CREDIT OPINION
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New Issue

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Las Cruces School District 2, NM

New Issue - Moody's Assigns Aa3 to Las Cruces SD 2, NM's $20M GOULT Bonds, Ser. 2016C; Outlook is Negative

Summary Rating Rationale

Moody's Investors Service has assigned an Aa3 underlying rating to Las Cruces School District No. 2 (Dona Ana County), NM's $20 million General Obligation School Bonds, Series 2016C. Concurrently, Moody's affirms the Aa3 on outstanding general obligation bonds. Moody's has also assigned an Aa1 enhanced rating to the Series 2016C GO bonds based on the New Mexico School District Enhancement Program (NMSDEP) - Post March 30, 2007.

Assignment of the Aa3 reflects the district's narrow financial position, which is expected to improve in the next couple of years, in large part due to a new management team focused on rebuilding reserves; sizeable and stable tax base, anchored by a University and military installations; socio-economic indices that trend below national averages; and a manageable debt profile with average principal amortization.

The Aa1 enhanced rating on the Series 2016C General Obligation Bonds is based on our assessment of the NMSDEP - Post March 30, 2007 and a review of the district's proposed financing. For additional information on the program, please see Moody's report dated May 4, 2008.

Credit Strengths

» Sizeable tax base with institutional presence (New Mexico State University and White Sands Missile Range)

» Manageable debt profile

» New management team focused on rebuilding reserves

Credit Challenges

» Narrow financial reserves and limited financial flexibility

» Uncertainty regarding fiscal 2017 and fiscal 2018 state funding

Rating Outlook

The negative outlook reflects the district's narrow reserve levels, which limit financial flexibility. Management's inability to restore structural operating balance, especially in light of expected cuts to state funding, over the near-term may place further downward pressure on the rating.

Factors that Could Lead to an Upgrade

» Return to structural balance with trend of operating surpluses, increasing financial reserves

» Tax base diversification and expansion, coupled with improved socioeconomic profile

Factors that Could Lead to a Downgrade

» Ongoing structural imbalance resulting in further deterioration of financial reserves including fiscal 2016 performance that is not in line with stated results

» Significant tax base contraction

Key Indicators

Exhibit 1

Las Cruces S.D. 2 (Dona Ana County), NM	2011	2012	2013	2014	2015
Economy/Tax Base					
Total Full Value ($000)	$ 8,982,148	$ 8,868,994	$ 9,043,591	$ 9,092,160	$ 9,240,754
Full Value Per Capita	$ 74,233	$ 58,703	$ 59,450	$ 59,770	$ 60,746
Median Family Income (% of US Median)	78.3%	79.5%	78.6%	78.6%	78.6%
Finances					
Operating Revenue ($000)	$ 179,012	$ 190,171	$ 193,107	$ 194,670	$ 200,923
Fund Balance as a % of Revenues	4.8%	12.3%	14.0%	11.6%	9.3%
Cash Balance as a % of Revenues	14.0%	16.5%	16.7%	13.1%	11.7%
Debt/Pensions					
Net Direct Debt ($000)	$ 91,145	$ 129,800	$ 118,798	$ 133,722	$ 143,130
Net Direct Debt / Operating Revenues (x)	0.5x	0.7x	0.6x	0.7x	0.7x
Net Direct Debt / Full Value (%)	1.0%	1.5%	1.3%	1.5%	1.5%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	N/A	3.0x	3.4x	3.7x	2.2x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	N/A	6.4%	7.2%	7.8%	4.8%

Source: District audits; Moody's Investors Service

Detailed Rating Considerations - Enhanced

Moody's has assigned an enhanced rating of Aa1 to the Series 2016C General Obligation bonds, equivalent to the NMSDEP-Post March 30, 2007 programmatic rating. Ratings on individual intercept financings depend on the programmatic rating as well as the evaluation of additional rating factors. These factors include the sufficiency of interceptable revenues as determined by specific coverage tests, the timing of the state's fiscal year as it relates to scheduled debt service payment dates, and the transaction structure.

Based on the district's state equalization guarantee (SEG) funds for fiscal year 2015, interceptable state-aid provides an ample minimum of 12.53 times coverage of maximum periodic debt service. Furthermore, state revenues provide a healthy minimum 11.49 times maximum periodic debt service coverage when coverage is stressed by deducting the state's final monthly state aid payment within a fiscal year. State aid funding was fairly stable since fiscal 2009 and fiscal 2010, in which the state made mid-year cuts. However, with the decline in oil and gas prices in late 2015 and 2016, the state is facing a sizeable budgetary gap, and will likely implement SEG funding reductions during fiscal 2017 and fiscal 2018. Specific to the enhanced rating, financial challenges are somewhat mitigated by the district's very ample debt service coverage, as discussed above. Principal payments are scheduled for August, early in the State's fiscal year, and is considered an average interval that mitigates the risk of late budgets. The program requires the appointment of a third-party fiscal agent, who is required to notify the state if an intercept of SEG is required. The Bank of Albuquerque is the fiscal agent for the current sale.

