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CREDIT OPINION
11 September 2017

New Issue

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Las Cruces School District 2, NM

New Issue: Moody's Assigns Aa3 UND/Aa2 ENH to Las Cruces SD 2, NM's GO Bonds, Ser. 2017A/B; Outlook is Negative

Summary Rating Rationale

Moody's Investors Service has assigned an Aa3 underlying rating to Las Cruces School District No. 2 (Dona Ana County), NM's $15 million General Obligation School Bonds, Series 2017A and $9.6 million General Obligation Refunding Bonds, Series 2017B. Moody's maintains the Aa3 on outstanding general obligation bonds. The outlook is negative. Moody's has also assigned a Aa2 enhanced rating to the Series 2017 GO bonds based on the New Mexico School District Enhancement Program (NMSDEP) - Post March 30, 2007.

Assignment of the Aa3 reflects the district's narrow financial position, which is expected to improve in the next couple of years, in large part due to a new management team focused on rebuilding reserves; sizeable and stable tax base, anchored by a University and military installations; socio-economic indices that trend below national averages; and a manageable debt profile with average principal amortization.

The Aa2 enhanced rating on the Series 2017A and Series 2017B General Obligation Bonds is based on our assessment of the NMSDEP - Post March 30, 2007 and a review of the district's proposed financing. For additional information on the program, please see Moody's report dated May 4, 2008.

Credit Strengths

» Sizeable tax base with institutional presence (New Mexico State University and White Sands Missile Range)

» Manageable debt profile

» New management team focused on rebuilding reserves

Credit Challenges

» Narrow financial reserves and limited financial flexibility

Rating Outlook

The negative outlook reflects the district's narrow reserve levels, which limit financial flexibility. Management's inability to restore structural operating balance over the near-term, especially on the heels of state-implemented funding reductions, may place further downward pressure on the rating.

Factors that Could Lead to an Upgrade (and Removal of the Negative Outlook)

» Return to structural balance with trend of operating surpluses, increasing financial reserves

» Tax base diversification and expansion, coupled with improved socioeconomic profile

Factors that Could Lead to a Downgrade

» Ongoing structural imbalance resulting in further deterioration of financial reserves

» Significant tax base contraction

Key Indicators

Exhibit 1

Las Cruces S.D. 2 (Dona Ana County), NM	2012	2013	2014	2015	2016
Economy/Tax Base					
Total Full Value ($000)	$ 8,868,994	$ 9,043,591	$ 9,092,160	$ 9,240,754	$ 9,506,941
Full Value Per Capita	$ 58,703	$ 59,450	$ 59,770	$ 60,287	$ 62,023
Median Family Income (% of US Median)	79.5%	78.6%	78.6%	78.9%	78.9%
Finances					
Operating Revenue ($000)	$ 190,171	$ 193,107	$ 194,670	$ 200,923	$ 204,178
Fund Balance as a % of Revenues	12.3%	14.0%	11.6%	9.3%	12.6%
Cash Balance as a % of Revenues	16.5%	16.7%	13.1%	11.7%	13.1%
Debt/Pensions					
Net Direct Debt ($000)	$ 129,800	$ 118,798	$ 133,722	$ 143,130	$ 148,440
Net Direct Debt / Operating Revenues (x)	0.7x	0.6x	0.7x	0.7x	0.7x
Net Direct Debt / Full Value (%)	1.5%	1.3%	1.5%	1.5%	1.6%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	N/A	3.4x	3.7x	3.3x	3.3x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	N/A	7.2%	7.8%	7.1%	7.1%

Operating Fund balance is the General Fund balance and Debt Service Fund balance
Source: District's Audits; Moody's Investors Service

Recent Developments

State funding to New Mexico school districts was reduced twice during fiscal 2017. In October 2016, the State cut state aid by 1.5%. Then in February 2017, the State swept $46.1 million in district cash balances state-wide, or an effective 2% reduction in state aid. In May 2017, the Governor signed the fiscal 2018 budget that restores state funding of public eduction to the level originally budgeted for 2017.

Detailed Rating Considerations - Enhanced

Moody's has assigned an enhanced rating of Aa2 to the Series 2017A General Obligation School Bonds and Series 2017B General Obligation Refunding Bonds, equivalent to the NMSDEP Post-March 30, 2007 programmatic rating. Ratings on individual intercept financings depend on the programmatic rating as well as our evaluation of the sufficiency of interceptable revenues, the timing of the state's fiscal year relative to scheduled debt service payment dates and the transaction structure.

