

## CREDIT OPINION

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## Roswell I.S.D. (Chaves County), NM

### Update to credit analysis

#### Summary

[Roswell Independent School District](#) (ISD; Aa2), NM's credit profile is stable overall. The district's financial position is healthy, especially relative to state peers. Fiscal 2018 is expected to end with a large surplus due to cost containment measures, and fiscal 2019 is balanced with a small amount of cash reserves. The tax base is moderately-sized, and includes Roswell, the largest city in southeastern New Mexico. The direct debt burden is manageable, and principal amortization is rapid. We note the credit profile is challenged by an elevated pension burden, and annual contributions remain unfavorably below the tread water level.

#### Credit strengths

- » Manageable debt burden with rapid principal amortization
- » Serves Roswell, a regionally important city in southeastern New Mexico
- » Sizeable surplus reported in fiscal 2018

#### Credit challenges

- » Elevated pension burden and weak annual pension contributions

#### Rating outlook

Moody's generally does not assign outlooks to local government credits with this amount of debt outstanding.

#### Factors that could lead to an upgrade

- » Trend of surplus operations, adding to fund balance and reserves
- » Significant tax base expansion
- » Material reductions to the pension and fixed cost burdens

#### Factors that could lead to a downgrade

- » Fiscal 2018 audited results that are not in line with reported performance; deterioration of reserves and fund balances
- » Sustained tax base contractions
- » Increases to the pension and fixed cost burdens that are not comparable to peers

## Key indicators

Exhibit 1

<b>Roswell I.S.D. (Chaves County), NM</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>
<b>Economy/Tax Base</b>					
Total Full Value (\$000)	\$2,726,674	\$2,786,744	\$2,923,504	\$3,051,295	\$3,119,981
Population	58,262	58,262	58,335	58,228	58,228
Full Value Per Capita	\$46,800	\$47,831	\$50,116	\$52,403	\$53,582
Median Family Income (% of US Median)	73.9%	73.9%	75.2%	75.2%	75.2%
<b>Finances</b>					
Operating Revenue (\$000)	\$74,276	\$77,768	\$82,285	\$82,287	\$78,049
Fund Balance (\$000)	\$9,385	\$8,153	\$12,147	\$14,565	\$18,009
Cash Balance (\$000)	\$13,483	\$13,399	\$16,893	\$19,456	\$11,582
Fund Balance as a % of Revenues	12.6%	10.5%	14.8%	17.7%	23.1%
Cash Balance as a % of Revenues	18.2%	17.2%	20.5%	23.6%	14.8%
<b>Debt/Pensions</b>					
Net Direct Debt (\$000)	\$43,660	\$46,250	\$49,680	\$45,255	\$40,950
3-Year Average of Moody's ANPL (\$000)	\$219,268	\$240,728	\$233,310	\$241,782	\$269,227
Net Direct Debt / Full Value (%)	1.6%	1.7%	1.7%	1.5%	1.3%
Net Direct Debt / Operating Revenues (x)	0.6x	0.6x	0.6x	0.5x	0.5x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	8.0%	8.6%	8.0%	7.9%	8.6%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	3.0x	3.1x	2.8x	2.9x	3.4x

Source: District's audits; Moody's; US Census (MFI)

## Profile

The district is located in the [City of Roswell](#) (Aa2), 200 miles southeast of the [City of Albuquerque](#) (Aa2 negative). The economy of the local area is based primarily upon agriculture, oil and gas production, industrial manufacturing and wholesale and retail distribution. The region is accessible by both rail and commercial airline. The district is the largest employer in the county, and educates a little over 10,000 students.

## Detailed credit considerations

### Economy and tax base: moderately sized base in southeastern New Mexico

Despite modest historic fluctuations, the district's tax base will likely remain stable over the mid-term, benefitting from residential development in and around Roswell. Fiscal 2018 assessed value (AV) contracted slightly to \$1 billion, derived from a full value (FV) of \$3.1 billion. The 0.3% decline in the base was attributed to volatility in the energy market, with oil and gas values decreasing to \$9.7 billion from \$13.6 billion. Positively, with oil production rebounding, preliminary fiscal 2019 values indicate expansion of 4.1% to \$1.1 billion, derived from a full value (FV) of \$3.2 billion.

Although the district is near the Permian Basin, the local economy is not centered around oil and gas production, but rather agriculture (dairy) and manufacturing. Leprino Foods, the largest manufacturer of mozzarella cheese in the world, has a plant in Roswell. Additionally, Roswell Industrial Air Center, formerly Walker Air Force Base, refurbishes aircraft. The base is further diversified by New Mexico Military Institute, Eastern New Mexico University - Roswell branch, and Eastern New Mexico Medical Center.

Officials report that tourism is increasing since the city is accessible by direct flights from [Dallas, Texas](#) (A1 stable) and [Phoenix, Arizona](#) (Aa1). Residential development is ongoing, with the city benefitting from a housing shortage in communities south of Roswell.

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Enrollment is fairly stable, although does exhibit some volatility. Fiscal 2018 headcount was 10,122, a decline of 1.8% from fiscal 2017. Management explains that around 100 to 200 students are from families affiliated with the oil and gas industry, thus, during a downturn, these families move elsewhere. Positively, based on fiscal 2019's 10th day count, enrollment was 10,233.