Detailed Rating Considerations - Underlying

Economy and Tax Base: Stable, Large Tax Base in Southern New Mexico

With Las Cruces (Aa2) serving as the regional economic hub and the significant institutional presence within the district, we believe the tax base will remain stable over the near-term and return to growth over the medium- and long-term. Encompassing 1,458 square miles in Dona Ana County (NR) in southern New Mexico (Aaa ratings under review), the district benefits from the economic stability provided by governmental entities, including White Sands Missile Range and New Mexico State University (Aa3 ratings under review). The district's assessed valuation (AV) has increased a modest 1.1% on average annually over the past five years, reaching $3.166 billion in fiscal 2016 (derived from a full value of $9.5 billion). Residential values account for 72% of the fiscal 2016 AV while commercial and centrally assessed properties represent a smaller portion at 24% and 4%, respectively. Officials anticipate similar AV expansion over the near-term given ongoing commercial and residential developments. Fiscal 2017 preliminary values indicate an AV of $3.220 billion (derived from a full value of $9.7 billion).

The district reports several established businesses are expanding, adding anywhere from 20 to 200 new jobs in the next year. Trade relations with Mexico remain strong, with Las Cruces benefitting from proximity to Union Pacific Railroad's “inland port”, a 24-hour facility that allows for companies to quickly move their products in and out of the country. Within the city, officials report a Neighborhood Walmart, Sportman's Warehouse and Border International Truck and Trailer Sales are opening locations, which will add jobs and increase the city's gross receipts tax (sales tax).

Top ten taxpayers are reportedly stable, accounting for 4.9% of fiscal 2016 AV, and are comprised of large utility companies, healthcare entities, and retail shopping centers. The district experienced notable population growth over the last census period, increasing 23.5% since the 2000 U.S. Census, to reach 149,482 residents for the 2010 U.S. Census. Resident wealth levels are below average measured by per capita income and median family income (2013 American Community Survey) that approximate 79.1% and 78.6% of the state levels, respectively. County unemployment rates are somewhat elevated at 7.5% (July 2016) compared to the nation's 5.1%.

Enrollment remains stable. District enrollment increased at a 0.1% average annual rate over the past five years to 24,301 students (fiscal 2016), making it the second largest school district in New Mexico. Officials report elementary school enrollment is up 400 students since the beginning of the fiscal 2017 school year. Over the next ten years, officials expect enrollment to increase with economic expansion, growing to 25,087 by 2026.

Financial Operations and Reserves: Narrow Reserves; Surplus Expected for Fiscal 2016

Moody's expects the district's financial position to remain pressured over the near-term. Since fiscal 2013, the district has utilized reserves for recurring expenditures, a primary driver in the recent rating downgrade. Fiscal 2015 continues this trend, ending with a $3.1 million deficit, as expected per our report published December 9, 2014. As such, General Fund balance declined to $5.7 million, or a very narrow 3% of revenues. State aid, which accounts for 98.4% of total revenues, increased by 3.3% year-over-year; however, instructional costs outpaced growth, increasing by 3.9%.

For fiscal 2016, preliminary results indicate a sizeable surplus of $6.0 million, which, if realized, would increase General Fund balance to $11.6 million, or 6.1% of unaudited revenues. Management successfully implemented several cost saving measures in fiscal 2016, including no salary increases for staff and three furlough days, with each furlough day being worth $700,000. The district eliminated roughly 49 full-time employees through retirement incentives, attrition and vacancies. Furthermore, utility costs were less than anticipated given a decline in prices and a mild winter.

The fiscal 2017 budget is balanced, and reflects additional cost-saving measures, including: three furlough days for administrative staff only, with each furlough day being worth $250,000; the school year was shortened to 180 days from 183 days; and, all high schools will implement a seven-period day (a departure from the historic eight-period day), reducing the number of staff required. The district does not anticipate utilizing reserves for capital needs or other one-time expenditures. Additionally, the district conservatively assumed $182.7 million in SEG; however, in fiscal 2016, the district received $186.8 million (unaudited).

With the decline in oil and gas severance taxes, the State of New Mexico is facing significant budgetary challenges. A Special Session began on September 30, 2016 to discuss how to address the deficit. A mid-year state aid cut of 1.5% is proposed (SB9), and has passed both houses of Congress. In Las Cruces' case, this would translate to a decline of $2.6 million over the course of fiscal 2017 or $325,000 per month. Additionally, legislators have suggested a $30 million reduction to supplemental funding (specifically, to transportation and instruction materials); it has yet to be determined how the state would allocate these cuts across the districts. Furthermore, legislators have outlined another $12.5 million from Capital Outlay funds that may serve to offset the supplemental funding reduction. The Governor is considering SB9 now. District officials are prepared to issue a moratorium on travel and professional development to offset these unexpected cuts.

