Summary:

Arlington Independent School District, Texas; School State Program

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Credit Profile		
US$310.125 mil unltd tax sch bldg and rfdg bnds ser 2020 dtd 02/15/2020 due 02/15/2045		
Long Term Rating	AAA/Stable	New
Underlying Rating for Credit Program	AA/Stable	New
Arlington Indpt Sch Dist PSF/CRS		
Long Term Rating	AAA/Stable	Affirmed
Underlying Rating for Credit Program	AA/Stable	Affirmed
Arlington Indpt Sch Dist PSF/CRS		
Long Term Rating	AAA/Stable	Affirmed
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Rationale

S&P Global Ratings assigned its 'AAA' long-term program rating and 'AA' underlying rating to Arlington Independent School District (Arlington ISD), Texas' series 2020 unlimited tax school building and refunding bonds. At the same time, S&P Global Ratings affirmed its 'AAA' long-term rating and 'AA' underlying rating on the district's existing general obligation (GO) debt. The outlook is stable.

The 'AAA' long-term rating reflects our view of the district's eligibility for the Texas Permanent School Fund (PSF) bond guarantee program. The program provides the security of a permanent fund of assets that the district can use to meet debt service on bonds guaranteed by the program. (For more information on the program rating, see our report, published June 7, 2019, on RatingsDirect.)

Credit overview

The underlying rating reflects our view of the district's broad economic base that is supported by its integral role in the deep and diverse Dallas-Arlington-Fort Worth metropolitan statistical area (MSA). Continued revenue growth and conservative budgeting practices, guided by what we consider good financial management practices have reinforced the district's overall strong financial profile evidenced by its positive budget-to-actual variances and the preservation of its very strong reserves. Despite declining enrollment trends over the past five years, the district has controlled expenditures by implementing sound budgeting practices, conservative assumptions, and various enrollment safeguarding measures. While the district has a large capital footprint, its tax base is strong enough to support its debt burden without compromising overall credit quality. Beyond the near term, we assess the district's credit stability will be contingent on its maintenance of its very strong reserves to sustain operations in the event the state is unable to shore up its share of school funding.

In our opinion, the district's general credit strengths include its:

- Direct access to, and status as a key component of, the deep and diverse Dallas-Arlington-Fort Worth MSA, providing sound economic growth;
- Sustained very strong available general fund balance, averaging 37.6% of expenditures over the past three fiscal years; and
- Good financial management practices and policies, which should enable the district to sustain its very strong financial position, despite recent declining enrollment trends.

Partially offsetting these strengths, in our view, are the district's lack of a formalized debt policy, which we assess would establish quantitative thresholds to monitor leverage, good-but-below-average income levels when compared with those of similarly rated peers, and declining enrollment, which could affect revenue received from the state, but is projected to stabilize in the near-term.

Security and purpose

An unlimited ad valorem property tax secures the series 2020 bonds and the district's bonds outstanding. Officials will use the new money portion of the bonds to fund various capital projects, renovate and replace existing facilities, security and technology upgrades, and vehicle and equipment purchases. The refunding portion of the bonds will be used to retire callable maturities from the district's series 2011 bonds for debt service savings, ultimately achieving a net present value savings of 9.37%.

Participation in a broad and diverse MSA with a sizable tax base

In the heart of the Dallas-Fort Worth MSA, Arlington ISD serves an estimated population of 326,891 and covers the cities of Arlington, Dalworthington Gardens, the portion of Grand Prairie in Tarrant County, and the town of Pantego. Management notes that locally derived projections indicate that the district served an estimated population of about 389,950 in 2019. Arlington's strategic position along several major transportations corridors, provides local residents and commuters direct access to employment opportunities within its boundaries and in the greater Dallas-Fort Worth MSA. The local economy is growing and vibrant due to substantial economic growth and an expanding employer base that is anchored by key industries such as health care, retail and trade, and manufacturing. The city also serves as a regional tourism and entertainment draw due to Global Life Park, AT&T Stadium, Six Flags Hurricane Harbor, and Texas Live!

