

CREDIT OPINION

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Arlington Independent School District, TX

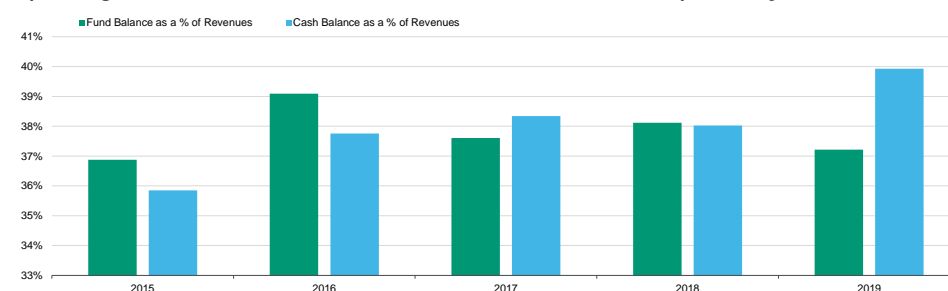
Update to credit analysis

Summary

[Arlington Independent School District, TX's](#) (Aa1 stable) credit profile is anchored by its large and growing tax base supported by a stable and diverse economy favorably located in the Dallas/Fort Worth metropolitan area. The profile is also strengthened by a long history of prudent fiscal practices driven by a fiscally conservative management team. These practices have allowed reserve levels to remain ample (see Exhibit 1) even after use in certain years for capital needs, and stagnant to declining enrollment, reflecting efficiencies in business practices. Although the pension burden is low, the district's direct debt levels are elevated compared with peers reflective of campus modernization in line with the district's strategic plan.

Exhibit 1

Operating fund balance has remained above 36% of revenue in the past five years



Source: Arlington Independent School District, TX Comprehensive Annual Financial Reports

Credit strengths

- » Large and growing tax base in the Dallas/Fort Worth metropolitan area
- » Ample reserves set to continue guided by conservative and experienced management team
- » Additional liquidity provided by the Natural Gas Fund

Credit challenges

- » Elevated debt burden compared with peers
- » Declining enrollment
- » Resident income levels are lower than similarly rated peers

Rating outlook

The stable outlook incorporates the district's conservative management and budgetary practices which have become institutionalized will continue to maintain the district's healthy financial profile. This factor supported by a positive economic environment will allow the relatively high debt burden remain affordable.

Factors that could lead to an upgrade

- » Moderated debt burdens to a level consistent with Aaa peers
- » Improved resident income levels relative to peers

Factors that could lead to a downgrade

- » Weakened economic performance that results in tax base loss
- » Reduced reserves to a level inconsistent with peers
- » Significant increases in the debt burden

Key indicators

Exhibit 2

Arlington Independent School District, TX	2015	2016	2017	2018	2019
Economy/Tax Base					
Total Full Value (\$000)	\$21,265,403	\$21,317,959	\$22,961,132	\$24,852,975	\$27,724,048
Population	351,957	353,571	354,089	354,089	354,089
Full Value Per Capita	\$60,420	\$60,293	\$64,846	\$70,188	\$78,297
Median Family Income (% of US Median)	89.1%	88.4%	88.8%	88.8%	88.8%
Finances					
Operating Revenue (\$000)	\$566,832	\$581,477	\$599,504	\$604,666	\$615,219
Fund Balance (\$000)	\$209,011	\$227,290	\$225,449	\$230,459	\$228,944
Cash Balance (\$000)	\$203,195	\$219,522	\$229,865	\$229,894	\$245,650
Fund Balance as a % of Revenues	36.9%	39.1%	37.6%	38.1%	37.2%
Cash Balance as a % of Revenues	35.8%	37.8%	38.3%	38.0%	39.9%
Debt/Pensions					
Net Direct Debt (\$000)	\$546,486	\$714,289	\$768,125	\$795,353	\$770,134
3-Year Average of Moody's ANPL (\$000)	\$337,443	\$407,653	\$495,581	\$555,044	\$587,907
Net Direct Debt / Full Value (%)	2.6%	3.4%	3.3%	3.2%	2.8%
Net Direct Debt / Operating Revenues (x)	1.0x	1.2x	1.3x	1.3x	1.3x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	1.6%	1.9%	2.2%	2.2%	2.1%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	0.6x	0.7x	0.8x	0.9x	1.0x

Source: Arlington ISD, TX Comprehensive Annual Financial Reports, US Government data sources

Profile

Arlington Independent School District is centrally located in the Dallas/Fort Worth (DFW) metropolitan area, and primarily serves the [City of Arlington](#) (Aa1 stable), the [Tarrant County](#) (Aaa stable) portion of [Grand Prairie](#) (Aa2), the Town of Pantego and the City of Dalworthington Gardens. The district provides k – 12 educational services to almost 60,000 students.

