S&P Global Ratings

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**Summary:**

# Midland Independent School District, Texas; School State Program

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## Summary:

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| Credit Profile | | |
|---|---|---|
| US$39.342 mil unltd tax rfdg bnds (taxable) ser 2020 dtd 07/01/2020 due 02/15/2040 | | |
| *Long Term Rating* | AAA/Stable | New |
| *Underlying Rating for Credit Program* | AA/Stable | New |
| Midland Indpt Sch Dist unltd tax rfdg bnds ser 2015 | | |
| *Long Term Rating* | AAA/Stable | Affirmed |
| *Underlying Rating for Credit Program* | AA/Stable | Affirmed |
| Midland Indpt Sch Dist PSF | | |
| *Long Term Rating* | AAA/Stable | Affirmed |
| *Underlying Rating for Credit Program* | AA/Stable | Affirmed |

## Rating Action

S&P Global Ratings assigned its 'AAA' long-term rating and 'AA' underlying rating to Midland Independent School District (ISD), Texas' $39.3 million taxable series 2020 unlimited-tax refunding bonds. At the same time, S&P Global Ratings affirmed its 'AA' underlying rating on the district's existing unlimited-tax general obligation (GO) debt. The outlook is stable.

The bonds are secured by an unlimited ad valorem tax on all taxable property within the district. Bond proceeds will be used to refund certain maturities of debt outstanding for a net present-value savings.

The 'AAA' program 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 could use to meet debt service on bonds guaranteed by the program. (For more information on the program rating, please see our analysis on the Texas PSF, published June 7, 2019, on RatingsDirect.)

### Credit overview

Despite a shift to distance learning as a result of the spread of COVID-19, as well as weakness in oil prices, the district's fiscal operations remain stable. The rating is supported by solid market value growth over the last five years and the district's ability to maintain its fund balance at a level we consider very strong; however, if state funding or market value, and subsequent local revenues, were to change as a result of COVID-19 and the current recession, the ISD's ability to maintain structural balance could be pressured in the long term. Social distancing, restrictions on movement, and businesses stopping or modifying operations as a result of the COVID-19 pandemic will dampen the local economy. S&P Global Economics recognizes consumer spending and business investment in the U.S. have been particularly affected by restrictions on movement and stay-at-home orders (see "U.S. Faces A Longer And Slower Climb From The Bottom," published June 25, 2020, on RatingsDirect). While we continue to monitor events related to

COVID-19, we do not expect them to affect the district's ability to pay debt service or maintain its financial position through our outlook horizon.

The 'AA' underlying rating reflects our view of the district's:

- Solid economic expansion over the last five years;
- Generally stable enrollment base;
- Very strong fiscal reserves; and
- Standard financial management policies under our Financial Management Assessment (FMA) methodology.

Partly offsetting the above strengths, in our view, is anticipated weakness in the local economy as a result of the spread of COVID-19 and weakness in oil prices.

The stable outlook on the program rating reflects our assessment of the Texas PSF's strength and liquidity.

The stable outlook on the underlying rating reflects our assumption that, despite the COVID-19-driven recession, the district will maintain its very strong financial position while the tax base remains stable.

### Environmental, social, and governance factors

Our rating and analysis incorporate our view of the health and safety risk posed by the COVID-19 pandemic, which we believe could pressure budgets in the short term, particularly if the state's funding of school districts is significantly modified. Overall, we consider the district's social risks in line with those of the sector. We also analyzed the district's environmental and governance risks relative to its credit factors, and we determined that both are in line with our view of the sector standard. We do note the district's linkage and the local economy's reliance on oil and gas mineral values, and will continue to incorporate these into our ratings.

## Stable Outlook

### Downside scenario

We could lower the rating if the district's economic metrics deteriorate significantly, or if financial performance or flexibility weakens to levels no longer comparable with those of peers.

### Upside scenario

Although we are unlikely to do so within the next two years, we could raise the underlying rating if tax base growth were to continue to grow and diversify substantially, moderating debt ratios to levels we consider commensurate with those of higher-rated peers, with all else remaining stable.

## Credit Opinion

### Economy

The district is located in the city of Midland, which serves as headquarters for several petroleum companies that have extensive mineral exploration, drilling, production, and processing activities throughout the Permian Basin. Midland

ISD serves an estimated population of 159,523. The median household effective buying income in the district is 138% of the national average and the per capita effective buying income in the district is 135% of the national average, both of which we consider very strong. At $219,914 per capita, the fiscal 2020 market value totaling $35.0 billion is extremely strong and represents a 42% over the previous year. The top 10 taxpayers make up an estimated 24% of net taxable assessed value (AV), which we consider concentrated, considering the vast majority of the top 10 are tied to oil and gas exploration, extraction, or transportation operations.

