FitchRatings

Fitch Rates Socorro Independent School District, TX ULTs 'AAA' PSF/'AA' Underlying; Outlook Stable

Fitch Ratings-Austin-03 January 2018: Fitch Ratings has assigned a 'AAA' rating based on the Texas Permanent School Fund (PSF) guarantee and an 'AA' underlying rating to the following Socorro Independent School District, TX unlimited tax (ULT) bonds:

--$173.5 million unlimited tax school building bonds, series 2018;
--$8.9 million unlimited tax refunding bonds, series 2018.

Additionally, Fitch has affirmed the district's $470 million in outstanding ULT bonds and Long-Term Issuer Default Rating (IDR) at 'AA'.

The Rating Outlook is Stable.

The bonds are expected to be sold through a negotiated sale the week of January 2. Proceeds from the sale of the ULT school building bonds will be used to construct, equip, acquire and renovate school buildings in the district. Proceeds from the sale of the ULT refunding bonds will refund a portion of the district's ULT bonds for savings. Both series incorporate costs associated with the issuance and sale of the bonds.

SECURITY

The bonds are payable from an unlimited property tax levy and are further backed by the Texas PSF bond guarantee program (for more information on the Texas PSF see 'Fitch Affirms Texas Permanent School Fund at 'AAA'; Outlook Stable', dated July 21, 2017, available at www.fitchratings.com).

ANALYTICAL CONCLUSION

The 'AA' IDR and ULT rating reflect the district's strong revenue growth prospects, satisfactory revenue-raising capacity, strong gap-closing capacity, and low fixed costs. The district faces capital needs given consistent modest to moderate enrolment 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 (general obligation bonds rated 'AA' with a Stable Outlook by Fitch) 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. Student enrollment is approximately 46,500 and growing at about a 2% compound annual growth rate over the past 10 years.

KEY RATING DRIVERS

Revenue Framework: 'aa'

The local property taxes and state aid that support district operations have yielded revenue growth in excess of the national GDP over the past decade, and that trend is expected to continue given anticipated growth patterns. The district's independent legal ability to raise revenues is limited by state law, although the district retains some margin to raise its maintenance and operation tax rate without voter approval under the legal limit.

Expenditure Framework: 'aa'

District expenditures are likely to keep pace with revenue as growth continues on a moderate trajectory. The low fixed-cost burden reflects state support for debt service, pension, and OPEB costs.

Long-Term Liability Burden: 'a'

Debt and pension liability levels are elevated but in a moderate range relative to personal income. Fitch anticipates the district's long-term liabilities will grow further given authorized debt but remain a moderate burden on resources.

Operating Performance: 'aaa'

The combination of the district's expenditure-cutting flexibility and healthy reserves leave it well positioned to address cyclical downturns.

RATING SENSITIVITIES

Maintenance of Financial Flexibility: The rating is sensitive to material changes in the district's overall financial flexibility, characterized by revenues-raising ability, spending flexibility and robust reserve levels.

CREDIT PROFILE

Economic growth prospects are solid given a history of solid growth in taxable assessed valuation (TAV) and the proximity to military facilities on ongoing expansion of the El Paso metropolitan area. El Paso's economic activity has historically come from its position as a key NAFTA trade corridor near Mexico's maquiladora assembly plants and from the presence of Fort Bliss, the Army's second largest installation.

The region is reliant on cross-border tourism and trade, exposing the district to any changes in U.S. trade policy or additional security measures that would negatively affect trade with Mexico. The district's economic base therefore retains exposure to the uncertainty related to the Trump administration's ongoing renegotiation of the North American Free Trade Agreement (NAFTA). Fitch expects any impact to the district would be mitigated by the large share of funding derived from the state's expansive and diverse economy. For more information, see Fitch Focus on Munis: Trade in the Time of Trump -Part 1 (Select U.S. Regions Could Feel Pinch if NAFTA Trade Policy Changes Dramatically), dated Aug. 30, 2017 and Trade in the Time of Trump - Part 2 (Border Blues: Is Uncertainty over NAFTA Impacting Border Cities) dated Nov. 15, 2017.

Revenue Framework
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 multiplied by average daily attendance (and adjusted for specific circumstances) produces a district's Tier 1 allotment.

Roughly three-quarters of the district's operating revenues come from state aid due to the district's low property wealth, with the remainder derived from local property taxes. Revenue growth is primarily a function of enrollment. Fitch anticipates the moderate projected enrollment growth will continue to spur revenue gains.

