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Carlsbad Municipal S.D., NM (Eddy County)

Update to credit analysis

Summary

The credit profile of Carlsbad Municipal School District (MSD), NM benefits from a large tax base, although it is significantly concentrated in oil and gas, and a low debt burden and average resident income indices. The credit profile is constrained by a limited financial position, a result of management's decision to utilize reserves, and an elevated pension burden based on the district's proportionate share of ERB's unfunded liability.

Credit strengths

» Large tax base that has expanded rapidly due to oil and gas production in the Permian Basin

» Low direct debt burden with rapid principal payout

Credit challenges

» Tax base and taxpayer concentration in the energy sector

» Limited general fund reserves relative to Aa-peers

» Elevated pension and fixed cost burdens

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

» Significant improvement to reserves

» Diversification of the tax base and economy

» Material reduction to the pension and fixed cost burdens

Factors that could lead to a downgrade

» Additional declines in reserves

» Material and sustained tax base contractions

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

Key indicators

Exhibit 1

Carlsbad MSD, NM	2015	2016	2017	2018	2019
Economy/Tax Base					
Total Full Value ($000)	$7,737,646	$8,254,446	$6,983,974	$6,400,238	$8,077,482
Population	35,031	35,411	35,643	35,715	35,715
Full Value Per Capita	$220,880	$233,104	$195,942	$179,203	$226,165
Median Family Income (% of US Median)	98.2%	100.8%	95.9%	95.9%	95.9%
Finances					
Operating Revenue ($000)	$63,224	$68,377	$68,275	$74,269	$83,509
Fund Balance ($000)	$23,651	$28,819	$27,266	$30,235	$33,157
Cash Balance ($000)	$22,476	$28,354	$26,067	$30,942	$34,924
Fund Balance as a % of Revenues	37.4%	42.1%	39.9%	40.7%	39.7%
Cash Balance as a % of Revenues	35.5%	41.5%	38.2%	41.7%	41.8%
Debt/Pensions					
Net Direct Debt ($000)	$39,855	$64,055	$57,295	$51,070	$44,280
3-Year Average of Moody's ANPL ($000)	$163,982	$183,089	$208,452	$238,330	$259,485
Net Direct Debt / Full Value (%)	0.5%	0.8%	0.8%	0.8%	0.5%
Net Direct Debt / Operating Revenues (x)	0.6x	0.9x	0.8x	0.7x	0.5x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	2.1%	2.2%	3.0%	3.7%	3.2%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	2.6x	2.7x	3.1x	3.2x	3.1x

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

Profile

The district is located in southeastern New Mexico, encompassing 2,497 square miles, and serving approximately 8,700 students.

Detailed credit considerations

Economy and tax base: large, concentrated tax base in southeastern New Mexico

Over the immediate term, the tax base will remain sizeable given ongoing oil and gas production. Located in southeastern New Mexico, the district serves the city of Carlsbad and surrounding area. Over the past several years, oil and gas production has ramped up in the Permian Basin, translating to significant tax base growth. Since fiscal 2015, assessed values (AV) have more than doubled to fiscal 2020's $4.2 billion, derived from a full value of $12.6 billion. Mineral values account for 64% of the base. The district's AV is volatile, being tied to the energy market, which has resulted in periods of material tax base expansions and contractions. Top ten taxpayers represent 20% of fiscal 2020 FV, with seven being oil and gas companies.

Outside of oil and gas, the base is somewhat anchored by the Department of Energy's (DoE) Waste Isolation Pilot Plant (WIPP), which employs close to 1,000 employees, and two potash mines, which also employ 1,000 employees (in total). Officials report that Holtech, another DoE-funded nuclear waste storage facility similar to WIPP, is coming online in three to four years, which will bring several hundred jobs to the county. Management reports that residential development is strong, with the county issuing close to a 1,000 building permits in the past year.

Despite concentration in oil and gas, enrollment has remained fairly stable since fiscal 2011, fluctuating between 6,600 and 7,000 students although fiscal 2020 enrollment is 7,174. There are two charters within the district's boundaries, both district-authorized, which educate around 1,500 students. Pecos Connections Academy (a virtual academy) accounts for the bulk at 1,300; the district reports that only 78 students are from Carlsbad, the remainder from elsewhere in the state.

Financial operations and reserves: general fund reserves have narrowed

The district has reduced general fund balance to 8.7% of operating expenditures as of fiscal 2019, narrow relative to Aa-peers, compared to a healthier 19.9% of revenues as of fiscal 2015. Management purposely drew on reserves for instructional expenses rather than potentially forego future funds, possible state sweeps (as experienced in fiscal 2017). Management expects to maintain reserves at current levels through expenditure management.