Despite the onset and spread of COVID-19, as well as recent decline in oil prices, district officials note the area continues to act as a hub for economic activity for the region. Both residential and commercial development have contributed to stable market value growth in recent years, yet the extraordinary growth in oil and gas and mineral values has been the main driver behind recent significant increases. Officials note no significant taxpayers shutting down operations and a positive rebound to oil prices from historic lows should support stable employment in the area over the near term. Prolonged difficult conditions could significantly stress such businesses and dampen the local economy. For additional information, see "'The worst is behind us': Analysts see continued recovery for global oil markets," published June 25, 2020 (https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/the-worst-is-behind-us-analysts-see-conti

## Finances

Solid gains in market value and subsequent increases in ad valorem tax collections have led to stable financial performance and maintenance of ample available reserves. The district's available fund balance of nearly $100 million is very strong, in our view, at 38.3% of general fund expenditures at fiscal year-end (June 30) 2019. The ISD reported a surplus operating result for the year of $20.7 million, following a $16.7 million transfer out of the general fund in support of other funds. For fiscal 2019, the district's general fund revenues were predominantly derived from local property taxes (89%), followed by state program revenues (9%).

Despite a challenging operating environment, finances remain very strong as a result of conservative budgeting, and the district reports no loss of revenue in 2020. Officials note modest cost savings from operating in a nontraditional distance learning environment shifted elsewhere; for example, to support meals being served and ensuring certain areas in the district had internet capabilities. For fiscal 2020, the district expects an approximately $40 million operating surplus, based on current trends. The budget included a lower maintenance and operating tax rate, as required by House Bill 3, yet solid market value gains allowed for the district to grow reserves commensurate with budget growth.

For fiscal 2021, the district does not anticipate drawing down its reserve position. While state funding for fiscal 2021 is not expected to change, some uncertainty remains regarding state funding of districts in the future and potential changes as a result of the global pandemic and weakness in the oil and gas sector. We expect the district will maintain its very strong financial profile, despite the recession and uncertain funding picture over the medium term, which are incorporated into the rating and outlook.

For the 2019-2020 school year, district enrollment was slightly over 26,000. Enrollment has remained relatively stable, despite some modest fluctuations. Officials will closely monitor district enrollment and we expect appropriate shifts in staff to student ratios going forward.

### Management

We consider the district's management practices standard under our FMA methodology, indicating the finance department maintains adequate policies in some, but not all, key areas.

Management prepares its budgets based on historical analysis of revenues and expenditures, as well as latest economic information, including data from outside sources. Management reviews historical enrollment figures, AV trends and current state funding formula, per the most recent legislative actions, to make informed decisions. Management remains in close contact with the appraisal district regarding future market value volatility. Officials can amend the budget as needed and provide monthly budget-to-actual reports to the board. The district has a formal investment policy that mirrors the state statute, and it provides monthly updates to the board on holdings and earnings. Management lacks formal policies in some areas, including long-term financial and capital planning, and debt management policies, although near-term facility maintenance planning is used, and new financial software should assist the district in preparing long-term financial forecasts. The district also intends on actively managing its debt profile and retiring debt early when available. While the district does not have a formal reserve policy, officials informally target a 35% general fund reserve levels as a percent of expenditures to account for more volatile revenues and notes a more formalized target is being considered.

### Debt

Overall net debt is low, at 1.5% of market value, and moderate, at $3,321 per capita. With 48% of direct debt scheduled to be retired within 10 years, amortization is slower than average. The debt service carrying charge was 5.5% of total governmental fund expenditures, excluding capital outlay, in fiscal 2019, which we consider low. The district has no authorized but unissued debt and has no near-term debt plans, but is contemplating future authorizations.

### Pension and other postemployment benefits liabilities

We do not view pension and other postemployment benefits (OPEB) liabilities as an immediate source of credit pressure for the district, 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.

Midland ISD participated in the following plans, as of June 30, 2019:

- Teacher Retirement System (TRS), 74% funded with a proportional share of the net pension liability equal to $74.4 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 2% funded and the district has a proportionate share of the net OPEB liability of $89.9 million.

Given that contributions are made on a statutory basis that is typically lower than the actuarially determined contribution, last year's TRS contributions were materially lower than both static funding and minimum funding progress. However, legislative changes increasing contribution rates will likely improve both funding metrics, though some assumptions remain a credit concern. For more information, see "Pension Spotlight: Texas," published Feb. 25, 2020.