S&P Global Ratings

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Summary:

Pecos Barstow Toyah Independent School District, Texas; School State Program

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Table Of Contents

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Credit Profile		
US$25.0 mil unltd tax sch bldg bnds ser 2017 dtd 01/15/2017 due 02/15/2037		
Long Term Rating	AAA/Stable	New
Underlying Rating for Credit Program	A+/Stable	New
Pecos Barstow Toyah Indpt Sch Dist PSF		
Long Term Rating	AAA/Stable	Affirmed
Underlying Rating for Credit Program	A+/Stable	Affirmed

Rationale

S&P Global Ratings assigned its 'AAA' program rating and 'A+' underlying rating for credit program to Pecos Barstow Toyah Independent School District, Texas' series 2017 unlimited-tax general obligation (GO) school building bonds. The outlook is stable. S&P Global Ratings also affirmed its 'A+' underlying rating, with a stable outlook, on the district's existing GO debt.

The program rating reflects the district's qualification for, and the guarantee provided by, the Texas Permanent School Fund bond guarantee program. The program provides the security of a permanent fund of assets the district could use to meet debt service on bonds guaranteed by the program. (For more information on the Texas Permanent School Fund, please see the article, published July 7, 2015, on RatingsDirect.)

An unlimited-ad valorem-property-tax pledge secures the series 2017 bonds. Officials intend to use series 2017 bond proceeds to fund various capital improvements, the purchase of new school buses and new security equipment, among other items.

The underlying rating reflects our opinion of the district's:

- Very strong finances, characterized by very strong available reserves; and
- Extremely strong, albeit fluctuating, market value per capita, primarily supported by oil-and-gas values.

We believe somewhat offsetting the above strengths are, what we consider, the district's:

- Moderately concentrated property tax base, coupled with a relatively shallow economy centered primarily on oil-and-gas production; and
- Low incomes per capita when compared with the national average.

Economy

Pecos Barstow Toyah Independent School District serves an estimated population of 12,980. In our opinion, median household effective buying income (EBI) is adequate at 86% of the national level, but per capita EBI is low at 60%. At

$236,695 per capita, the 2017 market value totaling $3.1 billion is, in our opinion, extremely strong. Net taxable assessed value declined by a total of 18.9% overall from 2015 to $3.1 billion in 2017, but in 2017 it increased by 3.8%. The 10 largest taxpayers make up an estimated 32.5% of net taxable assessed value, which we consider moderately concentrated.

The district encompasses 2,376 square miles within the towns of Pecos and Toyah in Reeves County and the city of Barstow in Ward County, approximately 75 miles southwest of Odessa. The district's economy primarily centers on agriculture and mineral production. We believe a moderately concentrated tax base, with exposure to oil-and-gas-related industries, somewhat constrains the rating currently. Following an increase of over 60% from 2014 to 2015, the total taxable assessed value of the district decline by roughly 22% the following year in 2016. The 10 leading taxpayers are all oil-and-gas-related entities, accounting for a combined 32% of taxable assessed value (AV). Before the 22% decline in taxable assessed value in 2016, these top 10 entities represented over 50% taxable AV. While management is not concerned with leading taxpayers, it attributes the decrease in fiscal 2016 AV to reduced oil-and-gas values. Without much local expansion and diversification occurring within the districts tax base currently, we believe future declines in oil-and-gas prices could result in further AV decreases. For 2017, however, the recent fluctuations appear to have leveled off with the tax base growing by a modest 4% and totaling just over $3 billion. In addition, oil and gas prices have somewhat stabilized toward the end of calendar year 2016.

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. In 2017, enrollment came in at 2,484 students. Enrollment increased in each year from 2013 to 2017.

Enrollment has increased slightly for the past five schools years, from roughly 2,200 students to nearly 2,500. In fiscal 2016, student enrollment increased by 1.6% to 2,473. Management is projecting roughly 3% annual enrollment growth over the next few fiscal years.

Because of the high market value of local industrial sites, the state characterizes the district as a Chapter 41, or property-wealthy, district under its funding formula. This means that the district receives only basic state aid for operations and that the district derives all debt service fund revenue locally. In addition, the district must remit a portion of local property tax revenue to the state for redistribution. The district contributed $20.5 million, or about 44% of general fund expenditures, of wealth-transfer payments to other districts in fiscal 2016, up from $11.7 million, or 28% in 2015. Moving forward, we believe these recapture payments should level off or decline following a decline in the taxable AV from its high in 2015.

