

## CREDIT OPINION

11 September 2018

 Rate this Research

### Contacts

Heather Correia +1.214.979.6868  
 Analyst  
 heather.correia@moody.com

Thomas Jacobs +1.212.553.0131  
 Senior Vice President/Manager  
 thomas.jacobs@moody.com

### CLIENT SERVICES

Americas 1-212-553-1653

Asia Pacific 852-3551-3077

Japan 81-3-5408-4100

EMEA 44-20-7772-5454

# Las Cruces S.D. 2 (Dona Ana County), NM

## Update to credit analysis

### Summary

[Las Cruces School District](#) (Aa3), NM's credit profile is stable overall. The district's financial position has improved, with a trend of surplus operations over the last 3 years. Fiscal 2018 is expected to end with a large surplus due to an uptick in revenues coupled with cost containment measures. The fiscal 2019 budget includes appropriation of a small amount of cash reserves. The tax base is large, and includes Las Cruces, the second largest city in the state with significant institutional presence. The direct debt burden is manageable; however, the credit profile is challenged by an elevated and growing unfunded pension burden.

### Credit strengths

- » Sizeable tax base anchored by institutional presence of New Mexico State University and White Sands Missile Range
- » Manageable direct debt profile

### Credit challenges

- » Narrow financial reserves and limited financial flexibility, relative to Aa peers
- » Elevated pension burden and weak annual pension contributions

### Rating outlook

Removal of the negative outlook is based on a trend of balanced operations after a period of large deficits. We expect the district to continue to maintain stable, if limited, reserves due to conservative budgeting practices.

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 pension and fixed cost burdens

### Factors that could lead to a downgrade

- » Fiscal 2018 audited results weaker than management's preliminary report

- » Operating deficits leading to depletion of financial reserves
- » Sustained tax base contraction
- » Continued growth in unfunded pension liability

## Key indicators

Exhibit 1

Las Cruces S.D. 2 (Dona Ana County), NM	2013	2014	2015	2016	2017
<b>Economy/Tax Base</b>					
Total Full Value (\$000)	\$9,043,591	\$9,092,160	\$9,240,754	\$9,506,941	\$9,717,506
Population	152,120	153,080	153,280	154,006	121,000
Full Value Per Capita	\$59,450	\$59,395	\$60,287	\$61,731	\$80,310
Median Family Income (% of USMedian)	78.6%	78.6%	78.9%	78.9%	78.9%
<b>Finances</b>					
Operating Revenue (\$000)	\$193,107	\$194,670	\$200,923	\$204,178	\$198,511
Fund Balance (\$000)	\$26,972	\$22,520	\$18,774	\$25,635	\$26,630
Cash Balance (\$000)	\$32,262	\$25,546	\$23,458	\$26,649	\$31,687
Fund Balance as a % of Revenues	14.0%	11.6%	9.3%	12.6%	13.4%
Cash Balance as a % of Revenues	16.7%	13.1%	11.7%	13.1%	16.0%
<b>Debt/Pensions</b>					
Net Direct Debt (\$000)	\$118,798	\$133,722	\$143,130	\$148,440	\$151,487
3-Year Average of Moody's ANPL (\$000)	N/A	\$712,151	\$653,848	\$673,813	\$735,498
Net Direct Debt / Full Value (%)	1.3%	1.5%	1.5%	1.6%	1.6%
Net Direct Debt / Operating Revenues (x)	0.6x	0.7x	0.7x	0.7x	0.8x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	N/A	7.8%	7.1%	7.1%	7.6%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	N/A	3.7x	3.3x	3.3x	3.7x

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

## Profile

The district is located in Dona Ana County in southern New Mexico, approximately 46 miles north of El Paso, Texas. The district provides primary and secondary education to approximately 24,000 students.

## Detailed credit considerations

### Economy and tax base: stable, large base in southern New Mexico

The district's tax base will likely remain large and stable over the mid-term given ongoing development in [Las Cruces](#) (issuer rating Aa2), the second largest city in the state. Encompassing 1,458 square miles in Dona Ana County (NR) in southern [New Mexico](#) (GO Aa2 stable), the district benefits from the economic stability provided by governmental entities, including White Sands Missile Range and [New Mexico State University](#) (A1 stable). The district's assessed valuation (AV) has increased a modest 2.0% on average annually over the past five years, reaching \$3.32 billion in fiscal 2018 (derived from a full value of \$9.99 billion). Officials anticipate ongoing AV expansion over the near-term given ongoing commercial and residential developments. Fiscal 2019 preliminary values indicate an AV of \$3.33 billion (derived from a full value of \$10 billion).