Over the next three to four years, the district hopes to rebuild General Fund balance, with a target goal of $16 million. Management expects to realize savings through conservative budgeting and use of furlough days. Future credit reviews will focus on the district's ability to balance the budget without use of reserves while adressing potential state aid cuts; failure to do so may result in negative rating action.

LIQUIDITY

The district’s cash position is weak, with fiscal 2015 General Fund cash reported at $8.9 million, or 4.9% of revenues. This is a decrease from the prior year’s $11.4 million, or 6.3% of revenues. Fiscal 2015 operating cash, including both General Fund and Debt Service Fund, is $23.5 million, or 11.7% of revenues. Positively, fiscal 2016 unaudited General Fund cash is reported at $10.5 million (cash-basis), which is an improvement to prior year’s General Fund cash of $7.6 million (cash-basis).

Debt and Pensions: Manageable Debt Burden with Plans to Issue in the Near-term

Despite plans for additional near-term borrowing, we believe the district's debt burden will remain manageable given the average rate of principal amortization coupled with taxable growth. The district's debt burden is 1.6% of fiscal 2017 preliminary full value, which is in-line with state and national medians. Post-sale, the district will have $15 million in authorized unissued bonds from the February 2014 election. Officials plan to issue the remaining available in 2017, returning to voters in February 2018 for another bond election. According to officials, the district needs $265.5 million to address capital needs over the next ten years. Historically, the district received approximately 64% of capital funding from the state; however, given financial uncertainty, state support may be reduced. This will likely not impact the district's CIP; capital needs are not imminent, and the district has the flexibility to postpone projects for a limited time.

DEBT STRUCTURE

Post-sale, the district will have $119.8 million in fixed-rate general obligation bonds, all of which retire by 2033. Additional debt outstanding include $34.5 million of capital lease bonds that are serviced by an authorized HB-33 three mill levy, which is up for renewal in 2020. The debt is fixed-rate, and retires by 2034.

DEBT-RELATED DERIVATIVES

The district does not have any variable rate debt and it is not a party to any interest rate swap agreements.

PENSIONS AND OPEB

The district has an above-average employee pension burden, based on unfunded liabilities for its share of the Educational Retirement Board (ERB), a cost sharing plan administered by the state. Moody's fiscal 2015 adjusted net pension liability (ANPL) for the district, under our methodology for adjusting reported pension data, is $662.7 million, or an elevated 3.40 times operating revenues. The three-year average of the district's ANPL to operating revenues is 2.2 times, while the three-year average of ANPL to equalized value is above average at 4.8%. 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.

The New Mexico pension plan funding structure experienced several changes with the signing of SB 115, including the reduction of a cost-of-living adjustment (COLA) and increases in employee contributions. The legislation will maintain the funding changes until the plan has reached 100% funding, which is estimated to be achieved in 2043. We believe the funding changes adopted in SB 115 will limit budgetary pressure on the district related to future pension costs.

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.

Management and Governance

New Mexico school districts have an institutional framework score of "A," or moderate. Districts have a low ability to raise revenues because state aid provides over 95% of funding, and property taxes are subject to a small 0.5 mill cap. State aid is moderately predictable given a recent trend of increased funding and a history of funding cuts over the past decade. Expenditures, which are primarily comprised of personnel and facility costs, are moderately predicable given flat student enrollment levels. Districts have a moderate ability to reduce expenditures given above average fixed costs.

The school district has had a change in management: the prior Superintendent resigned mid-fiscal 2016, and a previous administrator returned from retirement to act as Interim Superintendent. A new Superintendent is expected to be in place by early November 2016. Officials are focused on rebuilding reserves, and hope to report a General Fund balance of $16 million by fiscal 2020.

Legal Security

The bonds are secured by ad valorem taxes that are levied against all taxable property within the district without limitation as to the rate or amount.

Use of Proceeds

Proceeds from the Series 2016C bonds will be used for various capital projects, with the majority allocated to completion of Las Cruces High School.

Obligor Profile

The district is located in Las Cruces in Southern New Mexico, and serves approximately 24,000 students.

Methodology

The principal methodology used in the underlying rating was US Local Government General Obligation Debt published in January 2014. The principal methodology used in the enhanced rating was State Aid Intercept Programs and Financings: Pre and Post Default published in July 2013. Please see the Rating Methodologies page on www.moodys.com for a copy of these methodologies.

Ratings

Exhibit 2

Las Cruces S.D. 2 (Dona Ana County), NM

Issue	Rating
General Obligation School Bonds, Series 2016C	Aa3
Rating Type	Underlying LT
Sale Amount	$20,000,000
Expected Sale Date	10/13/2016
Rating Description	General Obligation
General Obligation School Bonds, Series 2016C	Aa1
Rating Type	Enhanced LT
Sale Amount	$20,000,000
Expected Sale Date	10/13/2016
Rating Description	General Obligation

Source: Moody's Investors Service

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