The district's income indices are below average, with median family income of 75.1% of the US, per the 2016 American Community Survey. Poverty levels are somewhat elevated at 22.6%. Positively, unemployment rates are 3.9% as of May 2018, which is slightly above the nation's 3.9%.

#### **Financial operations and reserves: stable financial position, with surplus expected in fiscal 2018**

The district's financial position will likely remain stable given conservative budgeting practices, and a management team focused on retaining cash. The district was negatively impacted by the state's mid-year cuts, which was the main driver of fiscal 2017's \$2.6 million deficit, reducing General Fund balance to \$12.5 million, or 17.3% of revenues.

Fiscal 2018 is a reportedly positive year, with the district increasing its fund balance by around \$1.7 million (unaudited, cash basis). Officials explain that they focused on expenditure management, ensuring that staffing levels were in line with enrollment, and consolidating or reallocating positions as needed. Further, the district monitored department budgets, and costs above and beyond what was allocated had to be approved by the Finance Team.

The fiscal 2019 budget is balanced with cash reserves, a practice required by the Public Education Department. However, rather than budgeting their full cash balance of \$13.9 million, the district budgeted \$372,000. Management anticipates revenues will increase given an uptick in students, as well as per pupil funding. Expenditures are conservatively forecasted, assuming all departments are fully staffed, which is not usually the case.

#### **LIQUIDITY**

Cash is stable. Fiscal 2017 ended with \$5.5 million in General Fund cash, or 7.7% of revenues. In order to avoid the state's cash balance sweep, the district loaned \$6 million in General Fund monies to a capital fund, only to return the funds at the beginning of fiscal 2018. As such, cash declined in line with fund balance. Beginning fiscal 2019 cash is projected at \$13.9 million.

#### **Debt and pensions: manageable direct debt burden, but elevated pension burden**

Despite plans to issue again in the near-term, the district's debt burden will likely remain manageable given rapid principal amortization. At 1.2% of fiscal 2018 full value, the district's debt burden is slightly below state and national medians. Principal payout is above average, with 93.2% retired in ten years. Management plans to approach voters in 2019 for a \$14 million bond package.

#### **DEBT STRUCTURE**

The district has \$39.1 million in outstanding, fixed-rate obligations. The debt service schedule is descending, with all debt retired by 2033.

#### **DEBT-RELATED DERIVATIVES**

The district is not party to any derivative agreements.

#### **PENSIONS AND OPEB**

The district has a high employee pension burden, based on unfunded liabilities for its share of the Educational Retirement Board (ERB), a cost sharing plan administered by the state. Roswell's annual contributions into the plan have been at the statutorily required amount, which is well below the actuarially required amount, a situation which has driven the large unfunded liability. Moody's fiscal 2017 adjusted net pension liability (ANPL) for the district, under our methodology for adjusting reported pension data, is \$318.5 million, or an elevated 4.08x operating revenues.

In addition to a steadily increasing ANPL, the district's tread water gap has widened over the last two years from 2.11% in fiscal 2015 to 4.59% in fiscal 2017. The "tread water" indicator measures the annual contributions required to prevent the reported net pension liability from increasing. That is, it is the amount that the district would have to pay on an annual basis to ensure the unfunded liability does not increase. In fiscal 2017, pension contributions of \$6.9 million were below the tread water indicator of \$10.5 million, a credit negative. Currently, the district is able to pay the statutorily-required contribution without impairing operations. Further, unlike many of its New Mexican peers, the district has a sizeable General Fund balance, which helps to mitigate the gap between contributions and tread water. However, the district's reserve position is not so ample as to mitigate multiple years of underfunding.

Going forward, in order for ERB to meet its obligations, contributions will have to increase, which would place pressure on the district's reserves. Given New Mexico school districts' reliance on the state for its operating revenue, it is possible that the legislature would appropriate additional funds to cover increased pension costs; however, the state's response to reform is unclear at this time.

The district's fiscal 2017 fixed costs, including debt service, pension and OPEB contributions, were an average 17.4% of operating revenues. Inclusive of the treadwater payment, fixed costs increase to a still-average 22%.

**Management and governance: institutional framework score of Baa**

The district is governed by a five-member board. Members serve without compensation for four-year terms. The Superintendent is selected by and serves at the discretion of the board. Of note, Roswell ISD hired a new Superintendent that started in July 2018.

New Mexico School Districts have an Institutional Framework score of Baa, which is low. Institutional Framework scores measure a sector's legal ability to increase revenues and decrease expenditures. The sector's major revenue source, state aid or SEG, is subject to a cap, which cannot be overridden (in that, the State determines annual appropriations based primarily on student enrollment). Reliance on state funding limits revenue-raising ability; school districts do not collect property taxes for operation. Unpredictable revenue fluctuations tend to be moderate, or between 5-10% annually. Across the sector, fixed and mandated costs are generally less than 25% of expenditures. However, New Mexico School Districts enter into annual teaching contracts, which can limit the ability to cut expenditures over the near-term. Unpredictable expenditure fluctuations tend to be moderate, between 5-10% annually.

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