal 2020, the first year of implementation. The district increased the rate an additional $.04 to reach the $0.97 statutory cap above which voter approval is required, leaving it with no independent revenue-raising flexibility. For fiscal 2021, districts will be compressing their M&O rates further to $0.9164 based on the state's projection of statewide property value growth of 4.01%, or further for those that realize property value increases greater than 4.01%.

The district levies a separate unlimited tax rate for debt service. The fiscal 2020 rate of $0,399 per $100 of TAV is well below the state enforced debt service rate cap of $0.50 for new money bond issuance.

Expenditure Framework

Expenditure Framework Details

Typical of school districts, expenditures are dominated by instructional costs, accounting for approximately 63% of general fund spending in fiscal 2019.

Pace of Spending Growth

Fitch expects the district's natural pace of spending growth will be in line with to marginally above the rate of natural revenue growth, based on moderate spending pressures.

Expenditure Flexibility

Expenditure flexibility is judged to be solid based on an analysis of the district's fixed carrying costs for debt service, pension and other post-employment benefits (OPEB) as well as the labor framework and control over service levels. Fitch expects the district's expenditure flexibility to remain solid over the foreseeable future, given its spending flexibility over staffing, strong control over wages and benefits as well as anticipated increases in debt service associated with planned debt issuance.

The Texas legislature in its 2019 session approved Senate Bill 12, which, when signed into law by the governor, will direct the allocation of $1.1 billion in state savings to help improve the funding level of the Texas Teachers Retirement System (TRS) over the next several years. Roughly $600 million from this allocation will be used to finance a one-time payment of $2,000 to retired teachers; the remainder will be used to gradually increase state contributions to TRS. Over the next six years, educators, school districts and the state will incrementally ramp up their respective contributions. Districts and teachers will begin to increase their contributions in 2022; by 2024 teachers will pay 8.25% of salary (up from 7.7% currently), with districts increasing their contributions (currently 1.5% of payroll) by 0.1% annually until reaching 2.0% in 2025. Between 2020 and 2024, the state will steadily increase its contribution of total teacher payroll to 8.25% from the current 6.80%. These changes would result in a pension amortization period of no more than 31 years, consistent with the current 32 years.

Fitch has consistently considered the risk that the state could increase district contributions to TRS in its assessment of each entity's expenditure framework, and believes most districts can accommodate the increases mandated by SB 12 without compromising spending flexibility.

Long-Term Liability Burden

Long-Term Liability Burden Details

Currently at 23%, Fitch expects the combined burden of overall debt and direct unfunded pension liabilities (adjusted for Fitch's standard 6% rate of return assumption) to remain elevated, but still within the moderate range, given district issuance plans and trends in personal income. The district has exhausted its 2017 bond authorization but may consider requesting additional bond authorization in the medium term.

Under GASB 67 and 68 reporting, TRS assets covered 82% of liabilities as of fiscal 2018, a ratio that falls to an estimated 65% when adjusted by Fitch to a 6% return assumption. The state assumes the majority of TRS employer contributions and net pension liability on behalf of school districts, except for small amounts that state statute requires districts to assume. The district's pension contributions are determined by state statute rather than actuarially, and they have historically fallen short of the actuarial level. Recent state reforms have lowered benefits and increased statutory contributions to improve plan sustainability over time.

The TRS board at its July 2018 meeting voted to lower the discount rate for the TRS pension plan to 7.25% from 8.00%. This move increases the plan's current $35.5 billion reported net pension liability (NPL) by $10 billion. As noted above, contributions by the state, districts and employees will be increasing over the next six years to help address the increased NPL without increasing the amortization period. This change in the discount rate and overall increase in the NPL does not affect Fitch's analysis of the long-term liability burden, as Fitch currently utilizes a lower 6% return assumption when considering the net pension liability.

Operating Performance

Financial Resilience

The district has high gap-closing capacity and is expected to manage through economic downturns while maintaining a high level of fundamental financial flexibility. The fiscal 2019 audit reported an ample unrestricted fund balance in excess of 30% of spending. The district attributes operating deficits in recent years to increasing employee health care benefit internal service fund contributions in order to maintain a positive position in that fund. The district plans on an additional $9 million (2.3% of budgeted general fund expenditures) cash infusion into the healthcare fund in fiscal 2020. Although additional health care benefit funding is planned through fiscal 2023, the amounts are expected to significantly decrease. The district is launching a new employee health clinic scheduled to begin operating next month that is expected to yield about $1.4 million in annual healthcare costs savings.

In fiscal 2020, the district projects an operating surplus of $11.1 million including one-time expenditures and the health care fund contribution. Fitch expects the district may use some fund balance for one-time expenditures and to make an employee healthcare fund contribution in fiscal 2021, but expects the district to maintain available reserves that are consistent with the 'aaa' financial resilience assessment throughout a typical recession.

Budgetary Management

Budget management during times of recovery is strong despite recent and planned use of reserves to shore up the employee health care benefit fund, as these are expected to be short-term in duration. The district recently adopted a more conservative fund balance policy of 75 days of operating expenditures, an increase from its previous 60-day requirement.

Sources of Information

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

ESG issues are credit neutral or have only a minimal credit impact on the entity(ies), either due to their nature or the way in which they are being managed by the entity(ies). For more informationen Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY/DEBT	RATING	PRIOR
Socorro Independent School District (TX)	LT IDR AA Rating Outlook Stable Affirmed	AA Rating Outlook Stable

ENTITY/DEBT		RATING	PRIOR
• Socorro Independent School District (TX) /General Obligation -	LT	AA Rating Outlook Stable Affirmed	AA Rating Outlook Stable

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

U.S. Public Finance Tax-Supported Rating Criteria -- Effective 3/27/20-5/4/21 (pub. 27 Mar 2020) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Portfolio Analysis Model (PAM), vl.3.1 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

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Socorro Independent School District (TX)	EU Endorsed

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