The district's available fund balance of $11.0 million is very strong in our view, at 24% of general fund expenditures at fiscal year-end (Aug. 31) 2016. The district reported a deficit operating result of 4.0% of expenditures in 2016.

For fiscal 2016, the draw down in the general fund reflects the use of reserves for capital-related items ahead of this bond issuance, including the construction of teacher housing, a salary increase of 2%, some additional hiring of teachers, and an increase in recapture payment. For fiscal 2017, the budget includes the use of over $2 million of fund balance but officials indicate that this figure could be smaller come year end due to positive budget variances throughout the year. Management indicates that available fund balance will not fall below $9 million, or roughly 20% of 2017 expenditures. Beginning in fiscal 2018, officials will reassess the student to teacher ratio for cost savings and capture potential cost saving opportunities related to attrition. With no additional plans to spend down reserves beyond 2017 and with the implementation of cost-cutting measures, reserve levels should begin to increase in fiscal 2018. As of fiscal 2016, available reserves have fallen below the district's informal target of 25% of expenditures.

The district currently levies a direct property tax rate of $1.1110 per $100 of AV: $1.06 for operations and maintenance and 5.1 cents for debt service. Voters in the district approved a $0.02 increase in the maintenance and operations tax rate pursuant to a tax ratification election held on Nov. 8, 2016.

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.

Key practices include management's use of some historical trends when developing revenue and expenditure assumptions. Management presents financial results on year-to-date performance to the school board monthly. The board can amend the budget on an ad hoc basis. The district also has a formally adopted investment policy with quarterly reports to the board on investment holdings and earnings. The district's informal reserve policy calls for maintaining 25% of operations, a level that the district has fallen below as of fiscal 2016. The district lacks long-term financial, formal capital planning, and debt management policies.

Debt

At 2.6% of market value, we consider overall net debt as low, but at $6,059 on a per capita basis, we view it as high. Amortization is slower than average, with 46% of the district's direct debt scheduled to be retired within 10 years. Debt service carrying charges were 4.2% of total governmental fund expenditures excluding capital outlay in fiscal 2016, which we consider low.

Currently, the district does not have any authorized, but unissued, debt remaining. We understand the district could approach the electorate for an additional $5 million-$10 million authorization within the next two years for facility maintenance and improvements.

Pension and other postemployment benefit liabilities

The district paid its full required contribution of $390,000 toward its pension obligations in fiscal 2016, or 0.8% of total governmental expenditures. Also the district paid $85,000, or 0.2% of total governmental expenditures, toward its other postemployment benefit (OPEB) obligations in fiscal 2016. Combined pension and OPEB carrying charges totaled 1.0% of total governmental fund expenditures in 2016.

The district participates in the Texas Teachers' Retirement System (TRS), a state-managed, cost-sharing, defined-benefit pension plan. All risks and costs associated with the program are the liability of the state. The district, however, contributes on the portion of employee salaries exceeding the statutory minimum. In addition, the district contributes to the Texas Public School Retired Employees' Group Insurance program, a cost-sharing, defined-benefit, postemployment health care plan administered by the TRS. The Texas Legislature sets contribution requirements each biennium.

Outlook

The stable outlook on the program rating reflects S&P Global Rating's assessment of the Texas Permanent School Fund guarantee's strength.

The stable outlook on the underlying rating reflects our opinion that the district will likely maintain very strong reserves, supported by conservative fiscal management practices, and that declining state recapture payments will likely offset decreasing taxable value. Given this, we do not expect to change the rating over the two-year outlook period.

Upside scenario

We could raise the underlying rating, assuming all other rating factors remain stable or improve, if the district were to experience economic expansion resulting in less oil and gas industry concentration and significantly improved income.

Downside scenario

We could lower the underlying rating if total taxable value were to significantly decrease from current levels, resulting in significantly elevated debt versus market value, or if finances were to weaken materially, resulting in available general fund reserves falling below a level we consider very strong or no longer commensurate with the current rating.

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.