We view the underlying economy as stronger than what our metrics represent, because of the city's diverse economic base coupled with ongoing developments that stimulate the economy, despite lower-than-average wealth and income levels compared with similarly rated peers. These underlying economic metrics are somewhat suppressed due to a number of tax-exempt properties and the University of Texas at Arlington's (UTA) student population, which we estimate at 10% of the city's population. While each tax-exempt institution on its own might not significantly affect the city's economy, in our view, when taken as a whole, these institutions generate significant economic activity for the surrounding areas, resulting in a more-vibrant economy than our initial economic indicators suggest.

After contracting in fiscal 2010 due to the national economic downturn, the district's property tax base has demonstrated healthy growth. Arlington ISD's strong tax base growth is attributed to robust commercial and residential development that district officials anticipate will continue due to an assortment of projects in varying stages of development. As a result of ongoing development, the district's tax base growth has averaged 9.5% over the past five years. In aggregate, the tax base increased approximately $11.8 billion, or 55.8% since tax year 2014. Assessed value (AV) totaled $31.1 billion in 2020, which we consider very strong at $95,299 per capita. Approximately 6.7% of net taxable AV comes from the 10-largest taxpayers, representing a very diverse tax base, in our opinion. At 96% and 90% of national averages, respectively, the district's median household and per capita effective buying incomes are good, in our view.

There are several economic projects that have been announced, or that are in various stages of development within the district's boundaries, which are expected to further strengthen and diversify the local economy. Some of the notable developments include an $810 million transformative development project that will be anchored by Loews Hotel and a new convention center. This mixed-use development will be built in the Arlington's entertainment district and is expected to create 3,000 jobs and an approximate economic impact of $1.8 billion. General Motors (GM) is investing an additional $20 million into one of its assembly plants to upgrade plant conveyors that is expected to be completed next year. Since 2015, GM has invested more than $1.4 billion in its assembly plant. We assess that the city's advantageous location, coupled with the various developments that have been completed or are in the pipeline, will support long-term economic strength and stability.

Very strong financial position, aided by growing revenue sources, and cost-control measures despite declining enrollment

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 corresponding increases or decreases in the amount of state revenue a district receives. Enrollment totaled 59,900 students in 2019. Since 2014, the district has experienced year-over-year declines in enrollment resulting in a cumulative decline of 7.4%. Student enrollment is projected to be 59,423 for 2019-2020, which is 846 students (or 1.4%) less than the projected enrollment of 60,269 used for last year's original budget. Officials attribute much of the decline to decreasing birth rates and natural demographic shifts, as family sizes within the district's boundaries are relatively smaller than historical figures. The growing presence of charter schools has also exacerbated the recent declining enrollment. Due to Arlington's built-out status, there are minimal residential developments in the pipeline that would attract additional families, leaving the district susceptible to demographic changes such as birth and fertility rates. However, management is executing measures to mitigate potential enrollment pressures. Some examples are identifying schools for closure, updating the district's student-transfer policy, adding special programs to its curriculum, and using its current staff to address fluctuations in classroom sizes. In addition, while enrollment has declined, student demographics have changed. The district has seen a substantial increase in students who are considered economically disadvantaged, resulting in additional state funding. Working with a demographer, the district conservatively estimates that enrollment will continue to decrease for the next four years before stabilizing.

For fiscal 2020, the district is budgeting to operate 77 schools, which are composed of 49 elementary schools, 10 junior high schools, eight high schools, three alternative centers, two fine arts and dual language academies, one elementary STEM academy, one elementary leadership academy, one elementary world language academy, one prekindergarten campus, and various administrative office buildings.

On May 27, 2019, Texas lawmakers passed a number of key bills that will have a notable effect on public kindergarten through 12th-grade funding statewide. Specifically, House Bill 3 (HB 3) provides additional school funding while lowering school district property tax rates. Meanwhile, Senate Bill 12 provides for increased contributions to the Texas Teachers' Retirement System (TRS) to shore up pension plan funding. In our opinion, the recent legislative enactments, will likely have an overall positive effect on local and charter school district credit quality statewide in the near term.

