FitchRatings

RATING ACTION COMMENTARY

Fitch Rates Lubbock-Cooper ISD, TX $48.33MM ULT School Building Bonds 'AAA' PSF/'AA' Underlying; Outlook Stable

Thu 06 Aug, 2020 - 4:04 PM ET

Fitch Ratings - Austin - 06 Aug 2020: Fitch Ratings has assigned a 'AAA' rating based on the Texas Permanent School Fund (PSF) guaranty and a 'AA' underlying rating to the following Lubbock-Cooper Independent School District, TX's bonds:

--$48.33 million unlimited tax (ULT) school building bonds series 2020;

In addition, Fitch affirms the following ratings:

--District Issuer Default Rating (IDR) at 'AA';

--Approximately $290 million outstanding ULTs at 'AA'.

The Rating Outlook is Stable.

The bonds are scheduled for competitive sale on August 13th. Proceeds from the sale will be used for construction and renovation of school facilities and to pay the costs of issuance.

SECURITY

The bonds are payable from an unlimited property tax levied against all taxable property within the district and are further backed by the PSF bond guarantee program, rated 'AAA' by Fitch. A change in Fitch's assessment of the Texas Permanent School Fund bond guarantee program would automatically result in a change in the rating of Lubbock-Cooper ISD's ULT school building bonds, series 2020. For more information on the Texas PSF see "Fitch Affirms Texas PSF Rating at 'AAA'; Outlook Stable," dated Nov. 25, 2019.

ANALYTICAL CONCLUSION

The 'AA' IDR and ULT rating reflect the district's strong operating performance while successfully managing rapid enrollment growth. Facility capacity needs may cause long-term liabilities to rise in the near term, although Fitch believes they will remain a moderate burden on resources. Strong residential growth is likely to continue through the medium term, driving revenue growth through enrollment gains.

ECONOMIC RESOURCE BASE

The district has an estimated population of over 40,000 and serves the southern portion of the city of Lubbock (GO bonds rated AA+/Stable by Fitch) and the unincorporated community of Woodrow. The district is experiencing fast population growth, leading to rapid enrollment gains. The 10-year compound average growth rate (CAGR) for enrollment is about 6.5% through 2020, while in that same time period, taxable assessed value (TAV) has grown at a CAGR of about 10%.

KEY RATING DRIVERS

Revenue Framework: 'a'

Post-pandemic revenue growth prospects remain strong due to healthy enrollment and tax base trends, though near-term economic risks could result in temporary revenue weakness. The district does not have the independent legal ability to raise maintenance and operation revenues as its ad valorem tax rate is at the statutory maximum.

Expenditure Framework: 'aa'

Fitch expects spending growth to remain in line with revenue growth, reflecting operating costs for new schools and additional teachers and staff. State support for retiree benefits helps keep the fixed-cost burden moderate, and expenditure flexibility is solid.

Long-Term Liability Burden: 'aa'

Fitch estimates long-term liabilities to be a moderate burden on resources, partly due to above-average income metrics. Additional debt plans to address growth-related capital needs may increase the burden on resources somewhat, but Fitch expects levels to remain in the moderate range due to continued growth in the resource base.

Operating Performance: 'aaa'

Fitch expects high reserve levels relative to low expected revenue volatility and midrange budget flexibility will enable the district to maintain a sustained healthy financial position through the current downturn as well as future economic cycles. Conservative budgeting practices have helped management navigate the recent rapid growth.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--While not expected, a sustained decline in the long-term liability burden at or below 10% of personal income.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--A sustained downward change in the district's enrollment trends leading to weaker revenue growth.

--An economic contraction extending well into the second half of 2020 or beyond, consistent with Fitch's coronavirus downside scenario, which triggers sustained and deeper than expected K-12 state education funding and local property tax revenue losses that lead to notably weaker financial resilience once recovery from the coronavirus pandemic takes hold.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit [https://www.fitchratings.com/site/re/10111579].

CURRENT DEVELOPMENTS

The ongoing outbreak of coronavirus and related government containment measures worldwide creates an uncertain global environment for U.S. state and local governments and related entities in the near term. While the district's most recently available fiscal and economic data may not fully reflect impairment, material changes in revenues and expenditures are occurring across the country and likely to worsen in the coming weeks and months as economic activity suffers and public health spending increases. Fitch's ratings are forward-looking in nature, and Fitch will monitor developments in state and local governments as a result of the virus outbreak as it relates to severity and duration, and incorporate revised expectations for future performance and assessment of key risks.

