MOODY'S INVESTORS SERVICE

CREDIT OPINION
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San Felipe-Del Rio Consolidated I.S.D., TX

Update to credit analysis

Summary

San Felipe Del Rio CISD (Aa3) benefits from a moderately sized and stable tax base supported by the institutional presence of Laughlin Air Force Base and the strong economic benefit resulting from cross-border employment and trade. Further, the financial position remains healthy despite a recent use of reserves for capital outlay, which will continue. The credit profile also incorporates a manageable debt burden, a growing pension liability, and below average income levels.

On May 23, we assigned an initial Aa3 rating to the district's general obligation limited tax Maintenance Tax Notes, Series 2018.

Credit strengths

» Above average general fund reserves despite ongoing draws for capital projects

» History of modest annual tax base growth with expectation to continue

» Proximity to employment opportunities at the Laughlin Air Force Base and in neighboring Ciudad Acuna (Mexico)

Credit challenges

» Below-average, though slightly improving, income levels

» Unemployment above state and national levels

Rating outlook

Moody's does not usually assign outlooks to local government credits with this amount of debt outstanding.

Factors that could lead to an upgrade

» Substantial and sustained tax base expansion

» Improved resident income or wealth levels

Factors that could lead to a downgrade

» Erosion of financial reserves and liquidity to levels below board policy

» Sustained contraction of the tax base

» Material increase net direct debt disproportionate to tax base growth

Key indicators

Exhibit 1

San Felipe-Del Rio Consolidated I.S.D., TX	2013	2014	2015	2016	2017
Economy/Tax Base					
Total Full Value ($000)	$1,439,663	$1,548,611	$1,545,691	$1,571,743	$1,677,156
Population	48,122	48,379	48,336	48,374	47,617
Full Value Per Capita	$29,917	$32,010	$31,978	$32,491	$35,222
Median Family Income (% of US Median)	70.2%	76.8%	74.1%	74.1%	74.1%
Finances					
Operating Revenue ($000)	$77,094	$83,057	$85,413	$91,950	$87,974
Fund Balance ($000)	$49,897	$53,654	$52,759	$42,374	$34,968
Cash Balance ($000)	$47,557	$51,188	$48,429	$42,871	$36,129
Fund Balance as a % of Revenues	64.7%	64.6%	61.8%	46.1%	39.7%
Cash Balance as a % of Revenues	61.7%	61.6%	56.7%	46.6%	41.1%
Debt/Pensions					
Net Direct Debt ($000)	$48,936	$45,451	$42,751	$40,159	$37,957
3-Year Average of Moody's ANPL ($000)	$16,290	$18,381	$29,610	$50,556	$75,873
Net Direct Debt / Operating Revenues (x)	0.6x	0.5x	0.5x	0.4x	0.4x
Net Direct Debt / Full Value (%)	3.4%	2.9%	2.8%	2.6%	2.3%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	0.2x	0.2x	0.3x	0.5x	0.9x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	1.1%	1.2%	1.9%	3.2%	4.5%

As of August 31 fiscal year-end; finances include general and debt service funds
Source: Moody's Investors Service; district's audited financial statements

Profile

San Felipe Del Rio CISD is a political subdivision of the State of Texas (Aaa stable), located in Val Verde County (A3), approximately 170 miles west of San Antonio (Aaa stable) on the US/Mexico international border. The district primarily serves the City of Del Rio (A1), surrounding communities within Val Verde County as well as dependents of staff at Laughlin Air Force Base. As of the 2017-2018 school year, the district had a total enrollment of 10,579 students.

Detailed credit considerations

Economy and tax base: modestly growing base at US/Mexico border that contains Laughlin AFB

The moderately-sized tax base will remain stable, but material new growth is not expected given a lack of significant new development. Laughlin Air Force Base is the largest employer in the district and a source of stability for the region. In addition to the base, other government agencies, including the US border patrol, are a major source of domestic employment. An international toll bridge in the district connects it to Ciudad Acuna in neighboring Mexico which facilitates cross-border trade and significant employment opportunities, most notably in the maquiladoras (factories owned by US and international corporations) benefiting from duty free movement of raw materials, other supplies and finished products across the border that have grown in number in the recent past.

Assessed values have grown moderately over the past decade, going from $1.1 billion in 2008 to $1.7 billion in 2018. Over the past five years, average annual growth has totaled 3.3%. Over the medium term, tax base growth is expected around 1% annually. The district's size is below average for the rating category, in part due to the presence of the Laughlin AFB which is exempt from taxation. The primarily residential tax base is relatively diverse, with the top ten taxpayers accounting for 11.4% of fiscal 2018 AV.

Income and wealth indicators are below national medians. The district's median family income of $50,583 (2016 ACS) represents 78.3% of the state and 74.5% of the US, but has been improving since the 1990s. Full value per capita is $35,463 (42.8% of the US). Unemployment in Val Verde County remains above that of the state and US.

