

CREDIT OPINION

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Deming Public S.D. 1 (Luna County), NM

Update to credit analysis

Summary

[Deming Public School District No 1, NM](#) (A2) credit profile is generally stable. Financial reserves have improved after a period of surpluses, but do remain below national medians. Fiscal 2020 is expected to close with another addition to cash balance, and the fiscal 2021 budget is balanced. The tax base is expected to remain around current levels, supported by future commercial development. The direct debt burden is manageable, and will remain as such given rapid principal payout. The credit profile is constrained by weak income indices, and high unemployment levels, reflecting the county's concentration in agriculture. Further, as a participant in ERB, a statewide, cost-sharing plan, the district's pension burden is elevated, and annual contributions are unfavorably below the tread water level.

We regard the coronavirus outbreak as a social risk under our ESG framework, given the substantial implications for public health and safety. We do not see any material immediate credit risks for the district. Despite moving to remote learning in mid-March 2020, the state has continued to fund the district in full. However, the situation surrounding coronavirus is rapidly evolving and the longer term impact will depend on both the severity and duration of the crisis. If our view of the credit quality of the district changes, we will update the rating and/or outlook at that time.

Credit strengths

- » Improving financial trends
- » Moderately-sized tax base

Credit challenges

- » Very weak income indices
- » Enrollment is inconsistent
- » 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

- » Substantial tax base expansion and diversification

- » Trend of operating surpluses, increasing cash reserves and fund balance
- » Reductions to the pension and fixed cost burdens

Factors that could lead to a downgrade

- » Reductions to reserves
- » Significant tax base contraction
- » Further increases to the pension and fixed cost burdens

Key indicators

Exhibit 1

Deming Schools, NM	2015	2016	2017	2018	2019
Economy/Tax Base					
Total Full Value (\$000)	\$1,653,402	\$1,653,541	\$1,742,528	\$1,784,512	\$1,793,837
Population	24,789	24,627	24,319	24,264	24,264
Full Value Per Capita	\$66,699	\$67,143	\$71,653	\$73,546	\$73,930
Median Family Income (% of US Median)	53.4%	52.4%	50.8%	56.4%	56.4%
Finances					
Operating Revenue (\$000)	\$44,139	\$47,233	\$44,714	\$44,899	\$46,613
Fund Balance (\$000)	\$5,709	\$5,481	\$5,352	\$6,641	\$7,801
Cash Balance (\$000)	\$5,940	\$4,935	\$5,284	\$4,501	\$5,754
Fund Balance as a % of Revenues	12.9%	11.6%	12.0%	14.8%	16.7%
Cash Balance as a % of Revenues	13.5%	10.4%	11.8%	10.0%	12.3%
Debt/Pensions					
Net Direct Debt (\$000)	\$17,700	\$22,080	\$28,885	\$26,395	\$26,370
3-Year Average of Moody's ANPL (\$000)	\$139,124	\$140,390	\$159,616	\$178,145	\$189,189
Net Direct Debt / Full Value (%)	1.1%	1.3%	1.7%	1.5%	1.5%
Net Direct Debt / Operating Revenues (x)	0.4x	0.5x	0.6x	0.6x	0.6x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	8.4%	8.5%	9.2%	10.0%	10.5%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	3.2x	3.0x	3.6x	4.0x	4.1x

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

Profile

The district is located in the southern portion of the state, along the US-Mexico border. The district contains approximately 2,968 square miles with an estimated population of 27,000. The district operates seven elementary schools, two middle school, two high schools and one alternative high school. Fiscal 2019 enrollment is approximately 5,100.

Detailed credit considerations

Economy and tax base: moderately-sized tax base is southern New Mexico; local economy based on agriculture

The coronavirus is driving an unprecedented economic slowdown. We currently forecast US GDP to decline significantly during 2020 with a gradual recovery commencing toward the end of the year. Local governments with the highest exposure to the tourism, healthcare, retail, oil and gas and international trade sectors could suffer particularly severe impacts.

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While a decline in assessed values (AV) would not impact the district's operations (by statute, a school district cannot levy for operations), it could impact the debt service fund. The debt service levy is set by the Department of Finance and Administration (DFA) using certified values. Rates are set to ensure annual debt service coverage of at least 1.05 times. If the base were to contract as a result of the pandemic, the DFA would increase the tax levy.

Located in Southern New Mexico, the tax base is moderately-sized, with fiscal 2020 assessed value (AV) of \$618 million, derived from a full value of \$1.9 billion. The local economy is based in agriculture, with the primary crops being green chilies, pecans, cotton, melons and grapes. Due to the seasonable nature of the produce, a large portion of the county's workforce is part-time and transient, which inflates the unemployment rate. Since 2010, the annual unemployment rate has hovered around 16% (average). However, due to the coronavirus pandemic, it has inched upwards to April 2020's 17.6%.

Despite the pandemic, and corresponding economic slowdown, management reports that two important projects are underway: construction of both a magnesium mine and a satellite campus for Western New Mexico University (WNMU).

The county's wealth indices are weak, with median family income reported at 56.4% of the US, per the 2018 American Community Survey. Top ten taxpayers comprise a moderate 27% of fiscal 2020 full value, but are electric utilities and railroad companies that have made significant investment in the area, and are unlikely to relocate elsewhere.