The district has historically maintained an overall very strong financial profile, resulting from a combination of conservative budgeting and strong revenue growth that have resulted in a track record of operating surpluses, subsequently swelling available reserves over the years. Management monitors the budget regularly throughout the year, and final results are frequently better than budgeted. As is common within the scope of its conservative financial practices, the 2019 budget was adopted with the use of $38.7 million in fund balance. However, when comparing final budget-to-actual results, outperformance by both revenues and expenditures of a combined $29 million contributed towards a strong operating surplus of 1.2% of expenditures or $6.3 million before transfers. After transfers, the net change in the district's available fund balance decreased about $3.8 million, resulting in an available fund balance of $196.1 million or 38% of general fund expenditures, which we consider very strong. The drawdown in available fund balance was due to a planned $10.2 million transfer out of the general fund to the capital projects fund to cash fund renovations and architectural designs to various facilities. The district's general fund relies primarily on local and intermediate sources (57%) and state-aid (40%) for revenue. It has approximately $11.9 million in its restricted natural gas fund that is not included in our available fund balance calculations. The fund is board restricted, but it can be made legally available with board approval. While the natural gas fund is not included in the district's overall available fund balance, we recognize that it provides additional budgetary flexibility.

The district's adopted budget for fiscal 2020 calls for a $6.9 million operating deficit, which is less than the amount appropriated in recent years. Management expects to continue its conservative budgeting strategy and use updated budgetary assumptions to produce positive variances and end the year with an operating surplus of $10.6 million or 1.9% of expenditures, which we consider strong. With the passage of HB 3, management expects the district to receive additional state aid revenue that will have a positive impact on the district's budget in the near term (for more information on state funding change, see our report "Texas Funds Public Schools, Staving Off Expenditure Growth For Now," published June 13, 2019). The district's adopted tax rate is $1.2987 per $100 of AV: 97 cents for maintenance and operations (M&O), and 32.87 cents for debt service. The 7-cent compression in the M&O rate in fiscal 2020 from the previous fiscal year is a result of HB 3 provisions; however, the interest and sinking (I&S) rate remains unchanged. In our view, the district's operations will remain at least balanced as ongoing economic expansion drives operating revenue, coupled with the district's conservative budgeting practices.

Professional management with a good Financial Management Assessment

We consider the district's management practices good under our Financial Management Assessment (FMA) methodology, indicating financial practices exist in most areas, but that governance officials might not formalize or monitor all of them on a regular basis.

Management analyzes three-to-five years of historical data regarding enrollment trends, state school funding, and AV trends. In addition to internal projections, it also works with external sources, such as a demographer. Management provides the school board with monthly budget-to-actual reports, and the board can amend the budget as needed. The district has developed a long-term financial plan that identifies both revenues and expenditures under meaningful assumptions, including AV and enrollment trends as well as personnel costs. The district's comprehensive capital planning overlaps its bond program, and details projects and phases for completion. The board is provided quarterly updates on the progress of the district's bond program. In addition, the Citizens Bond Oversight Committee monitors the overall progress of the district's bond program and reports findings and recommendations to the board relating to the expenditure of bond proceeds, progress of the bond program, and ways the district can maximize the outcome of the program. The district has a formal investment management policy and provides quarterly reports to the board. It also has a formal reserve policy, which requires a minimum fund balance level of two months of operations. While the district lacks a formal debt management policy, as part of its bond program, the board established criteria for the useful life of projects that are funded with bond proceeds and has historically funded them with fixed-rate GO debt.