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Detailed credit considerations

Economy and tax base: large and growing tax base in Dallas-Fort Worth metroplex

The district's large tax base will continue to grow supported by steady economic performance that includes some commercial and residential development and redevelopment. Although the tax base is largely built out, economic activity continues as sustained demand has fueled development of remaining vacant land and redevelopment of existing property. These factors have accelerated tax base growth allowing the values to increase a solid 7.9% on an average annual basis over the past five years, including a substantial 12.4% in fiscal 2020 to \$31.2 billion. District officials project the positive momentum will continue but conservatively estimate a 5% increase in fiscal 2022, a 4% increase in fiscal 2023 and a 3% increase each year after for the next three years.

The economy provides access to several job opportunities in the immediate area, as well as other employment centers within the larger metropolitan area. In the City of Arlington alone there are several large anchor entities such as [General Motors Company](#) (Baa3 stable), which continues its over \$1 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; current enrollment is about 42,500.

Despite this, the median family income (MFI) remains lower than peers with a 2017 value that equals 88.8% of the nation. Although not uncommon for areas with institutional presence, the low MFI is offset in part by a low cost of living with the 2017 median home value at 73.7% of the nation. This factor has contributed to the district's attractiveness and affordability compared with area peers, supporting stable population trends. Population grew 4.1% in the last decade through 2010 per the US Census. Since then, population has grown 12% to about 382,000 per district officials. The county's November 2019 3.1% unemployment rate was slightly below the state's and nation's 3.3%.

Despite economic growth, the district has been challenged with declining student enrollment within the past decade. More recently, enrollment has declined at an annual average rate of 1.8% in the past five years, as the district has faced competition from charter schools. Nevertheless, district officials expect the numerous program and facility enhancements, some of which are ongoing while others have been implemented, will stabilize enrollment.

Financial operations and reserves: ample reserve supported by prudent management team

The district's ample financial position, an underlying strength of the credit profile, is likely to remain for the foreseeable future supported by a fiscally conservative management team and guided by codified policies and institutionalized practices. Despite a financial history that has used excess reserves for one time capital needs, the district's available general fund balance has remained above 36% of revenue in the past six years. In fiscal 2019 (June 30 year-end) the general fund reported a \$3.9 million draw after a \$10.4 million transfer to a local construction fund, resulting in an available fund balance of \$196.1 million, a strong 37.6% of revenue. Including the debt service fund, the available operating fund balance totaled \$228.9 million, also a solid 37.2% of revenue.

The fiscal 2020 budget was adopted with an almost \$7 million draw. However, consistent with previous years, district officials currently project a \$10.6 million surplus having realized salary savings from unfilled positions among other expenditure savings as well as higher than expected revenue. Similarly healthy reserve levels will be maintained in the future given no planned use of reserves.

The district compressed its maintenance and operations tax rate to \$9.70 per \$1000 of assessed values in fiscal 2020 to comply with House Bill 3 mandates. Ultimately, the loss in property tax revenue, the largest source of revenue at over 63% in fiscal 2019, was offset by additional state aid.

LIQUIDITY

General fund liquidity totaled \$215.3 million, 41.3% of revenue, in fiscal 2019 and increased to \$245.7 million, 39.9% of revenue, when including the operating fund.

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. In fiscal 2019, the cash balance in this fund was \$11.9 million, representing 1.9% of operating revenue.

Debt and pensions: elevated but manageable debt burden

The district's high debt burden will likely remain over the next three to five years because of planned debt issuance. Including the February sale, the district's direct debt burden is 3.3% (4.9% overall) of the fiscal 2020 valuation. The sale is the first installment from the \$966 million authorized by voters in 2019. Following the sale, the district will have \$654.9 million in authorized but unissued debt which will be sold in annual installments over the next five years.

Despite the elevated debt burden, the debt level remains manageable for the district supported by the large and stable tax base which will continue to provide a stable source of funding for repayment. The district also continues to enjoy wide public support reflective of high community engagement and the district's strategic and capital plans.

In fiscal 2020, the district levied a debt service levy of \$3.29 per \$1,000 of assessed values and district officials expect the tax rate will remain flat through the projected debt issuance in the next five years.

