Austin Independent School District, TX

Update to credit analysis

Summary
Austin ISD’s TX (Aaa stable) credit profile benefits from the district’s participation in a vibrant local economy with strong institutional presence, which has led to favorable taxable value growth in recent years. The profile also benefits from very manageable debt and pension burdens in comparison to peers. Although declining student enrollment and rapid wealth recapture payments are considered a challenge to the profile, strong fiscal management has allowed the district to maintain stable operations and sound reserve levels.

Exhibit 1
Solid reserve levels maintained despite rapidly growth wealth recapture payment

Credit strengths
» Large, regionally important economy with significant institutional presence
» Healthy financial reserve position
» Manageable debt and pension burdens
» Above average income indices

Credit challenges
» Declining student enrollment
» Additional borrowing plans
» Growing wealth recapture payment pressuring operations
Rating outlook
The stable outlook is based on the strength of the tax base coupled with the sophisticated and forward-looking management team will lead to a continuation of healthy financial operations and reserve levels.

Factors that could lead to an upgrade
» Not applicable

Factors that could lead to a downgrade
» Poor financial performance leading to a weakening of reserve levels
» Trend of declining taxable values
» Significant increase in debt absent taxable value growth

Key indicators

<table>
<thead>
<tr>
<th>Exhibit 2</th>
<th>Austin Independent School District, TX</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>Economy/Tax Base</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Full Value ($000)</td>
<td>$67,349,174</td>
<td>$70,760,967</td>
<td>$81,020,803</td>
<td>$93,072,527</td>
<td>$103,221,368</td>
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</tr>
<tr>
<td>Population</td>
<td>675,107</td>
<td>691,483</td>
<td>701,348</td>
<td>701,348</td>
<td>701,348</td>
<td></td>
</tr>
<tr>
<td>Full Value Per Capita</td>
<td>$99,761</td>
<td>$102,332</td>
<td>$115,522</td>
<td>$132,705</td>
<td>$147,176</td>
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</tr>
<tr>
<td>Median Family Income (% of US Median)</td>
<td>105.0%</td>
<td>108.7%</td>
<td>108.7%</td>
<td>108.7%</td>
<td>108.7%</td>
<td></td>
</tr>
<tr>
<td>Finances</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Operating Revenue ($000)</td>
<td>$928,943</td>
<td>$1,014,759</td>
<td>$1,121,038</td>
<td>$1,303,349</td>
<td>$1,421,158</td>
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<tr>
<td>Fund Balance ($000)</td>
<td>$254,623</td>
<td>$257,567</td>
<td>$428,557</td>
<td>$444,287</td>
<td>$419,258</td>
<td></td>
</tr>
<tr>
<td>Cash Balance ($000)</td>
<td>$305,860</td>
<td>$329,958</td>
<td>$585,542</td>
<td>$540,269</td>
<td>$546,604</td>
<td></td>
</tr>
<tr>
<td>Fund Balance as a % of Revenues</td>
<td>27.4%</td>
<td>25.4%</td>
<td>38.2%</td>
<td>34.1%</td>
<td>29.5%</td>
<td></td>
</tr>
<tr>
<td>Cash Balance as a % of Revenues</td>
<td>32.9%</td>
<td>32.5%</td>
<td>52.2%</td>
<td>41.5%</td>
<td>38.5%</td>
<td></td>
</tr>
<tr>
<td>Debt/Pensions</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Net Direct Debt ($000)</td>
<td>$818,723</td>
<td>$814,616</td>
<td>$918,252</td>
<td>$1,048,526</td>
<td>$982,621</td>
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<tr>
<td>3-Year Average of Moody’s ANPL ($000)</td>
<td>$230,705</td>
<td>$312,845</td>
<td>$367,592</td>
<td>$419,730</td>
<td>$388,781</td>
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<tr>
<td>Net Direct Debt / Full Value (%)</td>
<td>1.2%</td>
<td>1.2%</td>
<td>1.1%</td>
<td>1.1%</td>
<td>1.0%</td>
<td></td>
</tr>
<tr>
<td>Net Direct Debt / Operating Revenues (x)</td>
<td>0.9x</td>
<td>0.8x</td>
<td>0.8x</td>
<td>0.8x</td>
<td>0.7x</td>
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</tr>
<tr>
<td>Moody’s - adjusted Net Pension Liability (3-yr average) to Full Value (%)</td>
<td>0.3%</td>
<td>0.4%</td>
<td>0.5%</td>
<td>0.5%</td>
<td>0.4%</td>
<td></td>
</tr>
<tr>
<td>Moody’s - adjusted Net Pension Liability (3-yr average) to Revenues (x)</td>
<td>0.2x</td>
<td>0.3x</td>
<td>0.3x</td>
<td>0.3x</td>
<td>0.3x</td>
<td></td>
</tr>
</tbody>
</table>

