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## Summary:

# Las Cruces School District No. 2, New Mexico; General Obligation

**Primary Credit Analyst:**
Christopher Grant, San Francisco + 1 (415) 371 5096; chris.grant@spglobal.com

**Secondary Contact:**
Joyce Jung, Centennial + 1 (303) 721 4189; joyce.jung@spglobal.com

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**Summary:**

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| US$12.25 mil GO sch bnds ser 2018 due 08/01/2034 | | |
| *Long Term Rating* | A/Stable | New |

## Rationale

S&P Global Ratings assigned its 'A' long-term rating to Las Cruces School District No. 2, N.M.'s series 2018 general obligation (GO) bonds with a par of roughly $12.25 million. The outlook is stable.

The GO bonds are secured by ad valorem property taxes levied against all taxable property within the district without limitation as to rate or amount. We understand that the district currently has roughly $112.0 million in GO debt outstanding and $31.1 million in capital lease debt outstanding. We further understand that the series 2018 bonds are being issued to finance the construction and improvement of school facilities and the purchase of educational equipment.

The rating reflects our view of the district's:

- Stable and diverse tax base;
- Positive general fund performance since fiscal 2016, with stable enrollment; and
- Low debt burden.

Partially offsetting these strengths, in our view, are the district's adequate income indicators, adequate available fund balance as recently as fiscal 2015, and low pension funding.

### Economy and tax base

The district encompasses about 1,460 square miles in Doña Ana County in southern New Mexico, including the city of Las Cruces, the town of Mesilla, and unincorporated areas of the county. The district operates 41 school sites and serves more than 24,000 students. The district's population was about 154,000 in 2017 and has been stable, growing by only 0.6% annually since 2010.

The district's local economy includes a significant military and federal presence, including the White Sands Missile Range, the NASA White Sands Test Facility, and multiple aerospace contractors. Other significant economic sectors include agriculture, manufacturing, and tourism. The district's median household effective buying income (EBI) was 83% of the national level in 2017 and its EBI per capita was 82% of the national level, both of which we consider adequate. The district's market value per capita (an indicator of wealth) is about $68,000 in fiscal 2018, which we view as strong. The county unemployment rate of 6.3% for the year ended June 2018 is in line with the state rate but above the national rate.

The district's tax base has been relatively stable across the current economic cycle, with assessed value (AV) growing at an average annual rate of 2.7% over the past five years and 2.4% over the past 10 years, reaching $3.5 billion in fiscal 2019. We also view the district's tax base as very diverse, with the top 10 taxpayers accounting for only 4.2% of total AV.

Looking forward, we are forecasting stable to positive economic performance for the mountain states, inclusive of New Mexico, based on steady growth in the professional services, hospitality, and leisure sectors. We expect that the district will benefit moderately from a trend of rising home prices. And while we do not view the regional economy as particularly vulnerable to rising international trade tensions, the district's proximity to a significant border crossing with Mexico could make it somewhat more vulnerable should NAFTA renegotiations lead to a trade slowdown. For additional information, please refer to our U.S. State And Local Government Credit Conditions Forecast, published July 26, 2018, on RatingsDirect.

### Financial profile

We view the district's financial profile as good. The district has achieved positive general fund results since fiscal 2016, when it made efforts to contain labor costs--including a three-day staff furlough and staff reductions through attrition--that had driven deficits from fiscal 2013 to 2015. Unlike several other school districts in the state, this district managed to maintain balanced operations (a 0.2% general fund surplus) in fiscal 2017 despite a midyear reduction in state education funding. These positive results increased the district's available fund balance to 6.5% of general fund expenditures ($11.5 million) as of fiscal 2017, which we consider good, from a low of 2.2% in fiscal 2015 (which we consider adequate).

The district's cash-basis unaudited actuals for fiscal 2018 show a surplus of 2.9% of expenditures and an increase in its available fund balance to 9.6% of expenditures, which we would consider strong. We understand that this surplus--which was higher than budgeted--was due to an improving state funding environment for education and an overestimation of staffing costs. In fiscal 2019, the district plans to increase its staffing levels somewhat, which will draw down some of the available fund balance accumulated in fiscal 2018. While the district's fiscal 2019 budget shows a deficit of 2.2%, we expect that the actual deficit will be smaller due to conservative budgeting practices. However, we expect that the district's available fund balance will remain at a level we consider good over the medium term.