Based on the district's state equalization guarantee (SEG) funds for fiscal year 2016, interceptable state-aid provides an ample minimum of 11.59 times coverage of maximum periodic debt service. Further, state revenues provide an adequate minimum 10.63 times maximum periodic debt service coverage when coverage is stressed by deducting the state's final monthly state aid payment within a fiscal year. State-aid funding levels for New Mexico school districts have been stable in recent years, but have been subject

to midyear cuts, as observed most recently in fiscal 2017. This weakness, however, is mitigated by ample debt service coverage even if aid is curtailed over the course of the year. Principal payments are scheduled for August, early in the State's fiscal year providing for an average interval to mitigate the risk of late budgets. The program requires the appointment of a third-party fiscal agent, who is required to notify the state if an intercept of SEG is required. The Bank of Albuquerque is the fiscal agent for the current sale.

Detailed Rating Considerations - Underlying

Economy and Tax Base: Stable, Large Tax Base in Southern New Mexico

With Las Cruces (Aa2) serving as the regional economic hub and the significant institutional presence within the district, we believe the tax base will remain stable over the near-term and return to growth over the medium- and long-term. Encompassing 1,458 square miles in Dona Ana County (NR) in southern New Mexico (GO Aa1 negative), 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 $3.2 billion in fiscal 2017 (derived from a full value of $9.7 billion). Officials anticipate ongoing AV expansion over the near-term given ongoing commercial and residential developments. Fiscal 2018 preliminary values indicate an AV of $3.3 billion (derived from a full value of $9.99 billion).

The Las Cruces economy remains stable. Several established businesses are expanding, and adding staff, including Virgin Galatic, which will likely hire 90 FTEs in the next year. Additionally, restaurant and hotel chains are under construction, as is a new 40-bed hospital. The city continues to benefit from proximity to Union Pacific Railroad's "inland port", a 24-hour facility that allows for companies to quickly move their products in and out of the country.

Top ten taxpayers are reportedly stable, accounting for 4.3% of fiscal 2017 AV, and are comprised of large utility companies, healthcare entities, and retail shopping centers. Income indices are below average, with median family income of 78.9% of the US, per the 2015 American Community Survey. Unemployment rates are elevated at 7.7% compared to the nation's 4.6% as of July 2017.

Enrollment remains stable. Fiscal 2017 enrollment was 24,325, making Las Cruces the second largest district in the state. Based on enrollment through the third week of fiscal 2018, enrollment is up at 24,694. Officials report that White Sands Missile Range will receive 120 new troops throughout the current fiscal year, which will likely increase enrollment. Management relies on demographer projections for budgeting, which, over the long-term, indicate a modest, ongoing increase in enrollment.

Financial Operations and Reserves: Fiscal 2017 Unaudited Results Look Positive; Decline in Reserves Expected for Fiscal 2018

Due to conservative budgeting, the district weathered the state aid declines with minimal use of reserves. Going forward, the new management team is focused on structural balance, and ensuring that the district maintains a narrow, but static, cash balance. Fiscal 2016 ended with a sizeable surplus of $6.1 million, increasing General Fund balance to $11.8 million, or 6.2% of revenues. Management instituted three furlough days for all staff, and eliminated around 49 FTEs through retirement incentives, attrition and vacancies.

The original fiscal 2017 budget was balanced, and reflected three furlough days for administrative staff only, a shortening of the school year, and further staff reductions. Las Cruces was subject to the mid-year cut, which amounted to $3.5 million, but did not experience a cash balance sweep (the district invests a majority of its liquid assets with the state, and this balance was not considered by the PED). Based on unaudited results, the district ended the year with $11.9 million in General Fund balance, or 6.6% of unaudited revenues.

The fiscal 2018 budget reflects use of around $3 million in reserves. Management has a cash balance target of $9 million, or 5% of operating revenues. Budgeted revenues are up 1.3%, reflective of an increase in enrollment and unit value (set by the State). Additionally, there is a possibility that the state may increase unit value by another $16 per pupil in December or January, which would equate to $700,000 in additional monies; however, given the inherent uncertainty, the district has not budgeted for these dollars. The district is focused on managing expenditure growth, and over the next three years, plans to reduce salary and benefit costs by around 3% through attrition, retirement and consolidation. Officials closely monitor enrollment, and staff based on class size. Temporary contracts are being considered over annual contracts as that provides more expenditure flexibility.

Future reviews will incorporate management's ability to operate within narrow margins. Moody's will focus on a demonstrated ability to manage expenditures while maintaining cash reserves in-line with internal policies.

LIQUIDITY

The district's cash position will likely remain narrow, but stable, over the near-term. Fiscal 2016 General Fund cash is $15.4 million, or 8.1% of revenues. The difference between cash and fund balance are payroll liabilities offset with grant receivables. Operating cash, including the General Fund and Debt Service Fund, is $26.6 million, or 13.1% of operating revenues. The district's annual debt service is due in August, and a vast majority of Debt Service Fund balance will be used for that payment.