Operating Revenue, Fund Balance, and Cash Balance are the general & debt service funds combined
Source: Austin ISD, TX; Moody’s Investors Service, US Census

Profile
Austin Independent School District is a political subdivision located in central Texas (Aaa stable) wholly within Travis County (Aaa stable). The district provides K-12 educational services to the City of Austin (Aaa stable) area and enrolls roughly 80,100 students.

Detailed credit considerations
Economy and tax base: large, regionally important economy continues to grow
The district’s significantly large and vibrant economy is expected to continue to see notable growth in the near term future driven by strong demand for residential, commercial and retail developments. Growth has accelerated in the last five years with the fiscal 2019
full valuation of $115.1 billion reflecting a sizeable 11.5% growth over the previous year. The five-year compound annual growth in the district’s tax base was a strong 11.3% from 2014 to 2019, which is above average for similarly rated and sized districts throughout the US. Based on preliminary indications from the county appraisal district, the district anticipates that tax base growth for fiscal 2020 will continue on a similar trend, but the pace of growth will likely slow in coming years. New construction as well as reappraisals of existing property within the district remains strong and the surrounding area continues to attract businesses, tourists, and visitors. The top taxpayers and employers are not only diverse, but also benefit from strong institutional presence as the district is home to the state capital and the University of Texas System (Aaa stable), both of which account for a significant amount of the employment base in the area.

According to Moody’s Economy.com, the Austin-Round Rock, TX area is in a late expansion business cycle. The area’s economy will grow at a pace above the national average over the coming year. IT-related industries and housing will lead the way. Longer term, the especially well-educated labor force, the high concentration of technology businesses, the relatively low costs of doing business compared with other high-tech centers, and fast population growth will contribute to an above-average performance (Précis U.S. Metro/South/January 2019).

The district exhibits favorable residential income indicators measured by both per capita income and median family income (2016 American Community Survey) that represent 118.1% and 111.3% of the nation, respectively. The December 2018 unemployment rate for Travis County of 2.6% was below that of the state (3.6%) and the nation (3.7%) for the same time period. District enrollment has fallen modestly in the last few years which district officials report is an indication of significant increases in housing prices, which in turn makes affordability of the area for families with school age children a growing challenge. Current district enrollment is estimated at 80,100. Management plans to conservatively budget for a modest annual enrollment decline for the coming year.

Financial operations and reserves: sound financial operations despite growing wealth recapture payment

The district’s financial reserves are expected to remain healthy in the near-term, despite potential draws on general fund balance and growing wealth recapture payments because of prudent fiscal practices. After surplus operations in fiscal 2016 and 2017, the district exhibited a $171.1 million deficit in fiscal 2018 (June 30), which decreased the available general fund balance to $284.2 million or a healthy 22% of revenues. Inclusive of the debt service fund, the total operating balance equaled $419.3 million, or a solid 29.5% of total operating revenues. The deficit was mainly driven by the district’s growing wealth recapture payment back to the state.

In fiscal 2018 general fund revenues were predominantly derived from property taxes (92.8% of revenues). The district remains in Chapter 41 or property wealthy status with recapture payments made annually, and is the state’s largest remitter. The recapture amount has continued to increase significantly given the rapid assessed value growth and declining enrollment levels. When comparing the available operating fund balance with revenues net of the fiscal 2018 $540.3 million wealth recapture payment, it was a stronger 47.6%. Historically district management has established and adhered to strong fiscal management practices, including a formal fund balance reserve policy of maintaining 20% of annual expenditures in reserve. Management recently adjusted the formal fund balance policy calculation to net out the increasing recapture payment while maintaining the 20% target. The district currently levies $10.79 per $1,000 of assessed valuation for its maintenance and operations (M&O) tax levy. This is not anticipated to change in the near-term.