In its baseline scenario, Fitch assumes sharp economic contractions to hit major economies in 1H20 at a speed and depth that is unprecedented since World War II. Sequential recovery is projected to begin from 3Q20 onward as the health crisis subsides after a short but severe global recession. GDP is projected to remain below its 4Q19 level until mid-2022. Additional details, including key assumptions and implications of the baseline scenario and a downside scenario, are described in the report entitled, "Fitch Ratings Coronavirus Scenarios: Baseline and Downside Cases - Update" (https://www.fitchratings.com/site/re/10120570), published April 29, 2020 on www.fitchratings.com.

The coronavirus pandemic is materially affecting state revenues and is expected to continue applying downward pressure in the coming months. While state officials have directed certain state agencies to reduce spending by 5% for the remainder of the 2020-2021 biennium, no reduction in K-12 funding was included in that directive. Changes to K-12 funding for the upcoming 2021-2022 biennium likely will be considered in the next legislative session, which convenes in January 2021.

From March through the last day of the spring semester, the district was designated as "Closed, Instructing" with the Texas Education Agency, indicating that normal operations had ceased and children no longer came to campuses but were instead provided support to receive instruction at home/off-site. This designation allowed the district to continue receiving state aid based on average daily attendance. TEA used the average daily attendance (ADA) of the first four six-week grading periods in the 2019-2020 academic year (or fiscal 2020) to estimate ADA during the last two six-week grading periods, accounting for historical difference in attendance rate.

CREDIT PROFILE

The district benefits from its location near Lubbock, where healthcare, education and government are the area's largest non-agricultural employment sectors. The largest employers include Texas Tech University (TTU), Covenant Health System and TTU Health Sciences Center. TAV has grown at a CAGR of nearly 10% over the past 10 years, including roughly 9% in fiscal 2020. Fitch expects solid TAV growth over the next several years given current trends in housing and commercial development. Near-term economic performance due to the pandemic may slow the rate of home sales and depress prices, but management reports growth has yet to slow. Additionally, management expects enrollment will continue to increase at a yearly rate of about 300 students (roughly 4.5% of 2019-2020 enrollment) over the medium term.

REVENUE FRAMEWORK

Funding for public schools in Texas is provided by a combination of local (property tax), state and federal resources. The state budgets the majority of instructional activity through the Foundation School Program (FSP), which uses a statutory formula to allocate school aid taking into account each district's property taxes, projected enrollment and amounts appropriated by the Legislature in the biennial budget process. The Tier 1 component of the FSP provides districts a certain level of operational funding, and the basis for most Tier 1 allotments is called the basic allotment. The basic allotment is a per-pupil dollar amount that, multiplied by average daily attendance, and adjusted for specific circumstances, produces a district's Tier 1 allotment.

The primary revenue source for the district is its property tax, accounting for roughly 66% of fiscal 2019 general fund revenues while state support accounted for about 32%.

The compound annual growth rate (CAGR) of district revenues for the 10-year period ended in fiscal 2019 was robust at 7.6 %, well in excess of the U.S. GDP over the same period. Fitch anticipates strong enrollment and tax base growth will continue to drive revenue growth in excess of national economic performance.

Pre-pandemic, the state increased TEA funding for the state's fiscal 2020-2021 biennium by $11.6 billion (roughly 20%) to $67 billion. House Bill 3--the funding legislation--includes a number of reforms to K-12 education. These changes include an early childhood allotment which may be used for full day pre-K for eligible children, increased funding for low-income student education, incentives for districts to offer dual language programs, and money for districts to develop merit pay programs for teachers.

The increased state funding is driven primarily by an increase in the per student basic allotment to $6,160 from $5,140. HB3 requires districts to apply 30% of annual increased funding to full-time employee compensation increases (75% of which would go to teachers, counselors, nurses and librarians). Finally, the legislation revised the equalization formula so that recapture payments by property-wealthy districts are projected to decline by $1.6 billion in fiscal 2020 and $1.9 billion in fiscal 2021.