DEBT STRUCTURE

All of the district's debt is fixed rate. Principal amortization is below the national Aa1 median with 42.3% retired in 10 years, and final maturity in 2045. 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

The district participates in the Texas Teachers Retirement System (TRS) pension plan. The [State of Texas](#) (Aaa stable) annually makes most the employer pension contributions on behalf of districts statewide. Given this continued support, budgetary pressure associated with the plan will remain minimal despite a drop in the discount rate to 7.25% from 8% in 2018, which subsequently led to the passage of Senate Bill 12 in the 2019 legislative session requiring increased annual contributions to return to actuarial soundness.

For fiscal 2019, the district reported a GASB net pension liability of \$215.9 million, based on a 6.91% GASB blended discount rate. Comparatively, the Moody's adjusted net pension liability (ANPL) based on a 4.07% discount rate (FTSE pension liability index), was \$572.5 million or a modest 0.9 times annual operating revenue in fiscal 2019.

Despite a 6% decline in the system's reported liabilities in fiscal 2019, ANPLs for all Texas school districts will spike significantly for fiscal 2020 based on fiscal 2019 measurements. The increase is mainly attributable to the drop in the FTSE pension liability index, which reached an all-time low of 3.0% at August 31, 2019.

In fiscal 2019, the district made \$13.4 million in pension contributions, net of contributions from the state. This contribution was notably below the Moody's calculated "tread water" level of \$23.4 million, or a gap equal to 1.6% of operating revenue. The "tread water" indicator measures the annual government contribution required to prevent the reported net pension liability from growing, under reported actuarial assumptions. Given the timing lag between the discount rate change (fiscal 2018) and the implementation of contribution increases (fiscal 2020), a tread water gap will likely persist over the next few years. Despite this weakness, the gaps are expected to remain a manageable percentage of an individual district's operating revenue and narrow as contribution increases are implemented, for the state, employees and school districts through 2025. Like all US public pension systems, TRS's annual contribution weakness could be compounded by poor asset returns in any given year.

The district funds other post employment benefits (OPEB) on a pay-as-you-go basis and contributed \$3.5 million in fiscal 2019. Moody's adjusted net OPEB liability (ANOL) is \$231.5 million, or a manageable 38% of operating revenue.

Total fixed costs, including debt service, pension contributions and OPEB contributions totaled \$109 million or manageable 17.7% of fiscal 2019 operating revenue. Fixed costs would remain manageable at 19.3% of operating revenue if the district's pension contributions were equal to the tread water indicator.

Management and governance: experienced management team with extensive planning, 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. The district demonstrates good governance by multiyear capital and financial planning as well as using a strategic plan obtained by high community engagement, that serves as a road map for future initiatives. Debt and financial plans are detailed and go out for at least five years although longer term planning is part of the district's practice. Codified policies include a fund balance policy that mandates a minimum of two months of operating expenditures in reserves. The management team is stable and grounded in an experienced staff that have allowed practices such as periodic review of staffing needs to become institutionalized.

Texas School Districts have an Institutional Framework score of "Aa", which is strong. Property taxes, one of the sector's major revenue sources is subject to a levy cap set by state statute, which can be overridden with voter approval by a limited amount. Property tax revenue growth is capped at 2.5% annually, but 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 less than 25% of expenditures and are primarily debt service expenditures. Unpredictable expenditure fluctuations tend to be minor, under 5% 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 3

Arlington Independent School District, TX

Rating Factors	Measure	Score
Economy/Tax Base (30%) ^[1]		
Tax Base Size: Full Value (in 000s)	\$31,152,352	Aaa
Full Value Per Capita	\$87,979	Aa
Median Family Income (% of US Median)	88.8%	A
Notching Factors: ^[2]		
Institutional Presence		Up
Finances (30%)		
Fund Balance as a % of Revenues	37.2%	Aaa
5-Year Dollar Change in Fund Balance as % of Revenues	4.4%	A
Cash Balance as a % of Revenues	39.9%	Aaa
5-Year Dollar Change in Cash Balance as % of Revenues	8.9%	A
Management (20%)		
Institutional Framework	Aa	Aa
Operating History: 5-Year Average of Operating Revenues / Operating Expenditures (x)	1.0x	A
Debt and Pensions (20%)		
Net Direct Debt / Full Value (%)	3.3%	A
Net Direct Debt / Operating Revenues (x)	1.7x	A
3-Year Average of Moody's Adjusted Net Pension Liability / Full Value (%)	1.9%	Aa
3-Year Average of Moody's Adjusted Net Pension Liability / Operating Revenues (x)	1.0x	A
Notching Factors: ^[2]		
Unusually Strong or Weak Security Features: Secured by statute		Up
	Scorecard-Indicated Outcome	Aa1
	Assigned Rating	Aa1

[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: US Census Bureau, Moody's Investors Service

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