

Texas School Credit Landscape

Gera McGuire – Senior Vice President

April 2021

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Agenda

1. Credit Themes and Hot Topics
2. Ratings & Rating Process Overview
3. New US K-12 Public School Districts Methodology
4. National Medians
5. Questions

1

Credit Themes and Hot Topics for Texas School Districts

Credit Quality Remains Strong Despite Pandemic

- » Texas school district credit quality remains generally stable despite the pandemic
- » Fiscal 2021 hold harmless
- » Local government outlook revised to stable in March



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OUTLOOK
11 March 2021

✓ Rate this Research

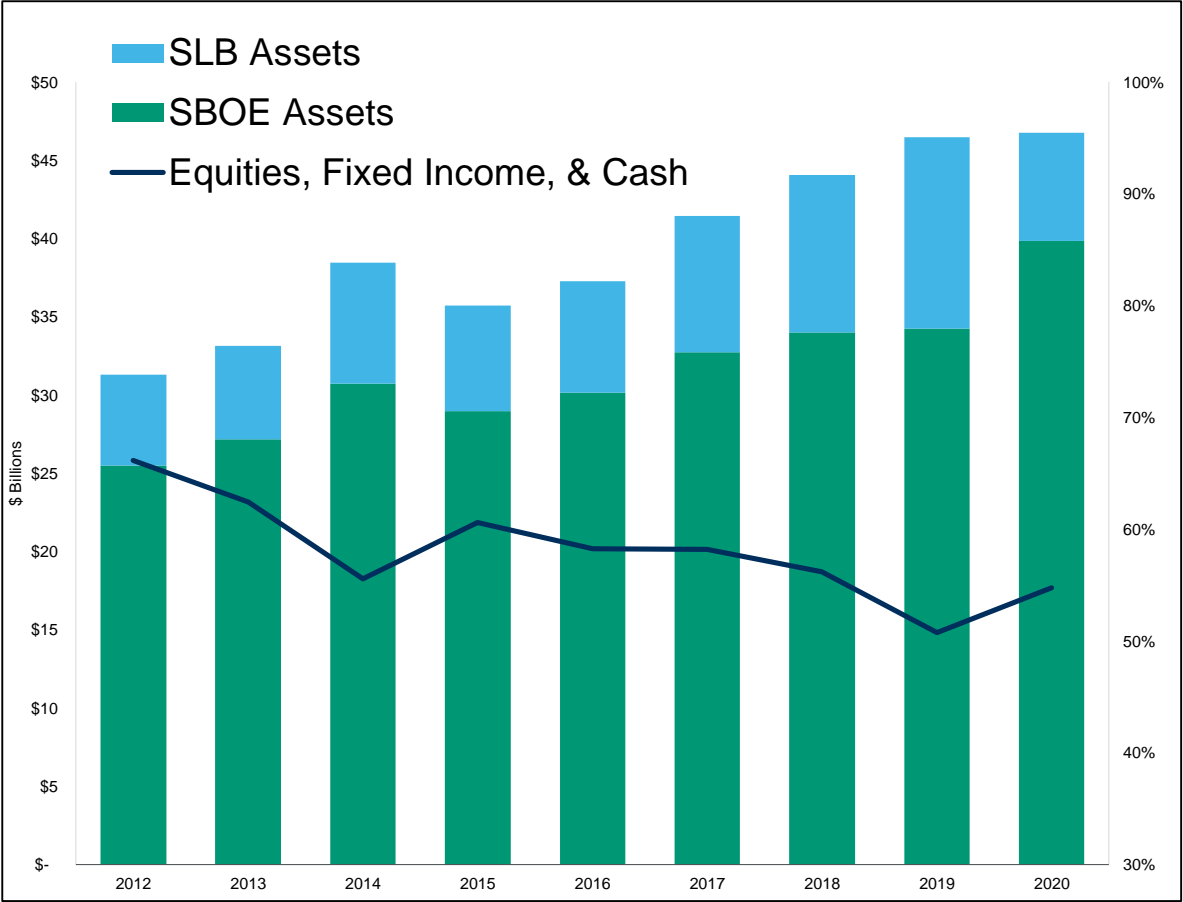
Local Government – US
Outlook changed to stable as revenue conditions improve, federal aid continues

General Credit Themes of Texas School Districts

- » Large and growing tax bases through fiscal 2021
 - Commercial values in fiscal 2022
- » Strong population and enrollment trends
- » Healthy reserve levels reflect conservative management teams
- » Elevated debt levels to accommodate rapid enrollment growth
 - Growing pension burdens, but they remain modest because of state on-behalf payments

