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CREDIT OPINION
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Arlington Independent School District, TX

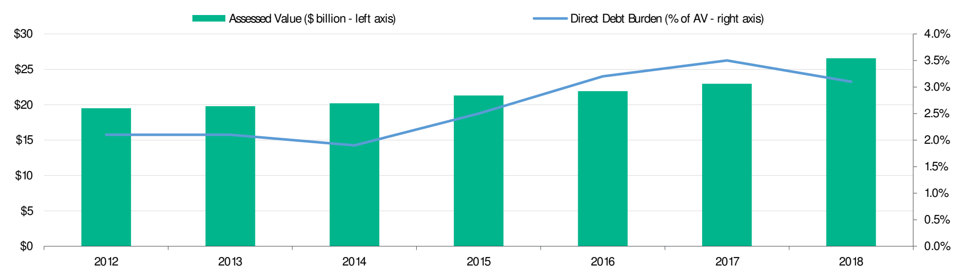
Update to credit analysis

Summary

Arlington ISD's, TX (Aa1 stable) credit profile benefits from a large and growing tax base, with a significant and expanding commercial presence, favorably located in the center of the Dallas (A1 stable)/Fort Worth (Aa3 negative) metroplex. Favorable economic trends coupled with the district's conservative fiscal management has lead to strong reserve levels despite a continued trend of declining enrollment. The profile also includes an elevated debt burden relative to peers, but a below-median pension burden.

Exhibit 1

Debt burden declines despite additional debt issuance due to strong tax base growth



Includes 2018 bond sale
Source: Arlington ISD audited financial statements and offering document

Credit strengths

» Healthy General Fund reserve supported by board adopted policies

» Large and growing tax base in the Dallas/Fort Worth metro area

» Additional liquidity provided by the Natural Gas Fund

Credit challenges

» Below-median resident income levels

» Ongoing trend of declining student enrollment

» Elevated debt burden relative to peers

Rating outlook

The stable outlook reflects the expectation that conservative management and budgetary practices will translate to a continued healthy financial profile, supported by favorable economic trends and manageable balance sheet leverage.

Factors that could lead to an upgrade

» Moderation of the debt burden

» Improvement in resident income levels

Factors that could lead to a downgrade

» Reduced reserves below targeted levels

» Trend of declining assessed values

» Significant increase in the debt burden

Key indicators

Exhibit 2

Arlington Independent School District, TX	2013	2014	2015	2016	2017
Economy/Tax Base					
Total Full Value ($000)	$19,779,331	$20,220,918	$21,265,403	$21,317,959	$22,961,132
Population	344,828	347,355	351,957	353,571	353,571
Full Value Per Capita	$57,360	$58,214	$60,420	$60,293	$64,941
Median Family Income (% of US Median)	89.4%	90.1%	89.1%	88.4%	88.4%
Finances					
Operating Revenue ($000)	$497,860	$545,829	$566,832	$581,477	$599,504
Fund Balance ($000)	$169,314	$201,583	$209,011	$227,290	$225,449
Cash Balance ($000)	$169,168	$190,854	$203,195	$219,522	$229,865
Fund Balance as a % of Revenues	34.0%	36.9%	36.9%	39.1%	37.6%
Cash Balance as a % of Revenues	34.0%	35.0%	35.8%	37.8%	38.3%
Debt/Pensions					
Net Direct Debt ($000)	$454,008	$428,988	$546,486	$714,289	$768,125
3-Year Average of Moody's ANPL ($000)	$247,586	$288,887	$337,443	$407,653	$495,581
Net Direct Debt / Operating Revenues (x)	0.9x	0.8x	1.0x	1.2x	1.3x
Net Direct Debt / Full Value (%)	2.3%	2.1%	2.6%	3.4%	3.3%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	0.5x	0.5x	0.6x	0.7x	0.8x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	1.3%	1.4%	1.6%	1.9%	2.2%

Source: Moody's Investors Service, Arlington ISD audited financial statements

Profile

Arlington Independent School District is centrally located in the Dallas/Fort Worth (DFW) metroplex, and primarily serves the city of Arlington (Aa1 stable), as well as the Tarrant County portion of Grand Prairie (Aa2), the town of Pantego and the city of Dalworthington Gardens. The district provides K-12 educational services to 61,076 students as of fiscal 2018.

Detailed credit considerations

Economy and tax base: large and stable tax base in Dallas-Forth Worth metroplex

The district's tax base will grow in the near term due to property appreciation and ongoing residential and commercial development and redevelopment. The district is largely mature and built out, but continues to experience population growth deriving from development of remaining vacant land as well as redevelopment of existing areas. Tax base growth has accelerated in the past five years, with average annual growth of a strong 6.1% over the period. Most recently, the tax base grew by a large 15.7%, bringing the fiscal 2018 value to $26.6 billion. Based on preliminary indications from the county appraisal district, the district anticipates that tax base growth for fiscal 2019 will be approximately 7%.