HB3 also requires the compression of the vast majority of districts' local operating tax rates from $1.00 to $0.93, which will be implemented in FY 2020. If they have not done so previously, districts will also have the ability to increase the operating rate by $0.04 without voter approval, and can add an additional $0.01 with unanimous board approval. HB 3 also requires districts to limit annual operating tax revenue increases to 2.5% (by requiring a further compression in the M&O rate if TAV increases by more than 2.5%) beginning in fiscal 2021. Additional enrichment pennies (up to an additional $0.12) can be added to the operating tax rate in fiscal 2021 if previously approved by voters; any additional enrichment pennies not previously authorized will require voter approval before being levied.

With the passage of HB 3, the district adopted an M&O tax rate for fiscal 2020 of $0.97, compressed from $1.04 the prior year. Changes in the tax rate setting process associated with HB 3 will not affect Fitch's current assessment of Texas districts' legal ability to increase revenues, which is uniformly at the 'bb' level given the limitations to any increase in M&O rates without voter approval. The district levies a separate, unlimited debt service tax rate that stands at $0.50 per $100, which is not subject to compression under HB 3. The timing and size of future new money borrowings will be contingent upon tax base growth, as the state attorney general will not approve new debt that requires a debt service tax rate in excess of $0.50.

EXPENDITURE FRAMEWORK

The district's main general fund expenditure item is instruction (63% of fiscal 2019 spending), which is typical for school districts. Adopted budgets generally include salary increases and additional staff to address growth, as well as some use of operating revenues for one-time spending.

District spending has generally kept pace with revenue growth to accommodate student body growth. This trend is likely to continue barring any changes in district policy.

The district's fixed-cost burden is moderate, with carrying costs for debt, pensions and other post-employment benefits (OPEB) equaling roughly 15% of fiscal 2019 governmental expenditures. Fitch expects the fixed-cost burden to climb slightly as the district continues to issue the remaining 2016 bond authorization to address capital needs, assuming adequate debt service tax rate capacity. However, given the likelihood of similar growth in the district's budget and current strong state support for retiree benefits, carrying costs should remain moderate. Areas of spending flexibility are primarily in instruction, including class sizes and staffing patterns.

The district participates in the Texas Teacher's Retirement System (TRS), a cost-sharing multiple employer system. Actual contributions are fixed in statute, while the actuarially determined contribution (ADC) measures contributions needed to eliminate the unfunded liability in 30 years. Statutory rates have often been below the ADC, with the resulting funding period slipping beyond the 31-year statutory maximum. Contributions (and the NPL) are shared by school districts and the state. In 2018, TRS lowered its discount rate to 7.25%, from 8%, and in 2019 the legislature raised state, employer and employee contribution rates over five years to bring the funding period within the legal maximum threshold. Like all Texas school districts, the district is vulnerable to future state policy changes that shift more of the contributions and liabilities onto districts, as well as to TRS' ability to achieve its funding assumptions over time.

LONG-TERM LIABILITY BURDEN

Fitch estimates the long-term liability burden at roughly 16% of personal income. Fitch's assessment incorporates a population estimate greater than that indicated by the U.S. Census Bureau, as the rapid enrollment growth that the district has experienced suggests a number higher than the 2018 Census estimate. As such, Fitch's assessment considers the population figure reported by the Municipal Advisory Council (MAC) of Texas, which is nearly twice the figure reported by the Census. Using the 2018 Census data the district's long-term liability burden rises materially above the 20% threshold.

The district will have roughly $20 million in authorized but unissued debt after this issuance and plans to return to voters sometime in the medium term. Growth in the resource base is expected to keep the burden in the moderate category, despite the very slow amortization (23% in 10 years).

Under GASB 67 and 68 reporting, TRS assets covered 74% of liabilities as of fiscal 2019, a ratio that falls to a Fitch-estimated 66% using Fitch's standard 6% return assumption. The state assumes the majority of TRS employer contributions and net pension liability on behalf of school districts, except for small amounts that state statute requires districts to assume. The district's pension contributions are determined by state statute rather than actuarially and they have historically fallen short of the actuarial level. Recent state reforms have lowered benefits and increased statutory contributions to improve plan sustainability over time.