District officials adopted the fiscal 2019 budget with a planned used of reserves of roughly $21.3 million. Management does not anticipate to fully utilize the entire amount due to positive budgetary variance and conservative budgeting, but anticipates a deficit similar in size to fiscal 2018. If fully realized, the total general fund balance would decline to $262.9 million, or a still satisfactory 18.6% of budgeted revenues. Net of the district’s budgeted $669.6 million wealth recapture payment, reserves would still equate to a healthy 35.2% of operations. Despite the sizable deficits for fiscal 2018 and anticipated for 2019, the projected reserve levels are still consistent with the Aaa rating category.

Management plans to implement an expenditure reduction plan that calls for roughly $33 million in expenditure cuts in fiscal 2020 in order to balance financial operations and to ensure the maintenance of healthy reserves. If unable to return to structural balance, or a prolonged trend of deficit operations decreases the district’s operating flexibility, the credit profile could be challenged.
LIQUIDITY
Liquidity maintained in the district’s operating funds was $546.6 million as of fiscal year-end 2018 (a strong 38.5% of revenues). Net of the recapture payment, total operating liquidity was a very strong 62.1% of operations. If the budgeted draw for fiscal 2019 is realized, liquidity levels will likely decrease in tandem and remain similar to total General Fund balance levels.

Debt and pensions: very manageable debt and pension burdens
Despite additional borrowing plans, the district’s debt burden is expected to remain manageable given the ongoing assessed value growth. Following the Series 2019 issuance, the district will have $1.2 billion in outstanding general obligation debt, which equates to a manageable 1% of the fiscal 2019 assessed value. The overlapping debt burden is higher at 2.7% and heavily influenced by the City’s of Austin.

The district has roughly $877 million of general obligation bond authorization remaining, mainly attributable to the successful $1.05 billion bond election in November of 2017. Although the size of the bond package was significant, officials are targeting no tax rate increase from the current $1.13 per $1,000 of assessed value for the debt service fund levy due to the favorable assessed value growth. Management plans to exhaust the authorization over the next few years.

The district’s debt management plan includes the use of commercial paper to short-term finance capital expenditures throughout the year. Long-term, fixed rate debt is typically issued annually to redeem the commercial paper notes as is with the current issuance. The program is rated P-1. For additional information on the district’s program, see report published on June 28, 2018.

DEBT STRUCTURE
All of the district’s debt is fixed rate. Principal amortization is below-average at 53.1% retired in ten years, and final maturity in 2039. Debt service payments are structured to slightly decline over time.

DEBT-RELATED DERIVATIVES
The district is not party to any interest rate derivative agreements.

PENSIONS AND OPEB
The district participates in the Texas Teachers Retirement System (TRS) pension plan, where the State of Texas makes the majority of the employer pension contributions on behalf of districts annually. Given this support, budgetary pressure associated with the plan is expected to remain minimal in the near term despite a recent reduction of the plan’s assumed rate of investment return to 7.25% from 8.00%. Discount rate reductions typically signal future contribution increases, which can lead to potential budgetary pressure (see “Lower investment return assumption for Texas’ teacher pensions is positive, but signals likely cost hikes” for more information).

Moody’s adjusted net pension liability (ANPL) for the district, under our methodology for adjusting reported pension data, is $389 million. This liability is equal to a manageable 0.44 times annual operating revenues in fiscal 2018, including the general and debt service funds (net of the chapter 41 recapture payment). The three-year average of the district’s ANPL to operating revenues is 0.44 times and 0.38% of the district’s full valuation. The district’s adjusted net other post employment benefit (OPEB) liability was $267.3 million, or a modest 0.3 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 contribution information, or the reported liability information of the state-wide cost-sharing plans, but to improve comparability with other rated entities.

Total fixed costs including debt service, pension contributions, and OPEB were a modest 13.8% of fiscal 2017 operating revenues (net of recapture). The fixed cost burden would increase slightly to 14.1% of revenues if the district were to make its “tread water” payment, which highlights the district’s underfunding of pension contributions of 0.3% of operating revenues ($2.8 million) in fiscal 2017. The “tread water” indicator measures the annual government contributions required to prevent reported net pension liabilities from growing, under reported assumptions.

Management and governance: nine member board
The district’s board consists of nine 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. District management is fiscally conservative as demonstrated by the district’s favorable operating history and ample reserves.

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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