Large capital footprint, but an affordable debt profile

Inclusive of the district's medium-term debt plans, overall net debt is moderately high, in our opinion, at 6.3% of AV and high on a per capita basis, at $6,052. Amortization is slower than average, with 41.0% of the district's direct debt scheduled to be retired within 10 years. Debt service carrying charges were 11.9% of total governmental fund expenditures excluding capital outlay in fiscal 2019, which we consider moderate. The series 2020 bonds represent the first tranche of $966 million authorized by the district electorate in November 2019. Officials intend to issue the remaining $665 million in authorized debt annually through 2024. Based on current projections, the district will be able to support the full authorization at the existing I&S tax rate of 32.87 cents. Due to ongoing capital needs, we expect the district's debt profile to remain elevated as officials continue to issue debt to address growth needs. However, we assess projected tax-base growth should allow the district to issue new debt while it maintains a stable tax rate.

We note that the district has two series of debt that have been privately placed with principal outstanding of $88.8 million (8.3% of total direct debt). However, the obligations do not contain any provisions, such as acceleration or nonstandard events of default that we view as a potential liquidity risk.

Pension and other postemployment benefits liabilities that will be an increasing challenge

- We do not view pension and other postemployment benefits (OPEB) liabilities as an immediate source of credit pressure for Arlington ISD, as required contributions account for a small portion of total governmental expenditures and are not expected to materially increase over the next few years.
- Under a special funding situation, the state contributes a sizable share of the employer contribution and carries responsibility for its proportionate share of the unfunded liability.

Arlington ISD participated in the following plans as of Aug. 31, 2018:

- Teacher Retirement System (TRS), 73.7% funded with a proportional share of the net pension liability equal to $215.9 million.
- Texas Public School Retired Employees Group Insurance Program (TRS-Care), which provides health insurance coverage to members of the TRS pension plan. TRS-Care is 1.6% funded and the district has a proportionate share of the net OPEB liability of $248 million.

In fiscal 2019, the district paid its full required contribution of $13.4 million, or 1.6% of total governmental expenditures, toward its pension obligations. The district also contributed $3.5 million, or 0.4% of total governmental expenditures, toward its OPEB obligations in fiscal 2019. Combined pension and OPEB carrying charges totaled 2.1% of total governmental fund expenditures in 2019.

The district provides pension benefits for full-time employees through the statewide multiple-employer defined benefit plan (TRS). It also provides OPEBs in the form of retiree health care through TRS-Care. We also note that TRS recently lowered the discount rate to 7.25% from 8.00% and updated its mortality tables. These updated assumptions resulted in a decrease in the funded ratio, to 73.7% in fiscal 2018 from 82.2% in fiscal 2017.

While the state makes the bulk of contributions to TRS and TRS-Care for the district, we believe the revised assumptions to TRS and escalating health care cost trends will likely result in increased costs to the district over the next several years. However, given the special funding situation, we assess that the district's postemployment benefit costs and OPEB liabilities will remain manageable.

Outlook

The stable outlook on the 'AAA' rating reflects our view of the strength of the Texas PSF guarantee, based on the fund's assets and performance. The outlook on the underlying rating reflects our view that that the district's experienced management team will maintain its very strong financial position despite the recent decline in enrollment. The outlook further reflects our expectation that sustained economic growth and tax base expansion will continue to benefit the district, enabling Arlington ISD to continue to implement its approved bond program, with limited impact to our view of the district's debt profile. We do not expect to change the rating within our two-year outlook horizon.

Upside scenario

All else equal, we could raise the rating if continued economic expansion and diversification results in improved wealth and income indicators, compared with those of higher-rated peers coupled with strengthened and adopted financial management policies according to our FMA methodology.

Downside scenario

Conversely, we could lower rating if the district is unable to make the necessary structural adjustments to maintain its very strong financial profile, leading to a financial position that we no longer consider comparable with those of similarly rated peers.

Related Research

- Alternative Financing: Disclosure Is Critical To Credit Analysis In Public Finance, Feb. 18, 2014
- Criteria Guidance: Assessing U.S. Public Finance Pension And Other Postemployment Obligations For GO Debt, Local Government GO Ratings, And State Ratings, Oct. 7, 2019