The TRS board at its July 2018 meeting voted to lower the discount rate for the TRS pension plan to 7.25% from 8%. This move increases the plan's current $35.5 billion net pension liability (NPL) by $10 billion. As noted above, contributions by the state, districts and employees will be increasing over the next six years to help address the increased NPL without increasing the amortization period. This change in the discount rate and overall increase in the NPL does not affect Fitch's analysis of the long-term liability burden, as Fitch currently utilizes a lower 6% return assumption when considering the burden.

OPERATING PERFORMANCE

The Fitch Analytical Stress Test (FAST) scenario analysis tool, which relates historical tax revenue volatility to GDP to support the assessment of operating performance under Fitch's criteria, has now been adjusted to reflect GDP parameters consistent with Fitch's global coronavirus forecast assumptions. FAST is not a forecast, but it represents Fitch's estimate of possible revenue behavior in a downturn, based on historical revenue performance.

The district's unaddressed FAST results under both the coronavirus baseline and downside scenarios indicate pressure on the district's financial resilience in the medium-term, absent policy interventions. The 'aaa' operating performance assessment reflects Fitch's expectation that based on the district's capability and willingness to make spending cuts and its commitment to maintain a solid reserve cushion, the district will maintain the highest level of financial resilience through the current economic contraction. This assessment is also based on the district's low expected relative revenue volatility. The district has strengthened reserve levels over the past several years by achieving moderate yearly surpluses; unrestricted fund balance at fiscal 2019 year-end equaled about 23% of spending.

The district has demonstrated a strong commitment to supporting financial flexibility. Fiscal 2020 year-end projections indicate a surplus of at least $3.5 million (about 28% of fiscal 2019 reserves), outperforming the budgeted surplus of $1.5 million. Management's generally conservative budget assumptions have allowed the district to respond to recent operational adjustments and address ongoing growth needs, while maintaining superior financial flexibility. Another modest surplus is expected for fiscal 2021 due to continued strong enrollment growth and the state's commitment to essentially hold harmless K-12 education funding for the second year of the current biennium.

Texas MAC

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

The highest level of ESG credit relevance, if present, is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity(ies), either due to their nature or to the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY/DEBT	RATING		
Lubbock-Cooper Independent School District (TX)	LT IDR	AA Rating Outlook Stable	Affirmed
• Lubbock-Cooper Independent School District (TX) /General Obligation - Unlimited Tax/1 LT	LT	AA Rating Outlook Stable	Affirmed

VIEW ADDITIONAL RATING DETAILS

FITCH RATINGS ANALYSTS

Brittany Pulley
Associate Director
Primary Rating Analyst
+1 512 215 3734
Fitch Ratings, Inc. 111 Congress Avenue Suite 2010 Austin 78701

Emmanuelle Lawrence
Director
Secondary Rating Analyst
+1 512 215 3740

Steve Murray
Senior Director
Committee Chairperson
+1 512 215 3729

MEDIA CONTACTS

Sandro Scenga
New York
+1 212 908 0278
sandro.scenga@thefitchgroup.com

Additional information is available on www.fitchratings.com

APPLICABLE CRITERIA

U.S. Public Finance Tax-Supported Rating Criteria (pub. 27 Mar 2020) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

FAST States & Locals - Fitch Analytical Stress Test Model, v2.4.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Lubbock-Cooper Independent School District (TX)	EU Endorsed

DISCLAIMER

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK:

COPYRIGHT

in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed.

The information in this report is provided "as is" without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US$1,000 to US$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US$10,000 to US$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.

For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001

Fitch Ratings, Inc. is registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (the "NRSRO"). While certain of the NRSRO's credit rating subsidiaries are listed on Item 3 of Form NRSRO and as such are authorized to issue credit ratings on behalf of the NRSRO (see https://www.fitchratings.com/site/regulatory), other credit rating subsidiaries are not listed on Form NRSRO (the "non-NRSROs") and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.

READ LESS

SOLICITATION STATUS

The ratings above were solicited and assigned or maintained at the request of the rated entity/issuer or a related third party. Any exceptions follow below.

ENDORSEMENT POLICY

Fitch's approach to ratings endorsement so that ratings produced outside the EU may be used by regulated entities within the EU for regulatory purposes, pursuant to the terms of the EU Regulation with respect to credit rating agencies, can be found on the EU Regulatory Disclosures page. The endorsement status of all International ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for all structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.

US Public Finance Infrastructure and Project Finance North America United States