

CREDIT OPINION

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Bernalillo Mun. S.D. 1 (Sandoval County), NM

Update to credit analysis

Summary

[Bernalillo Municipal School District No. 1](#), NM's (A1) credit profile is stable. After a period of surpluses, financial reserves narrowed after fiscal 2017's draw, but officials report fiscal 2018 ended positively and fiscal 2019 is expected to be balanced. The tax base is moderately-sized, and is expected to stabilize over the near-term given commercial development. 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
- » Sizeable surplus reported in fiscal 2018

Credit challenges

- » Recent fluctuations in assessed values due to revaluation of property in unincorporated portion of the county
- » 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
- » Trend of tax base growth
- » Material reductions to the pension and fixed cost burdens

Factors that could lead to a downgrade

- » Further deterioration of fund balance and reserves; fiscal 2018 results that are not in line with reported performance
- » Sustained tax base contractions

» Increases to the pension and fixed cost burdens that are not in line with peers

Key indicators

Exhibit 1

| Bernalillo Mun. S.D. 1 (Sandoval County), NM | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|-------------|-------------|-------------|-------------|-------------|
| Economy/Tax Base | | | | | |
| Total Full Value (\$000) | \$1,847,757 | \$1,824,238 | \$1,872,303 | \$1,859,849 | \$1,893,139 |
| Population | 25,680 | 25,680 | 25,521 | 25,521 | 25,443 |
| Full Value Per Capita | \$71,953 | \$71,037 | \$73,363 | \$72,875 | \$74,407 |
| Median Family Income (% of US Median) | 90.7% | 90.7% | 92.6% | 92.6% | 92.6% |
| Finances | | | | | |
| Operating Revenue (\$000) | \$34,716 | \$33,296 | \$33,134 | \$33,869 | \$31,423 |
| Fund Balance (\$000) | \$9,943 | \$11,045 | \$11,338 | \$10,499 | \$9,020 |
| Cash Balance (\$000) | \$7,502 | \$10,148 | \$10,350 | \$8,862 | \$8,544 |
| Fund Balance as a % of Revenues | 28.6% | 33.2% | 34.2% | 31.0% | 28.7% |
| Cash Balance as a % of Revenues | 21.6% | 30.5% | 31.2% | 26.2% | 27.2% |
| Debt/Pensions | | | | | |
| Net Direct Debt (\$000) | \$35,950 | \$35,920 | \$35,850 | \$36,745 | \$36,177 |
| 3-Year Average of Moody's ANPL (\$000) | \$98,323 | \$103,544 | \$97,825 | \$100,583 | \$112,733 |
| Net Direct Debt / Full Value (%) | 1.9% | 2.0% | 1.9% | 2.0% | 1.9% |
| Net Direct Debt / Operating Revenues (x) | 1.0x | 1.1x | 1.1x | 1.1x | 1.2x |
| Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%) | 5.3% | 5.7% | 5.2% | 5.4% | 6.0% |
| Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x) | 2.8x | 3.1x | 3.0x | 3.0x | 3.6x |

Source: District's audits; Moody's

Profile

Located in Sandoval County, north of the [City of Albuquerque](#) (GO Aa2 negative) in central [New Mexico](#) (GO Aa2 stable), the district encompasses approximately 648 square miles and serves approximately 3,000 students.

Detailed credit considerations

Economy and tax base: moderately sized base north of Albuquerque

Despite fluctuations in assessed value, the district's tax base will likely remain stable over the mid-term, benefitting from proximity to the state's largest city, Albuquerque. Fiscal 2018 assessed value (AV) expanded by 1.1% to \$637.6 million, derived from a full value (FV) of \$1.914 billion, but declined by 0.2% in fiscal 2019 (preliminary) to \$636 million, derived from a FV of \$1.910 billion. Tax base contractions in recent years are attributed to negative reappraisals of non-residential (commercial) properties.

Officials report that Interstate 25 added two lanes, which has spurred auxiliary development, including retail. Further, a large brewery and casino hotel are opening in late 2018 or early 2019, which will add several hundred jobs.

Enrollment is fairly stable, although does exhibit some volatility. Fiscal 2018 headcount was 2,917, a decline of 3% from fiscal 2017. Management is very focused on retaining students, and are offering new programs for pre-K and bilingual students. For fiscal 2019, the district is assuming flat enrollment for budgeting purposes. Future reviews will focus on the district's ability to manage enrollment without compromising financial performance.

The district's income indices are slightly below average, with median family income of 91.6% of the US, per the 2016 American Community Survey. Poverty levels are somewhat elevated at 19.8%. Similarly, unemployment rates are 4% as of May 2018, which is above the nation's 3.6%. Positively, the district's tax base is not concentrated in top ten taxpayers.

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Financial operations and reserves: narrow financial position, but surplus expected in fiscal 2018

Given conservative budgeting, the district's financial position is expected to improve over the near-term. Fiscal 2017 ended with a large deficit of \$1.5 million, reducing general fund balance to \$2.5 million, or a limited 9.7% of reserves. The spend down was driven by the state's mid-year cuts, which amounted to around \$800,000, which was then compounded by a decline in enrollment.

Management reports that fiscal 2018 is expected to end with a surplus, with unaudited results indicating an increase in general fund balance to \$3.6 million, or 14.2% of fiscal 2017 revenues. Positive performance was a result of vacancy savings, with the district unable to fill 10 to 15 positions. Additionally, Bernalillo received around \$300,000 in impact aid, which was unexpected.

The fiscal 2019 budget reflects use of \$3.3 million in cash balance. In practice, management plans to maintain reserves, and explains that expenditures will likely come in under budget due to teacher vacancy savings.

Future reviews will focus on the district's ability to rebuild reserves after a period of decline. Further deterioration of reserves may negatively impact credit quality.

LIQUIDITY

Cash reserves are stable, and in line with fund balance. Fiscal 2017 ended with \$2 million in general fund cash, or 8% of revenues.

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 1.8% of fiscal 2018 full value, the district's debt burden is slightly above state and national medians. Positively, principal payout is above average, with 100% retired in ten years. Management plans to sell another \$5 million in 2019.

DEBT STRUCTURE

The district has \$34.6 million in outstanding, fixed-rate obligations. The debt service schedule is descending, with all debt retired in ten years.

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. Bernalillo'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 \$133.9 million, or an elevated 4.26x operating revenues.

In addition to a steadily increasing ANPL, the district's tread water gap has widened over the last two years from 2.18% in fiscal 2015 to 5.23% in fiscal 2017. The "tread water" indicator measures the annual contributions required to prevent the reported net pension liability from increasing under plan unfunded liability does not increase. 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 \$2.7 million were below the tread water indicator of \$4.4 million, 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 limited 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 above average 29% of operating revenues. Inclusive of the treadwater payment, fixed costs increase to 34.2%. Moody's notes that a majority of the fixed cost burden (19%) is debt service.

Management and governance: institutional framework score of Baa

The district's policy making and supervisory functions are the responsibility of and are vested in a five-member Board of Education. The Board delegates administrative responsibilities to the Superintendent of Schools.

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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