In fiscal 2017, officials report that they utilized around $3.5 million in cash reserves to offset state aid cuts, thus, General Fund cash declined to $11.8 million (6.6% of unaudited revenues) from $14.6 million. These numbers are on a cash-basis, and will likely vary somewhat from audited results.

Debt and Pensions: Manageable Debt Burden with Plans to Issue in the Near-term

Despite plans for additional near-term borrowing, we believe the district's debt burden will remain manageable given the average rate of principal amortization coupled with taxable growth. The district's debt burden is 1.6% of fiscal 2018 preliminary full value, which is in-line with state and national medians. Principal payout is average with 70.3% retired in ten years. The Series 2017A bonds will exhaust all remaining authorization from the 2014 election. Officials plan to approach voters for a $50 million bond package in February 2018.

DEBT STRUCTURE

Post-sale, the district will have $122.8 million in fixed-rate general obligation bonds, all of which retire by 2033. Included in the debt burden is $34.5 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 retires by 2034.

DEBT-RELATED DERIVATIVES

The district does not have any variable rate debt and it is not a party to any interest rate swap agreements.

PENSIONS AND OPEB

The district has an above-average employee pension burden, based on unfunded liabilities for its share of the Educational Retirement Board (ERB), a cost sharing plan administered by the state. Moody's fiscal 2016 adjusted net pension liability (ANPL) for the district, under our methodology for adjusting reported pension data, is $711.1 million, or an elevated 3.48 times operating revenues. The three-year average of the district's ANPL to operating revenues is 3.30 times, while the three-year average of ANPL to full value is high at 7.09%.

The district's ANPL has fluctuated over the last several years. In fiscal 2016, pension contributions of $17.7 million were below Moody's "tread water" value of $26.7 million, a credit negative. The "tread water" indicator measures the annual contributions required to prevent the reported net pension liability from increasing, under reported assumptions. Positively, the district's fixed costs, including debt service, pensions contributions and OPEB contributions, totaled a manageable 16.8% of revenues. However, inclusive of the tread water payment, fixed costs increase to 21.2%.

The New Mexico pension plan funding structure experienced several changes with the signing of SB 115 (2013 Regular Session), including the reduction of a cost-of-living adjustment (COLA) and increases in employee contributions. The legislation will maintain the funding changes until the plan has reached 100% funding, which is estimated to be achieved in 2043. We believe the funding changes adopted in SB 115 will somewhat mitigate budgetary pressure on the district related to future pension costs.

For more information on Moody's insights on employee pensions and the related credit impact on companies, government, and other entities across the globe, please visit Moody's on Pensions at www.moodys.com/pensions.

Management and Governance

New Mexico School Districts have an Institutional Framework score of A, which is moderate compared to the nation. 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 overriden (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 has public sector unions, which can limit the ability to cut expenditures. Unpredictable expenditure fluctuations tend to be moderate, between 5-10% annually.

The school district has had a change in management: the prior Superintendent resigned fiscal 2016 year-end, and a previous administrator returned from retirement to act as Interim Superintendent. A new Superintendent was hired and in place by early December 2016.

Legal Security

The bonds are secured by ad valorem taxes that are levied against all taxable property within the district without limitation as to the rate or amount.

Use of Proceeds

Proceeds of the Series 2017A bonds will fund a variety of capital improvements. The Series 2017B bonds will refund the Series 2009 bonds for net present value savings of approximately $500,000.

Obligor Profile

The district is located in Las Cruces in Southern New Mexico, and serves approximately 24,000 students.

Methodology

The principal methodology used in this underlying rating was US Local Government General Obligation Debt published in December 2016. The principal methodology used in this enhanced rating was State Aid Intercept Programs and Financings: Pre and Post Default published in July 2013. Please see the Rating Methodologies page on www.moodys.com for a copy of these methodologies.

Ratings

Exhibit 2

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

Issue	Rating
General Obligation School Bonds, Series 2017A	Aa3
Rating Type	Underlying LT
Sale Amount	$15,000,000
Expected Sale Date	09/19/2017
Rating Description	General Obligation
General Obligation School Bonds, Series 2017A	Aa2
Rating Type	Enhanced LT
Sale Amount	$15,000,000
Expected Sale Date	09/19/2017
Rating Description	General Obligation
General Obligation Refunding Bonds, Series 2017B	Aa3
Rating Type	Underlying LT
Sale Amount	$9,625,000
Expected Sale Date	09/19/2017
Rating Description	General Obligation
General Obligation Refunding Bonds, Series 2017B	Aa2
Rating Type	Enhanced LT
Sale Amount	$9,625,000
Expected Sale Date	09/19/2017
Rating Description	General Obligation

Source: Moody's Investors Service

REPORT NUMBER 1090044

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