S&P Global
Ratings

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Summary:

Santa Fe Public School District, New Mexico; General Obligation; Note

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Table Of Contents

Rating Action

Negative Outlook

Credit Opinion

Related Research

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Credit Profile		
US$15.0 mil GO sch bldg bnds ser 2020 dtd 06/20/2020 due 08/01/2032		
Long Term Rating	AA/Negative	New
US$11.0 mil GO ed technol nts ser 2020 dtd 06/20/2020 due 08/01/2023		
Long Term Rating	AA/Negative	New
Santa Fe N Mex Pub Sch Dist		
Long Term Rating	AA/Negative	Outlook Revised

Rating Action

S&P Global Ratings revised its outlook on Santa Fe Public School District, N.M.'s general obligation (GO) bonds outstanding to negative from stable, affirming its 'AA' rating on the bonds. At the same time, S&P Global Ratings assigned its 'AA' rating to the district's $15 million series 2020 GO school building bonds and $11 million series GO educational technology notes.

The negative outlook reflects our view that the district's available fund balance may decline and be maintained below its formal policy of 5% of operational revenues, as the district relies on state funding for 94% of its general fund revenue and the potential for funding cuts over the next two years, given budgetary pressures at the state level. The revision also reflects the district's declining enrollment trend, which is the primary driver of the state's equalization formula, as well as the district's fund balance drawdown in fiscal 2019, and expected drawdown in fiscal 2020. We therefore believe there is at least a one-in-three chance of lowering the rating within the next two years.

Security and Use of Proceeds

Ad valorem property taxes levied against all taxable property within the district without limitation as to rate or amount secure the GO bonds. The ETNs are secured by rental payments that are paid by the district to the Education Technology Leasing Corp. LLC, as lessor, pursuant to a lease purchase agreement between the district and the corporation. Rent is payable from ad valorem property taxes levied against all taxable property within the district without limitation as to rate or amount, and rental payments are not subject to annual appropriation or abatement. The GO bonds will finance the construction and improvement of school facilities, and the purchase of educational equipment. The ETNs will finance the purchase of educational technology equipment. The district will have approximately $235.8 million of net direct debt outstanding after these issuances.

Credit Overview

Santa Fe Public Schools, like all New Mexico school districts, relies on state funding for over 90% of its general fund revenue. Although state aid has been stable in recent years, the state is convening a special legislative session, starting June 18, to address budgetary pressures brought on by the recession and oil and gas industry downturn (see "U.S.

Oil-Producing States Dealt Double Blow From Price Collapse And COVID-19," published on June 8, 2020). While the outcome of the special legislative session, in regards to school funding, is unknown, a severe cut would exert pressure on the district's budget, especially given the district's declining enrollment trend, which is the primary driver of the state's equalization formula. We therefore believe there is at least a one-in-three chance we could lower the rating within the next two years, if budgetary pressures cause the district's fund balance to fall and be maintained below its fund balance policy of 5% of operational revenue. We note that the district expects to end fiscal year 2020 with its fund balance near the lower bound of its fund balance policy after fund balance drawdowns in consecutive years. However, if the district is able to make budgetary adjustments to maintain its fund balance at levels in accordance with its fund balance policy, we could revise the outlook to stable.

The rating also reflects our view of the district's:

- Very strong market value per capita and good-to-strong income indicators; and
- Low-to-moderate debt burden with a rapid amortization rate.

Partially offsetting these strengths, in our opinion, are the district's lack of significant revenue flexibility outside the state funding formula and a large unfunded pension liability.

Environmental, social, and governance factors

The rating also incorporates our view of the health and safety risks posed by the COVID-19 pandemic, which we consider social risk factors. Although the scope of economic and financial challenges posed by the pandemic remains unknown, we believe a prolonged disruption could weaken the district's local economy. Absent the implications of COVID-19, we consider the district's social risks to be in line with those of the sector. We also view governance and environmental risks as being in line with our view of the sector as a whole.