After three consecutive deficits, the district's general fund balance declined to $4.2 million, or 7.5% revenues during fiscal 2018 from a high of $11.9 million, or 21.6% of revenues, during fiscal 2015. Positively, fiscal 2019 saw a surplus of $1 million, increasing general fund balance to $5.1 million, or 8.7% of revenues. The district saw an additional $3.2 million in state aid revenues, driven by enrollment gains and an increase in unit values. Operating fund balance, including the general and debt service funds, was $35.2 million, or 42.1% of operating revenues. Annual debt service is due in August, thus, debt service fund balance is at its peak at fiscal year-end (June 30).

The fiscal 2020 budget projected a surplus, with general fund revenues of $32.2 million against expenditures of $26.4 million. Based on performance through January 2020, officials report that they have $8 million in cash balance. By year-end, officials expect to report at least $5 million in fund balance on a modified accrual basis.

LIQUIDITY

Cash and fund balance are in line. At fiscal 2019 year-end, general fund cash was $5 million, or 8.5% of revenues. Operating fund cash was $33.2 million, or 39.7% of operating revenues.

Debt and pensions: low direct debt burden, but elevated pension burden

Despite plans to borrow in the near-term, the district's debt burden will remain low and manageable given rapid principal amortization. At 0.5% of fiscal 2020 full value, the district's debt burden is below state and national medians. Principal payout is rapid, with 100% retired in ten years. The district plans to exhaust remaining voter authorization ($50 million) in the next few years, borrowing $30 million in 2021 and $20 million in 2023. Debt is structured so as to allow the layering in of additional bonds without adjustment to tax rates.

DEBT STRUCTURE

Inclusive of the current issuance, the district has $59.6 million in fixed-rated obligations. All debt matures in 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 Educational Employees Retirement System (EERS), a cost sharing plan administered by the state and managed by the Educational Retirement Board (ERB). Carlsbad'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 2019 adjusted net pension liability (ANPL) for the district, under our methodology for adjusting reported pension data, is $259.7 million, or an elevated 3.11x operating revenues.

In addition to a high ANPL (relative to revenues), the district's tread water gap has widened over the last several years. 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 2019, pension contributions of $5.9 million were below the tread water indicator of $9.2 million, a credit negative.

Moody's calculated unfunded OPEB liability was $42.2 million in fiscal 2019, or an above average 51% of operating revenues. Fixed costs, including pension and OPEB contributions and debt service are an above average 32% of operating revenue. Inclusive of tread water, they jump to 36%.

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. The district has an informal fund balance policy to maintain at least 8% of operating expenditures in reserve, above the state's recommended 3% to 5%.

Of note, the district's fiscal 2018 audit was delayed, and was published 18 months after fiscal year-end. Under the previous financial director (who resigned in March 2019), the district was challenged to produce timely and accurate cash balance reports, which, in turn, impacted the auditors' ability to audit the financial statements. The district now has a new superintendent and financial director, and the fiscal 2019 audit was published around six months after fiscal year-end.

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.

Rating methodology and scorecard factors

The US Local Government General Obligation Debt methodology includes a scorecard, a tool providing a composite score of a local government's credit profile based on the weighted factors we consider most important, universal and measurable, as well as possible notching factors dependent on individual credit strengths and weaknesses. Its purpose is not to determine the final rating, but rather to provide a standard platform from which to analyze and compare local government credits.

Exhibit 2

Carlsbad MSD, NM

Rating Factors	Measure	Score
Economy/Tax Base (30%) [1]		
Tax Base Size: Full Value (in 000s)	$12,562,490	Aaa
Full Value Per Capita	$351,743	Aaa
Median Family Income (% of US Median)	95.9%	Aa
Notching Factors:[2]		
Economic Concentration		Down
Finances (30%)		
Fund Balance as a % of Revenues	39.7%	Aaa
5-Year Dollar Change in Fund Balance as % of Revenues	16.8%	Aa
Cash Balance as a % of Revenues	41.8%	Aaa
5-Year Dollar Change in Cash Balance as % of Revenues	19.8%	Aa
Management (20%)		
Institutional Framework	Baa	Baa
Operating History: 5-Year Average of Operating Revenues / Operating Expenditures (x)	1.0x	Aa
Debt and Pensions (20%)		
Net Direct Debt / Full Value (%)	0.5%	Aaa
Net Direct Debt / Operating Revenues (x)	0.7x	A
3-Year Average of Moody's Adjusted Net Pension Liability / Full Value (%)	2.1%	Aa
3-Year Average of Moody's Adjusted Net Pension Liability / Operating Revenues (x)	3.1x	A
	Scorecard-Indicated Outcome	Aa3
	Assigned Rating	Aa3

(1) Economy measures are based on data from the most recent year available.
(2) Notching Factors are specifically defined in the US Local Government General Obligation Debt methodology.
(3) Standardized adjustments are outlined in the GO Methodology Scorecard Inputs publication.
Source: Moody's; US Census

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