

RatingsDirect®

Summary:

Ector County Independent School District, Texas; School State Program

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Table Of Contents

Rationale

Outlook

Related Research

Summary:

Ector County Independent School District, Texas; School State Program

Credit Profile

Ector Cnty Indpt Sch Dist PSF

Long Term Rating

AAA/Stable

Current

Underlying Rating for Credit Program

A+/Stable

Downgraded

Rationale

S&P Global Ratings lowered its underlying rating to 'A+' from 'AA-' on Ector County Independent School District, Texas' outstanding general obligation debt. The outlook is stable.

The rating action reflects our view of the district's weakened financial profile, driven by revenue pressures related to the district's concentration within the energy sector and the resulting volatility of the tax base.

The 'A+' underlying rating further reflects our view of the district's:

- Participation in the strong Midland-Odessa combined statistical area, despite concentration in the oil and gas industry;
- Good to strong wealth and income indicators; and
- Moderate debt burden.

Partly offsetting the above strengths, in our view, are the district's:

- Materially weakened, albeit strong, financial profile, and
- Recent assessed value (AV) and enrollment declines.

The bonds are secured by revenue from an ad valorem tax levied, without legal limitation as to the rate or amount, on all taxable property within the district.

Economy

Ector County Independent School District serves an estimated population of 159,126. In our opinion, median household effective buying income (EBI) is strong at 110% of the national level, but per capita EBI is good at 99%. At \$76,612 per capita, the 2018 market value totaling \$12.2 billion is, in our opinion, strong. Net taxable AV declined by a total of 7.6% overall from 2016 to \$12.2 billion in 2018, but in 2018 it increased by 2.8%. The 10 largest taxpayers make up an estimated 14.2% of net taxable AV, which we consider very diverse.

Coterminous with the boundaries of Ector County, the district includes the Odessa metropolitan statistical area in West Texas. The local economy, as part of the Midland-Odessa combined statistical area, is located in the heart of the Permian Basin oil production area and serves as a major oil field service and supply center. Despite our opinion of the diverse tax base, we consider the local economy concentrated given the heavy reliance on the oil industry.

Oil price volatility has resulted in AV declines of 7.5% in fiscal 2016 and 10.1% in fiscal 2017. These declines stemmed primarily from lower mineral values, but with the recent improvement in prices, the district saw modest AV growth in 2018. Management anticipates that oil prices will remain stable, which, in conjunction with ongoing residential development in the area, will help support modest AV growth, which is consistent with our own projections (for more information, please see our report "S&P Global Ratings Raises Its Oil And Natural Gas Prices Assumptions For 2017," published Dec. 14, 2016, on RatingsDirect).

Finances

A wealth equalization formula, based on property values and average daily attendance (property wealth per student), determines state funding for all school districts. Therefore, increases or decreases in average daily attendance (enrollment) can lead to increases or decreases, respectively, in the amount of state revenue a district receives. Enrollment totaled 31,807 students in 2018. Enrollment increased overall from 2014 to 2018. Given ongoing residential construction in the area, management projects that enrollment will continue to trend upward, which we believe is reasonable.

The district's available fund balance of \$19.6 million is strong in our view, at 8.2% of general fund expenditures at fiscal year-end (June 30) 2017. The district reported a deficit operating result of 7.1% of expenditures in 2017. The district depends primarily on property taxes for general fund revenue (56.3%), followed by state aid (40.8%).

The district has posted three consecutive operating deficits, reducing its available reserves from a very strong 24.9% of expenditures in fiscal 2014, to the aforementioned 8.2% of expenditures at the end of fiscal 2017, which we consider only strong. Management attributes the operating deficits to declining AV, lower enrollment figures, and increased payroll and personnel costs. For fiscal 2018, management made a number of expenditure cuts and consequently adopted a balanced operating budget. We note that the rating could come under further pressure if the district underperforms in comparison to its budget and further materially reduces reserves.

For fiscal 2018, the district is levying a total tax rate of \$1.15 per \$100 of AV: \$1.04 for operations and 11 cents for debt service. The tax rate for operations can be raised to \$1.17 with electorate approval.

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.

Highlights of the district's financial management policies and practices include the use of historical data in the development of its budgets, monthly reporting to the board on budget-to-actual performance, maintenance of a formal investment management policy, and quarterly reporting to the board on investment holdings. The district does not project operations beyond the current budget year, does not maintain a formal debt management policy, and is not in compliance with its formal reserve policy of maintaining 20% of expenditures on hand. Although the district has a 10-year capital improvement plan, we believe that the plan lacks a number of key details.

Debt

Overall net debt is moderate, in our opinion, at 3.0% of market value and \$2,078 per capita. Amortization is slower than average, with 38% of the district's direct debt scheduled to be retired within 10 years. Debt service carrying

charges were 4.7% of total governmental fund expenditures excluding capital outlay in fiscal 2017, which we consider low.

The district may seek to issue debt for construction of additional schools and other capital projects in the near future; however, we do not anticipate that such an issuance would increase the district's debt burden beyond what we would consider to be a moderate level. Additionally, although the district holds one privately placed debt obligation, we do not believe that it would pose a material risk to either the district's liquidity or finances.

Pension and other postemployment benefit (OPEB) liabilities

In fiscal 2017, the district paid its full required contribution of \$12.6 million, or 4.2% of total governmental expenditures, toward its pension obligations. Also the district paid \$906,000, or 0.3% of total governmental expenditures, toward its other postemployment benefit

The district participates in the Texas Teachers' Retirement System (TRS). According to its 2017 audit, which adhered to Governmental Accounting Standards Board Statement No. 68 reporting standards, its proportionate share of the plan's net pension liability was roughly \$67.2 million. The plan's fiduciary net position was 78% of the total pension liability. The district also contributes to TRS Care, a cost-sharing, multiemployer defined benefit postemployment health care plan. Given the small size of the district's pension and OPEB contributions as a percentage of its budget, we view the resulting financial burden as minimal.

Outlook

The stable outlook reflects our expectation that the district will maintain at least good reserves while continuing to benefit from its participation in the Midland-Odessa economy. Consequently, we do not anticipate changing the rating within the two-year outlook horizon.

Upside scenario

If the district were to demonstrate a trend of strong operations and thereby increase its reserves to a level we considered commensurate with that of higher-rated peers, we could consider raising the rating.

Downside scenario

If the district were to continue posting deficit operating results, and thus further reduce its reserves, we could consider lowering the rating.

Related Research

Alternative Financing: Disclosure Is Critical To Credit Analysis In Public Finance, Feb. 18, 2014

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Summary: Ector County Independent School District, Texas; School State Program

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