Negative Outlook

The negative outlook reflects our view that there is at least a one-in-three chance we could lower the districts rating within the next two years, if the district's available fund balance significantly declines or is maintained below its policy minimum of 5% of operational reserves, particularly if the budget is pressured by greater than expected state funding cuts, given the district's reliance on state funding. However, if the district is able to make budgetary adjustments to maintain its fund balance at levels in accordance with its fund balance policy, we could revise the outlook to stable.

Credit Opinion

Economy

Santa Fe Pub School District serves an estimated population of 122,878 and encompasses the city of Santa Fe, which is the state capital. In our opinion, median household effective buying income (EBI) is good at 106% of the national level, but per capita EBI is strong at 125%. The district's total $23.4 billion actual valuation in 2020 is extremely strong, in our view, at $190,560 per capita. The 7.6% increase since 2018 brought assessed valuation to $6.9 billion in 2020 (the most recent year available). The tax base is very diverse, in our view, with the 10 largest taxpayers accounting for

approximately 2.3% of assessed valuation.

Santa Fe is a retail and tourism center, and is also known for its arts and culture. The area's employment base is stabilized by the presence of government, with the two largest employers being the state and Los Alamos National Laboratory (federal government), at 26,280 and 11,956 employees, respectively. Although the recession and COVID-19 pandemic may affect the district's income and unemployment metrics, given the local economies reliance on tourism and retail, the district's revenue does not directly rely on such activity and the district's property tax base is unlikely to see an immediate negative effect. For fiscal 2021, the district expects assessed value to increase by about 4%, which we believe is reasonable based on historical trends and the timing of assessments. However, future growth may slow depending on the effect the current recession has on development in the district.

Finances

Enrollment is a primary driver in the state's equalization formula. Enrollment totaled 11,724 in 2020, which was an 8.6% decline from the prior year, and had declined in each of the last five years. The district attributes the declining enrollment trend to a decline in birthrates. District officials believe the large decline in 2020 to be a one-time occurrence (the district averaged a 1.4% decline the prior three years), and expect enrollment to stabilize in the near-term. Considering the district depends on state aid for general fund revenue (94.2%), variations in state funding can greatly affect its financial operations. Although state aid has been stable in recent years, the state is convening a special legislative session, starting June 18, to address budgetary pressures brought on by the recession and oil and gas industry downturn. While the outcome of the special legislative session, in regards to school funding, is unknown, a severe cut would exert pressure on the district's budget, and could lead to downward pressure on the rating.

Out of a concern for potential state aid reductions if fund balance levels grow too high, the district strives to maintain its available fund balance in-line with its formal policy of 5% to 7.5% of general fund revenue. In fiscal 2019, the district reported a deficit operating result of 2.2% of expenditures, due to increased programmatic costs, which brought the district's available fund balance down to $7.5 million, or 7% of expenditures, which we consider good. Similarly, for fiscal 2020, the district expects to end the fiscal year on June 30, with an available fund balance of between $5.3 and $5.4 million, or near 5% of expenditures, which we would consider good. While district officials expect the state to cut school funding in the special legislative session, relative to the state's original budget, officials note that they will target budgetary adjustments based on what revenues, if any, the state cuts (i.e. if the state cuts grants for specific programs, the district would look to cut those programs before adjusting core programming).

However, we note that voters have consistently approved two direct property tax levies that provide some support to the district's revenue flexibility, although these revenues are accounted for outside of the general fund and are largely restricted to capital expenditures. Voters approved a six-year extension of the district's two-mill Senate Bill 9 levy in fiscal 2018, and a six-year extension of its 1.5-mill House Bill 33 levy in fiscal 2015. The tax revenues generated by these levies are used for capital-related expenses and some operational expenses, and were equivalent to 19% of general fund revenues ($20 million) in fiscal 2019. These funds, which collectively had reserve levels of $14.8 million in fiscal 2019, should in our view, provide the district with sufficient liquidity to be able to respond to any capital related emergency costs. The district expects to maintain these levies for the foreseeable future.