The Las Cruces economy remains stable. Several established businesses are expanding, and adding staff, including Virgin Galactic, which plans to add approximately 100 employees over the next year. Additionally, several restaurants and hotels are under construction. The city continues to benefit from proximity to Union Pacific Railroad's "inland port", a 24-hour facility that facilitates international shipping.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on [www.moody's.com](http://www.moody's.com) for the most updated credit rating action information and rating history.

Resident incomes are below national average, with median family income of 77.6% of the US (2016 ACS). Resident incomes may be artificially low due to the significant presence of military personnel and university students.

Enrollment remains stable. Fiscal 2018 enrollment was 24,105, making Las Cruces the second largest district in the state. Management relies on demographic projections for budgeting, which, over the long-term, indicate a modest, ongoing increase in enrollment.

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

Since fiscal 2016, the district's financial position has stabilized, a main driver in the removal of the negative outlook. Fiscal 2017 ended with a modest surplus, increasing General Fund balance to \$12.1 million representing a limited 6.6% of revenues. The district controlled expenditures to effectively offset \$3.3 million in mid-year state funding cuts.

Management reports, on a preliminary unaudited basis, that General Fund balance increased to \$17.8 million in fiscal 2018. Officials explain that the Public Education Department (PED) implemented two mid-year funding adjustments, awarding the district an additional \$2.7 million in funding, which was not budgeted. In addition, the district reduced its operating budget by 20% through benefit reductions and caps on department budgets.

The fiscal 2019 budget includes appropriation of \$10.7 million in cash reserves, a budgeting practice required by the PED. Although the district expects to minimize its use of reserves by freezing 50 positions and closely monitoring staffing levels relative to enrollment, management does anticipate utilizing \$4 million in reserves to address deferred maintenance and to purchase instructional materials. Inability to maintain reserves and establish sustainable balanced operations within the state funding formula would challenge the district's credit profile.

#### **LIQUIDITY**

General Fund cash is stable. At fiscal 2017 year-end, cash was \$16.8 million, or 9.2% of revenues. Based on unaudited fiscal 2018 results, operational cash increased to \$17.6 million.

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

Despite plans to issue additional debt in the near-term, the district's debt burden will remain manageable because it is capped by statute at 2% of full value. At 1.6% of fiscal 2018 full value, the district's debt burden is slightly above state and national medians. Principal payout is average, with 76.4% retired in ten years. Voters approved a \$50 million bond package in February 2018 which the district plans to issue in four equal annual installments through 2021. Debt is structured so as to allow the layering in of additional bonds without adjustment to tax rates.

#### **DEBT STRUCTURE**

The district has \$125.2 million in fixed-rate general obligation bonds outstanding, all of which mature by 2034. Included in the debt burden is \$31.1 million of capital lease bonds that are secured by a voter-authorized HB-33 three mill levy, which is up for renewal in 2020. The debt is fixed-rate, and matures by 2034.

#### **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 New Mexico Educational Retirement Board (ERB), a cost sharing plan administered by the state. Las Cruces' annual contributions into the plan have been at the statutorily required amount, which is well below the actuarially required amount resulting in large unfunded liability. At the close of fiscal 2017 the district reported an unfunded pension liability of \$321 million. Moody's fiscal 2017 adjusted net pension liability (ANPL) for the district, under our methodology for adjusting reported pension data, is \$847.8 million, or an elevated 4.27x operating revenues.

In addition to a steadily increasing ANPL, the district's tread water gap has widened over the last two years from 2.29% in fiscal 2015 to 4.80% 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 keep the reported unfunded liability from increasing if investment return assumptions are met. In fiscal 2017, pension contributions of \$18.1 million were below the \$27.6 million amount required to tread water, a credit negative. Currently, the district is able to pay the statutorily required contribution without impairing operations.

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. The state has not, to date, made public a plan to address the ERB's unfunded pension liability.

The district's fiscal 2017 fixed costs, including debt service, pension and OPEB contributions, were an average 17.7% of operating revenues. If the district had funded its pension at "treadwater" fixed costs increase would have been 22.5%, which is within the average range.

#### **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. As noted above, in 2017 management left positions unfilled and cut other expenditures to offset a mid-year cut in state funding.

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.

© 2018 Moody's Corporation, Moody's Investors Service, Inc., Moody's Analytics, Inc. and/or their licensors and affiliates (collectively, "MOODY'S"). All rights reserved.