Enrollment is the primary driver of the state's school district equalization formula, which accounts for about 98% of this district's general fund revenues. This district's enrollment has been roughly stable over the past 10 years, despite a 0.9% decline in fiscal 2018 due to competition from private schools. Looking forward, management expects the district's enrollment to remain stable.

### Financial policies and practices

We consider the district's financial management practices to be standard under our financial management assessment (FMA) methodology, indicating our view that the finance department maintains adequate policies in some, but not all, key areas. Key policies and practices include:

- Budgetary assumptions that are based on internal trend analysis of labor costs, stakeholder consultations, and sporadic formal forecasting of enrollment;

- Monthly budget-to-actuals sent to the board, and quarterly cash reports to the state education department;
- A lack of long-term financial projections due to the district's reliance on state equalization revenues for its operations;
- A history of sequential five-year capital improvement plans that include a detailed discussion of funding strategies, but a current absence of an active capital plan since the previous plan expired at the end of fiscal 2018;
- Investment management practices that we consider prudent, but a lack of a formal investment policy;
- A lack of a debt management policy; and
- A lack of a minimum fund balance or reserve policy.

### Debt, pension, and other postemployment (OPEB) liabilities

We consider the district's debt profile to be a credit strength. We consider its debt burden to be low both on a per capita basis (about $1,300) and as a share of market value (1.9%), including the series 2018 bonds. We also view its debt carrying charge as low, at 5.1% of total noncapital governmental funds expenditures in fiscal 2017, and its pace of debt amortization to be rapid, with 79% of principal retired within 10 years. The district has roughly $31.1 million in privately placed capital lease debt outstanding, but we have reviewed the documentation for this debt and believe it does not pose a contingent liquidity risk. Finally, while the district plans to issue roughly $38 million in additional debt through fiscal 2021, we do not expect these issuances to change our view of its debt profile.

On the other hand, we consider the district's pension liability to be a source of long-term risk. The district participates in the New Mexico Educational Retirement Board (ERB) pension plan, which is a cost-sharing, multiple-employer, defined-benefit pension system. In April 2017, the ERB made a number of adjustments to its actuarial assumptions and methods, including lowering its discount rate to 7.25% (from 7.75%) and its payroll growth rate to 3.00% (from 3.50%). While we believe that these changes will likely support the plan's sustainability over the long term, they also decreased the plan's reported funded ratio to 53.0% in fiscal 2017 (from 61.6% in fiscal 2016) under Governmental Accounting Standards Board's current reporting guidelines. Additionally, under the new assumptions, the plan's actuarial assets and future contributions will only be able to finance benefits payments through 2053. Finally, while the district has historically made its full statutorily required pension contribution, planwide actual contributions were only 82.8% of the actuarially determined contribution (which is based on an amortization of the plan's unfunded liability by 2042) in fiscal 2017. Accordingly, we believe that the district's pension costs are likely to rise significantly in the coming years, although its fiscal 2017 pension carrying charge of 6.4% of total governmental funds expenditures is still moderate.

The district's OPEBs consist of health care benefits provided through the New Mexico Retiree Health Care Fund (a cost-sharing, multiple-employer plan). The plan is funded on a pay-as-you-go basis, and the district's contributions accounted for 0.9% of total governmental funds expenditures in fiscal 2017.

## Outlook

The stable outlook reflects our view that the district will maintain an available fund balance that we consider at good, supported by stable enrollment, an improving state funding environment, and low debt. Accordingly, we do not expect to change the rating within the next two years.

### Upside scenario

We could raise the rating if the district's economy were to improve significantly, or if the district were to develop a longer track record of available fund balances at the upper end of the range we consider good (4% to 8% of expenditures) and were to strengthen its financial policies as measured by our FMA.

### Downside scenario

We could lower the rating if the district's staffing or pension costs were to increase beyond what could be supported by the district's state equalization payments, leading us to believe that its operations are structurally imbalanced, or if the district were to reduce its available fund balance to below its fiscal 2015 level of 2.2% of expenditures.

## Related Research

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

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.