Historic enrollment trends are inconsistent. Fiscal 2019 headcount is 5,087, a modest decline from prior year's 5,147. However, in fiscal 2020, enrollment rebounded to 5,142. Officials are focused on retaining students, and have partnered with WNMU and local businesses to create pipelines that allow students to obtain their associate degrees and find jobs in the region.

Financial operations and reserves: financial position shows improvement, remains below national medians

In the wake of the coronavirus pandemic, the district has transitioned to remote learning. For the remainder of the fiscal 2020, the state is making the district whole, and providing aid in full.

Fiscal 2019 ended as projected, with a \$1 million surplus, increasing general fund balance to \$4.3 million, or 10% of revenues. Due to a change in the state funding formula, the district received additional aid; the increase in revenues outpaced the increase in expenditures. Operating fund balance, including the general fund and debt service fund, is \$7.8 million, or 16.7% of operating revenues.

The fiscal 2020 budget was balanced. The district closed its schools mid-March, and management anticipates facilities to remain closed through the summer. Officials report that professional development and transportation costs are down, which will likely drive another surplus at year-end.

The fiscal 2021 budget is balanced, although it includes \$4.6 million in cash balance (this is a budgeting practice required by the PED). Management explains that Deming's state aid award was adjusted downwards due to the receipt of \$3.9 million in CARES funding. The district does not anticipate hiring additional staff, but depending on how New Mexico decides to educate in the fall (in person, remote or a hybrid of the two), additional janitorial costs may be incurred.

LIQUIDITY

General Fund cash tracks below fund balance. Fiscal 2019 ending cash was \$2.4 million, or 5.6% of revenues. General Fund balance is higher as it incorporates a \$3.7 million receivable associated with state and federal grants. In practice, many New Mexico districts float grant funds with operating dollars, being reimbursed in July at the start of the next fiscal year. Operating fund cash is \$5.6 million, or 12.3% of operating revenues. Included in fund balance is annual debt service, which is paid in August.

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

Despite plans to issue in the mid-term, the district's debt burden will likely remain manageable given rapid principal amortization. At 1.5% of fiscal 2020 full value, the district's debt burden is slightly above state and national medians. Positively, principal payout is rapid, with 91.4% retired in ten years. The district plans to issue another \$2.5 million in 2021 before going to voters in November 2021 for additional authorization. Debt service is front-loaded, allowing for the layering in of additional bonds without adjustments to tax rates.

DEBT STRUCTURE

Inclusive of the current issuance, the district has \$28.7 million in fixed-rate obligations. All debt matures by 2033.

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 Plan (EERP), a cost sharing plan administered by the state and managed by the Educational Retirement Board (ERB). Deming'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 \$180.3 million, or an elevated 3.87x operating revenues. In 2019, the legislature made minor changes to EERP, increasing contribution rates. These changes do not materially reduce the Plan's unfunded liability. To date, the legislature has not made any changes to benefit payouts.

In addition to a high ANPL (relative to revenue), 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 \$4.2 million were below the tread water indicator of \$6.2 million, a gap equal to 4% of operating revenues.

Moody's calculated unfunded OPEB liability was \$28.6 million in fiscal 2019, or an above average 61.4% of operating revenues. Fixed costs, including pension and OPEB contributions and debt service are an average 18% of operating revenue. Inclusive of tread water, fixed costs jump to 22%.

ESG considerations**Environmental**

Environmental considerations are not considered a material risk. The district is located in southern New Mexico, and is not susceptible to environmental disasters, such as hurricanes, tornados or fires. The state as a whole is at risk of drought, but that is not currently in effect.

Social

Social considerations were considered as part of Deming's credit profile. Wealth indices are well below average, and even before the pandemic, the unemployment levels were in the double-digits. It is expected that true unemployment in the county is close to 20%.

Governance

The district is governed by a five-member board of trustees who serve four-year terms. The board performs policy-making and supervisory functions and delegates administrative responsibilities to the superintendent of schools, who is the chief administrative officer of the district.

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, 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

Deming Schools, NM		
Scorecard Factors	Measure	Score
Economy/Tax Base (30%) ^[1]		
Tax Base Size: Full Value (in 000s)	\$1,855,887	Aa
Full Value Per Capita	\$76,487	Aa
Median Family Income (% of US Median)	56.4%	Baa
Notching Factors: ^[2]		
Outsized Unemployment or Poverty Levels		Down
Finances (30%)		
Fund Balance as a % of Revenues	16.7%	Aa
5-Year Dollar Change in Fund Balance as % of Revenues	4.2%	A
Cash Balance as a % of Revenues	12.3%	Aaa
5-Year Dollar Change in Cash Balance as % of Revenues	-0.6%	Baa
Management (20%)		
Institutional Framework	Baa	Baa
Operating History: 5-Year Average of Operating Revenues / Operating Expenditures (x)	1.0x	A
Debt and Pensions (20%)		
Net Direct Debt / Full Value (%)	1.5%	Aa
Net Direct Debt / Operating Revenues (x)	0.6x	Aa
3-Year Average of Moody's Adjusted Net Pension Liability / Full Value (%)	10.2%	Baa
3-Year Average of Moody's Adjusted Net Pension Liability / Operating Revenues (x)	4.1x	Baa
Notching Factors: ^[2]		
Other Analyst Adjustment to Debt and Pensions Factor (specify):		Down
	Scorecard-Indicated Outcome	A3
	Assigned Rating	A2

(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 (MFI)

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