CREDIT RATINGS ISSUED BY MOODY'S INVESTORS SERVICE, INC. AND ITS RATINGS AFFILIATES ("MIS") ARE MOODY'S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES, AND MOODY'S PUBLICATIONS MAY INCLUDE MOODY'S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES. MOODY'S DEFINES CREDIT RISK AS THE RISK THAT AN ENTITY MAY NOT MEET ITS CONTRACTUAL, FINANCIAL OBLIGATIONS AS THEY COME DUE AND ANY ESTIMATED FINANCIAL LOSS IN THE EVENT OF DEFAULT. CREDIT RATINGS DO NOT ADDRESS ANY OTHER RISK, INCLUDING BUT NOT LIMITED TO: LIQUIDITY RISK, MARKET VALUE RISK, OR PRICE VOLATILITY. CREDIT RATINGS AND MOODY'S OPINIONS INCLUDED IN MOODY'S PUBLICATIONS ARE NOT STATEMENTS OF CURRENT OR HISTORICAL FACT. MOODY'S PUBLICATIONS MAY ALSO INCLUDE QUANTITATIVE MODEL-BASED ESTIMATES OF CREDIT RISK AND RELATED OPINIONS OR COMMENTARY PUBLISHED BY MOODY'S ANALYTICS, INC. CREDIT RATINGS AND MOODY'S PUBLICATIONS DO NOT CONSTITUTE OR PROVIDE INVESTMENT OR FINANCIAL ADVICE, AND CREDIT RATINGS AND MOODY'S PUBLICATIONS ARE NOT AND DO NOT PROVIDE RECOMMENDATIONS TO PURCHASE, SELL, OR HOLD PARTICULAR SECURITIES. NEITHER CREDIT RATINGS NOR MOODY'S PUBLICATIONS COMMENT ON THE SUITABILITY OF AN INVESTMENT FOR ANY PARTICULAR INVESTOR. MOODY'S ISSUES ITS CREDIT RATINGS AND PUBLISHES MOODY'S PUBLICATIONS WITH THE EXPECTATION AND UNDERSTANDING THAT EACH INVESTOR WILL, WITH DUE CARE, MAKE ITS OWN STUDY AND EVALUATION OF EACH SECURITY THAT IS UNDER CONSIDERATION FOR PURCHASE, HOLDING, OR SALE.

MOODY'S CREDIT RATINGS AND MOODY'S PUBLICATIONS ARE NOT INTENDED FOR USE BY RETAIL INVESTORS AND IT WOULD BE RECKLESS AND INAPPROPRIATE FOR RETAIL INVESTORS TO USE MOODY'S CREDIT RATINGS OR MOODY'S PUBLICATIONS WHEN MAKING AN INVESTMENT DECISION. IF IN DOUBT YOU SHOULD CONTACT YOUR FINANCIAL OR OTHER PROFESSIONAL ADVISER. ALL INFORMATION CONTAINED HEREIN IS PROTECTED BY LAW, INCLUDING BUT NOT LIMITED TO, COPYRIGHT LAW, AND NONE OF SUCH INFORMATION MAY BE COPIED OR OTHERWISE REPRODUCED, REPACKAGED, FURTHER TRANSMITTED, TRANSFERRED, DISSEMINATED, REDISTRIBUTED OR RESOLD, OR STORED FOR SUBSEQUENT USE FOR ANY SUCH PURPOSE, IN WHOLE OR IN PART, IN ANY FORM OR MANNER OR BY ANY MEANS WHATSOEVER, BY ANY PERSON WITHOUT MOODY'S PRIOR WRITTEN CONSENT.

CREDIT RATINGS AND MOODY'S PUBLICATIONS ARE NOT INTENDED FOR USE BY ANY PERSON AS A BENCHMARK AS THAT TERM IS DEFINED FOR REGULATORY PURPOSES AND MUST NOT BE USED IN ANY WAY THAT COULD RESULT IN THEM BEING CONSIDERED A BENCHMARK.

All information contained herein is obtained by MOODY'S from sources believed by it to be accurate and reliable. Because of the possibility of human or mechanical error as well as other factors, however, all information contained herein is provided "AS IS" without warranty of any kind. MOODY'S adopts all necessary measures so that the information it uses in assigning a credit rating is of sufficient quality and from sources MOODY'S considers to be reliable including, when appropriate, independent third-party sources. However, MOODY'S is not an auditor and cannot in every instance independently verify or validate information received in the rating process or in preparing the Moody's publications.