Management

We consider the district's management practices "standard" under our Financial Management Assessment methodology, indicating the finance department maintains adequate policies in some but not all key areas.

Key policies and practices include:

- A robust budget-formulation process based on external enrollment projections and close consultation with state authorities regarding updates to the equalization formula;
- Budget study sessions with the board approximately quarterly, although the reports provided to the board during these sessions are not in the form of budget to actuals;
- A lack of long-term financial projections due to the district's reliance on state equalization revenues for its operations;
- A five-year facilities master plan that is updated approximately every other year, but does not match specific funding sources to projects or timing needs;
- A formal investment policy, with all funds invested in the state local government investment pool, and quarterly reporting on performance to the board;
- A lack of a debt management policy that provides significant restrictions or guidance beyond the state guidelines; and
- A cash balance target of 5.0%-7.5% of operational revenues

Debt

Overall net debt is low, in our opinion, as a percentage of market value at 1.8%, and moderate on a per capita basis at $3,411. With 95% of the district's direct debt scheduled to be retired within 10 years, amortization is rapid. Debt service carrying charges were 22.7% of total governmental fund expenditures excluding capital outlay in fiscal 2019, which we consider elevated.

After these issuances, the district plans on issuing the remaining $33 million of authorized but unissued GO education technology notes, over the next three years, in $11 million annual increments. The district has about $2.7 million in privately placed debt outstanding (issued through the New Mexico Finance Authority), which it has used to finance renewable energy projects; we have reviewed the terms of these obligations and do not believe they contain clauses that could result in liquidity risk.

Pension and other postemployment benefit liabilities

While we do not view pension and OPEB liabilities as an immediate credit risk for the district, we do acknowledge the weak funded status of the New Mexico Education Retirement Board (ERB) pension plan. Weakness in the plan could negatively pressure the rating if funding metrics deteriorate and costs associated with the plan escalate, putting budgetary pressure on the district. Additionally, OPEB liabilities are funded on a pay-as-you-go basis, which given claims volatility, as well as medical cost and demographic trends, is likely to lead to escalating costs.

The district participates in the following plans:

- The New Mexico ERB pension plan, with a 64.1% funded ratio and a net pension liability of $199.2 million.

- The New Mexico Retiree Health Care Fund, which is funded on a pay-as-you-go basis and a net OPEB liability of $55.2 million.

The district paid its full required contribution of $10.7 million toward its pension obligations in fiscal 2019, or 4.3% of total governmental expenditures. The district also contributed $2.6 million, or 1.1% of total governmental expenditures, toward its other postemployment benefit (OPEB) obligations in fiscal 2019. Combined pension and OPEB carrying charges totaled 5.4% of total governmental fund expenditures in 2019.

Although the district met is required pension contribution in fiscal 2019, contributions fell short of both our static and minimum funding progress metrics. In general, we expect progress toward full funding to be slow given the plan's amortization basis of level percent using a payroll growth assumption of 3.25%, over a closed 30-year period. Furthermore, we believe the discount rate of 7.25% could lead to significant contribution volatility.

Related Research

- Alternative Financing: Disclosure Is Critical To Credit Analysis In Public Finance, Feb. 18, 2014
- Criteria Guidance: Assessing U.S. Public Finance Pension And Other Postemployment Obligations For GO Debt, Local Government GO Ratings, And State Ratings, Oct. 7, 2019

Ratings Detail (As Of June 15, 2020)		
Santa Fe Pub Sch Dist lse purch ed technology nts		
Long Term Rating	AA/Negative	Outlook Revised
Santa Fe Pub Sch Dist GO ed technol nts		
Long Term Rating	AA/Negative	Outlook Revised

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