The district's general fund revenues have grown at a compound annual growth rate of 3.1% over the past 10 years ending fiscal year 2017, exceeding both U.S. GDP and inflation over that period.

The district's M&O tax rate of $0.981 per $100 taxable assessed value (TAV) could be increased to the statutory cap of $1.04 without voter approval. By 2020 the district will likely increase the M&O rate in order to accommodate growing operational expenses. The district currently levies a separate debt service tax rate of $0.293 per $100 TAV, well under the $0.50 statutory cap for new debt issuances. The rate is unlimited once debt is outstanding. Given the district's newly authorized debt, the debt service tax rate is projected to increase to$0.399 per $100 TAV assuming that about 42% of the district's debt service will be subsidized by the state as it is currently.

Expenditure Framework
The district's main expenditures are salaries and benefits at over 80% of general fund spending.The district also funds some annual capital outlay for maintenance and repairs of facilities from general fund revenues.

Fitch expects expenditure growth to align with revenue growth absent policy actions.

The district's fixed cost burden is low, with carrying costs for debt, pensions and OPEB equaling just under 12% of fiscal 2017 governmental expenditures. This figure falls to approximately 7.6% when state support for debt service is netted out. Areas of spending pressure going forward include climbing health care costs. Over the next three years growth in healthcare costs to the district will be mitigated by recent changes to the benefit plan including increases in premiums, deductibles and employee out-of-pocket contributions. A 3% salary increase was instituted in FY2017 and FY 2018 in order to remain competitive in retaining and attracting teachers. Historical pay increases have averaged 1.5% annually as is planned for FY2019.

Long-Term Liability Burden
The district's long-term liability burden is elevated but within the moderate range at about 22% of personal income, and is constituted mostly of the district's slowly-amortizing outstanding direct debt load. The district's remaining bond authorization suggests that direct debt levels will increase in future years. In addition, there is potential for new borrowing by overlapping entities, currently 36% of net overall debt. Long-term liabilities will likely remain elevated although growth in the burden could be mitigated by expanding population and personal income levels.

In November 2017 the district acquired voter authorization to issue $448.5 million in bonds to construct one middle and two elementary schools and reconstruction of a high school as well as improvements to three other high schools. The board and administration accelerated debt plans given concerns over rising construction costs and interest rates. After the current bond sale the district plans on issuing the remaining of the authorization in July 2019 and July 2020 in $150 million and $98.5 million tranches, respectively. The district anticipates having all bond projects completed by 2022.

Pension and other post-employment benefit (OPEB) liabilities (largely healthcare benefits) are limited because of the district's participation in the state pension program administered by the Teachers Retirement System of Texas (TRS). TRS is a cost-sharing, multiple-employer plan for which the state provides the bulk of the employer's annual pension contribution. Under GASB 67 and 68, TRS's assets cover 78% of liabilities as of fiscal 2017, a ratio that falls to 62% using the more conservative 6% return assumption included in Fitch's updated U.S. Public Finance Tax-Supported Rating Criteria (released May 31, 2017). 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.

Like all Texas school districts, Socorro ISD is vulnerable to future policy changes that shift more of the contributions and liabilities onto districts, as evidenced by a relatively modest 1.5% of salary contribution requirement that became effective in fiscal 2015. Employer pension contributions are determined by state statute rather than actuarially and, like other Texas school districts, have historically fallen short of the actuarial level. Recent state reforms have lowered benefits and increased statutory contributions to improve plan sustainability over time.

Operating Performance
The district has consistently kept a healthy financial cushion. General fund unrestricted reserves are over 33% of spending at fiscal 2017 year-end, slightly lower than in fiscal 2016 due a combination of planned use of committed funds for one-time projects involving improvements to athletic facilities at various campuses and a $4.5 million increase in health care funding. The district retains ample expenditure flexibility to manage well through economic downturns.

The district has demonstrated a strong commitment to supporting financial flexibility. Budgeting is conservative, and historically management has been proactive in using excess revenues to boost reserves and preserve the district's financial position. In fiscal 2017 most of the district's draw on its robust reserves was planned to cover one-time expenditures. Similarly, management has made a strategic decision to use approximately $10 million available reserves to also offset one-time spending in fiscal 2018. Despite the reserve draws outlined, overall reserve levels are expected to remain consistent with the 'aaa' operating performance assessment in fiscal 2018.

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Applicable Criteria

U.S. Public Finance Tax-Supported Rating Criteria (pub. 31 May 2017) (https://www.fitchratings.com/site/re/898466)

Additional Disclosures

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