To the extent permitted by law, MOODY'S and its directors, officers, employees, agents, representatives, licensors and suppliers disclaim liability to any person or entity for any indirect, special, consequential, or incidental losses or damages whatsoever arising from or in connection with the information contained herein or the use of or inability to use any such information, even if MOODY'S or any of its directors, officers, employees, agents, representatives, licensors or suppliers is advised in advance of the possibility of such losses or damages, including but not limited to: (a) any loss of present or prospective profits or (b) any loss or damage arising where the relevant financial instrument is not the subject of a particular credit rating assigned by MOODY'S.

To the extent permitted by law, MOODY'S and its directors, officers, employees, agents, representatives, licensors and suppliers disclaim liability for any direct or compensatory losses or damages caused to any person or entity, including but not limited to by any negligence (but excluding fraud, willful misconduct or any other type of liability that, for the avoidance of doubt, by law cannot be excluded) on the part of, or any contingency within or beyond the control of, MOODY'S or any of its directors, officers, employees, agents, representatives, licensors or suppliers, arising from or in connection with the information contained herein or the use of or inability to use any such information.

NO WARRANTY, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS, COMPLETENESS, MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE OF ANY SUCH RATING OR OTHER OPINION OR INFORMATION IS GIVEN OR MADE BY MOODY'S IN ANY FORM OR MANNER WHATSOEVER.

Moody's Investors Service, Inc., a wholly-owned credit rating agency subsidiary of Moody's Corporation ("MCO"), hereby discloses that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by Moody's Investors Service, Inc. have, prior to assignment of any rating, agreed to pay to Moody's Investors Service, Inc. for appraisal and rating services rendered by it fees ranging from \$1,500 to approximately \$2,500,000. MCO and MIS also maintain policies and procedures to address the independence of MIS's ratings and rating processes. Information regarding certain affiliations that may exist between directors of MCO and rated entities, and between entities who hold ratings from MIS and have also publicly reported to the SEC an ownership interest in MCO of more than 5%, is posted annually at [www.moody's.com](http://www.moody's.com) under the heading "Investor Relations — Corporate Governance — Director and Shareholder Affiliation Policy."

Additional terms for Australia only: Any publication into Australia of this document is pursuant to the Australian Financial Services License of MOODY'S affiliate, Moody's Investors Service Pty Limited ABN 61 003 399 657 AFSL 336969 and/or Moody's Analytics Australia Pty Ltd ABN 94 105 136 972 AFSL 383569 (as applicable). This document is intended to be provided only to "wholesale clients" within the meaning of section 761G of the Corporations Act 2001. By continuing to access this document from within Australia, you represent to MOODY'S that you are, or are accessing the document as a representative of, a "wholesale client" and that neither you nor the entity you represent will directly or indirectly disseminate this document or its contents to "retail clients" within the meaning of section 761G of the Corporations Act 2001. MOODY'S credit rating is an opinion as to the creditworthiness of a debt obligation of the issuer, not on the equity securities of the issuer or any form of security that is available to retail investors. It would be reckless and inappropriate for retail investors to use MOODY'S credit ratings or publications when making an investment decision. If in doubt you should contact your financial or other professional adviser.

Additional terms for Japan only: Moody's Japan K.K. ("MJJK") is a wholly-owned credit rating agency subsidiary of Moody's Group Japan G.K., which is wholly-owned by Moody's Overseas Holdings Inc., a wholly-owned subsidiary of MCO. Moody's SF Japan K.K. ("MSFJ") is a wholly-owned credit rating agency subsidiary of MJJK. MSFJ is not a Nationally Recognized Statistical Rating Organization ("NRSRO"). Therefore, credit ratings assigned by MSFJ are Non-NRSRO Credit Ratings. Non-NRSRO Credit Ratings are assigned by an entity that is not a NRSRO and, consequently, the rated obligation will not qualify for certain types of treatment under U.S. laws. MJJK and MSFJ are credit rating agencies registered with the Japan Financial Services Agency and their registration numbers are FSA Commissioner (Ratings) No. 2 and 3 respectively.

MJJK or MSFJ (as applicable) hereby disclose that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by MJJK or MSFJ (as applicable) have, prior to assignment of any rating, agreed to pay to MJJK or MSFJ (as applicable) for appraisal and rating services rendered by it fees ranging from JPY200,000 to approximately JPY350,000,000.

MJJK and MSFJ also maintain policies and procedures to address Japanese regulatory requirements.

## CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454