Despite a below-average wealth level, the local and regional economy provide ample job opportunities, which contributes to the stability of the tax base. Median family income in the district is 88.4% of the national level as of the 2016 American Communities Survey. However, characteristic of the DFW metroplex, unemployment in the district is low, at 3.7% as of March 2018, which compares favorably to both the state level (4.1%) and the national level (4.1%) over the same period. Residents have access to numerous employment opportunities in the region, including within the city of Arlington. The city of Arlington includes a number of large anchor entities such as such as General Motors Company (Baa3 stable), which is in the process of a $1.5 billion expansion, AT&T Stadium, home field for the Dallas Cowboys, Globe Life Park, home field for the Texas Rangers, and Six Flags/Hurricane Harbor amusement parks. Also of great economic importance to the region is the presence of the University of Texas at Arlington (University of Texas System rated Aaa stable), which has experienced steady enrollment growth and is up to nearly 42,000.

Enrollment in the district as of the 2017/18 school year was 61,076 which reflected the fifth year of modest enrollment decline in part due to the opening of several charter schools. With the numerous program and facility enhancements being implemented with the current bond program, the district does anticipate enrollment to stabilize. Over the past five years, the average annual change in enrollment is -1.2%.

Financial operations and reserves: healthy reserves to continue despite draws

The district's general fund reserves will modestly decline through fiscal 2019 but remain at healthy levels, supported by sophisticated and forward-looking financial management and the underlying strength of the tax base. Since 2007 the district's management has demonstrated conservative budgeting reflected in favorable budget-to-actual general fund results, a practice expected to continue. The district board has adopted financial policies which include a target to maintain 2 months (approximately 16.7%) of operating expenses in reserve, which they exceed.

Most recently, in fiscal 2017, the district adopted a $31.7 million general fund deficit, but realized a much smaller $5.3 million draw on reserves, all for one-time capital expenditures. The modest draw brought the available general fund balance to $197.7 million, a still strong 38.4% of general fund revenues. When including the district's debt service fund, total operating reserves equaled $225.5 million or 37.6% of total available operating revenues.

Looking to fiscal 2018, the district expects to report a draw on general fund reserves of approximately $7.6 million, again for one time capital expenditures. While the fiscal 2019 budget is not yet final, district officials expect another decline in general fund reserves in the $10 million range. Beyond fiscal 2019, the district is planning for stable reserves. Based on expected draws, general fund reserves should remain above 30% of revenues.

The district has a maintenance and operations (M&O) tax rate of $10.40/$1000 of assessed valuation, which is the statutory maximum without voter approval. The district has the option to increase the M&O levy to $11.70/$1000 with voter approval, and may seek voter approval to increase the M&O rate in the next year. Local sources represent approximately 54.7% of operating revenues.

LIQUIDITY

Liquidity maintained in the district's general fund was $208 million as of fiscal year-end 2017 (a healthy 40.4% of revenues). Inclusive of the debt service fund, total operating cash equaled $229.9 million (a healthy 38.3% of operating revenues). Given the anticipated draw on general fund reserves in fiscal 2018 and 2019, liquidity levels will likely decrease in tandem and remain similar to total general fund balance levels.

The district has access to additional liquidity outside the general fund associated with natural gas lease bonuses and royalties paid to the district. These funds may be used for operations if necessary, although the intention is to apply them to investments in instruction innovation and capital needs. As of fiscal 2017, the cash balance in this fund was $30.3 million, representing about 5% of operating revenues.

Debt and pensions: elevated but manageable debt burden

Inclusive of the 2018 bond sale, the district's net debt burden is elevated relative to rated peers at 3.1% of the fiscal 2018 full value. Despite the elevated debt burden, the debt level remains manageable for the district supported by the large and stable tax base, wide public support, and strong management. The 2018 bonds represent the final series under the district's $663.1 million general obligation authorization election that was held in May 2014. The district expects to go to voters with a new bond package in the next few years based on the results of a capital assessment study underway.

As of fiscal 2018, the district levied an interest and sinking (I&S) fund levy of $3.29/$1,000 of AV. The district has lowered the I&S rate over the past two years as AV has grown, and the rate remains below the original estimate presented to voters with the May 2014 bond authorization of $3.92/$1,000. The district expects to hold the rate flat in fiscal 2019.

The district's fixed cost burden, which includes debt, pensions and OPEB, is moderate and manageable at 16.3% of operating revenues as of 2017.

DEBT STRUCTURE

All of the district's debt is fixed rate. Principal amortization is below-average due to annual issuance, with 52.8% retired in ten years, and final maturity in 2043. Debt service payments are structured to slightly decline over time.

DEBT-RELATED DERIVATIVES

The district is not a party to any 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 minimal in the near term. The State of Texas (Aaa stable) makes most of the employer pension contributions on behalf of the district annually. In fiscal 2017, the district contributed the statutorily required amount of $13.1 million to the pension fund, representing a small 2.2% of operating revenues. However, annual contributions modestly fall below an amount needed to “tread water” on the unfunded liability, or prevent the liability from growing. The district's payment would have needed to be increased to $16.8 million in order to meet the “tread water” indicator. The tread water indicator measures the annual government contributions required to prevent reported net pension liabilities from growing, under reported assumptions, and is calculated as the normal cost plus interest on the unfunded liability. Nonetheless, the district's $3.7 million annual contribution gap to “tread water” is modest, representing a small 0.6% of operating revenues.

Moody's fiscal 2017 adjusted net pension liability (ANPL) for the district, under our methodology for adjusting reported pension data, is $606.6 million, or a modest 1.0 times operating revenues. 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.

Management and governance: strong institutional framework score

The district's board consists of seven members and supervises and controls all public schools and property within the district. The board employs a Superintendent of Schools, delegates administrative and supervisory functions to the superintendent, reviews and approves the district's budget.

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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