Management projects enrollment will remain stable. Over the past five years (2014-2018), enrollment is down a total of 0.4%. Fiscal 2018 enrollment increased 0.4% to 10,579.

Financial operations and reserves: above-average reserves despite recent draws for capital projects

Despite recent drawdowns for capital outlay, the district maintains healthy reserves well above an informal policy to keep 25% of general fund expenses in reserve (equal to roughly $21 million). Going forward, the district will continue to spend down reserves for capital until unassigned general fund balance reaches the target, a level that is within the state median and above the national median for the rating category. At fiscal 2017 year-end, available general fund balance totaled $33.5 million or 39.9% of revenues. Of this amount, $28.3 million (33.7% of revenues) is unassigned.

Management reports that fiscal 2018 operations are on target, but unassigned general fund balance will decline by roughly $2 million at year-end as funds are committed for future capital outlay.

Inclusive of the General and Debt Service funds, the district's available operating fund balance totaled $35 million, or 39.7% of combined revenues, at fiscal 2017 year-end. State aid consistently represents 72-75% of annual operating revenues, followed by property taxes at 22-25%.

The district currently levies a maintenance and operations (M&O) tax rate of $10.40 per $1,000 of AV and an interest and sinking fund (I&S) rate of $1.20, for a combined total tax rate of $11.60. The district is considering a tax ratification election (TRE) for November. The TRE would leave the total tax rate unchanged at $11.60, but all of the levy would come from M&O and nothing would be levied for I&S. This would necessitate General Fund transfers for debt service, but the district estimates that the net result would be a $3.1 million increase in General Fund state aid in fiscal 2019 and a $1.3 million increase in fiscal 2020 (compared to not issuing a TRE to swap the I&S levy to M&O). The TRE would decrease the district's operating revenue flexibility given that the M&O statutory maximum is $11.70 (with voter approval).

LIQUIDITY

Similar to fund balance, liquidity will continue to decline as cash is spent for capital outlay. General fund cash totaled $34.7 million at fiscal 2017 year-end, equal to 41.3% of revenue. When including the debt service fund, total operating cash was $36.1 million or 41.1% of combined revenues.

Debt and pensions: debt burden will remain manageable; growing pension liability

The direct debt burden is slightly elevated at 3.2% of AV (inclusive of the Series 2018 notes), but it will begin to decline given satisfactory payout and no future debt plans. When including debt issued by overlapping local governments, the district's overall debt burden is a high 9.9%. In fiscal 2017, state aid covered a high 45.6% of debt service costs.

DEBT STRUCTURE

All debt is fixed rate and principal amortization is faster than the state median, with 65.5% retired in 10 years.

DEBT-RELATED DERIVATIVES

The district is not party to any interest rate swaps or other derivative agreements.

PENSIONS AND OPEB

Budgetary pressure due to the district's participation in the Texas Teachers Retirement System (TRS) pension plan is expected to remain manageable in the near term. The state makes most of the employer pension contributions on behalf of the district annually. Moody's three year average adjusted net pension liability (ANPL) for the district (fiscal 2015-2017), under our methodology for adjusting reported pension data, is $75.9 million, or a below average 0.9 times operating revenues (general and debt service funds) and an elevated 4.5% of AV. We determined the district's share of liability for the state-run TRS in proportion to its contributions to the plan.

Moody's ANPL reflects certain adjustments we make to improve comparability of reported pension liabilities. The adjustments are not intended to replace the district's reported liability information, but to improve comparability with other rated entities. 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.

Total fixed costs, including debt service, pension and OPEB contributions, totaled $4.4 million, representing a manageable 8.4% of fiscal 2017 operating expenditures.

Management and governance: strong institutional framework

The district is governed by a seven-member Board of Trustees. The Board delegates administrative responsibilities to the Superintendent of Schools who is the chief administrative officer of the district. The management team of San Felipe Del Rio CISD has demonstrated strong fiscal management evidenced by a decade of general fund surpluses and buildup of above-average reserves, as well as forward-thinking capital and programmatic planning to maintain manageable debt levels and attract students.

Texas School Districts have an Institutional Framework score of Aa, which is high. Institutional Framework scores measure a sector's legal ability to increase revenues and decrease expenditures. Property taxes, one of the sector's major revenue sources is subject to a cap of $10.40 per 1,000 of assessed value, which can be overridden at the local level to $11.70 (with voter approval). The voter approved levy override provides for additional revenue-raising flexibility. Unpredictable revenue fluctuations tend to be minor, or under 5% annually. Across the sector, fixed and mandated costs are generally greater than 25% of expenditures. Texas is a Right to Work state, providing significant expenditure-cutting ability. Unpredictable expenditure fluctuations tend to be minor, under 5% annually.

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