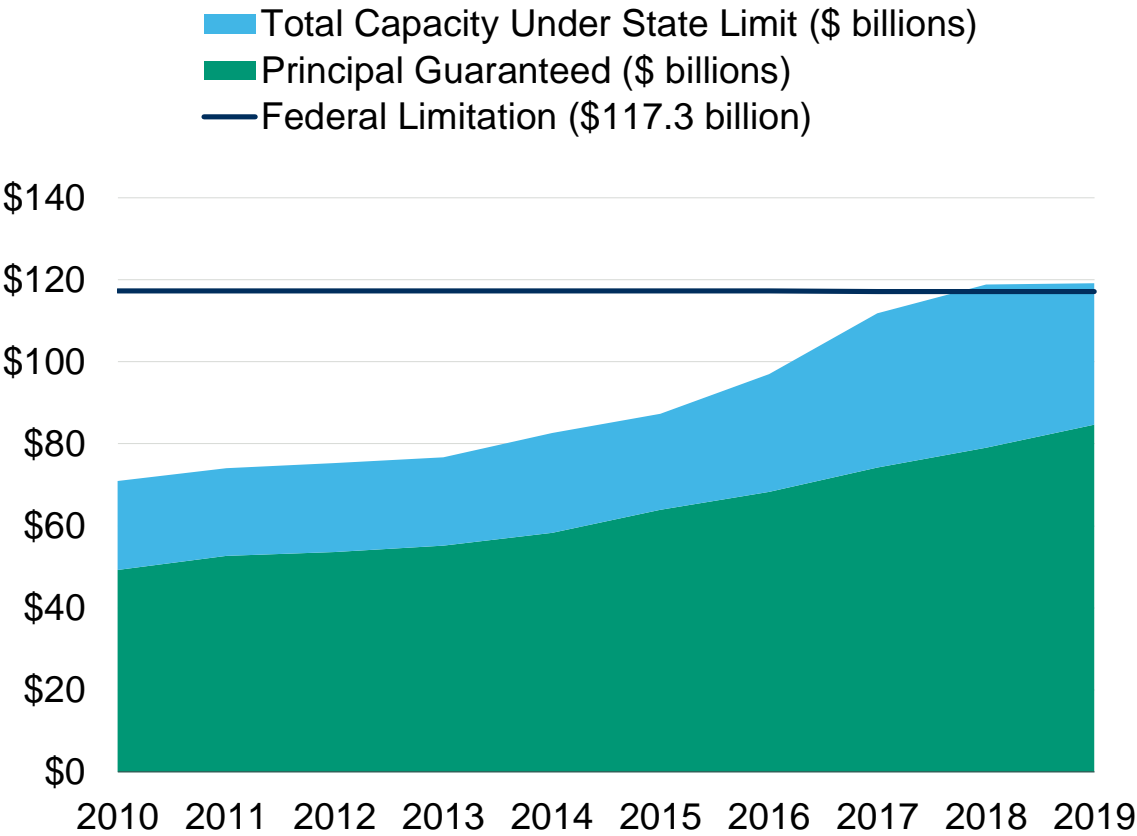
Texas PSF remains a very strong bond guarantee program

Fund continues to grow



Sources: Texas Education Agency; Texas Permanent School Fund annual financial audits

Ample capacity remains under federal limit



Sources: Texas Education Agency; Texas Permanent School Fund annual financial audits

Cyber risk: ransomware attacks are increasing

Targeted ransomware with data theft



2

Ratings and Rating Process Overview

Moody's Ratings

What They Are:

- » Independent, impartial assessments of the relative creditworthiness of debt obligations
- » Shorthand symbols denoting Moody's view of the relative ability and willingness of debt issuers to make full and timely payment
- » Opinions about the future

What They Are Not:

- » Ratings are not recommendations to purchase, sell, or hold particular securities
- » Ratings are not predictors of non-credit-related market price movements
- » Ratings are not audits, and do not guarantee the authenticity of information from issuers
- » Ratings are not public policy report cards
- » Ratings are not fixed; they may change over time
- » Rating analysts are neither financial advisors nor investment bankers

INVESTMENT GRADE	Aaa
	Aa1
	Aa2
	Aa3
	A1
	A2
	A3
	Baa1
	Baa2
	Baa3
SPECULATIVE GRADE	Ba1
	Ba2
	Ba3
	B1
	B2
	B3
	Caa1
	Caa2
	Caa3
	Ca
	C

Understanding the Rating Process



- » Assignment of an analyst
- » Selection of one or more rating methodologies
- » Gathering of information and analysis of the issuer or obligation to be rated
- » Discussions with the issuer (in-person/conference call)
- » Rating committee review
- » Publication of the rating and report
 - Issuer review for factual accuracy and inadvertent disclosure of confidential information
- » **Ratings are reviewed at least annually**

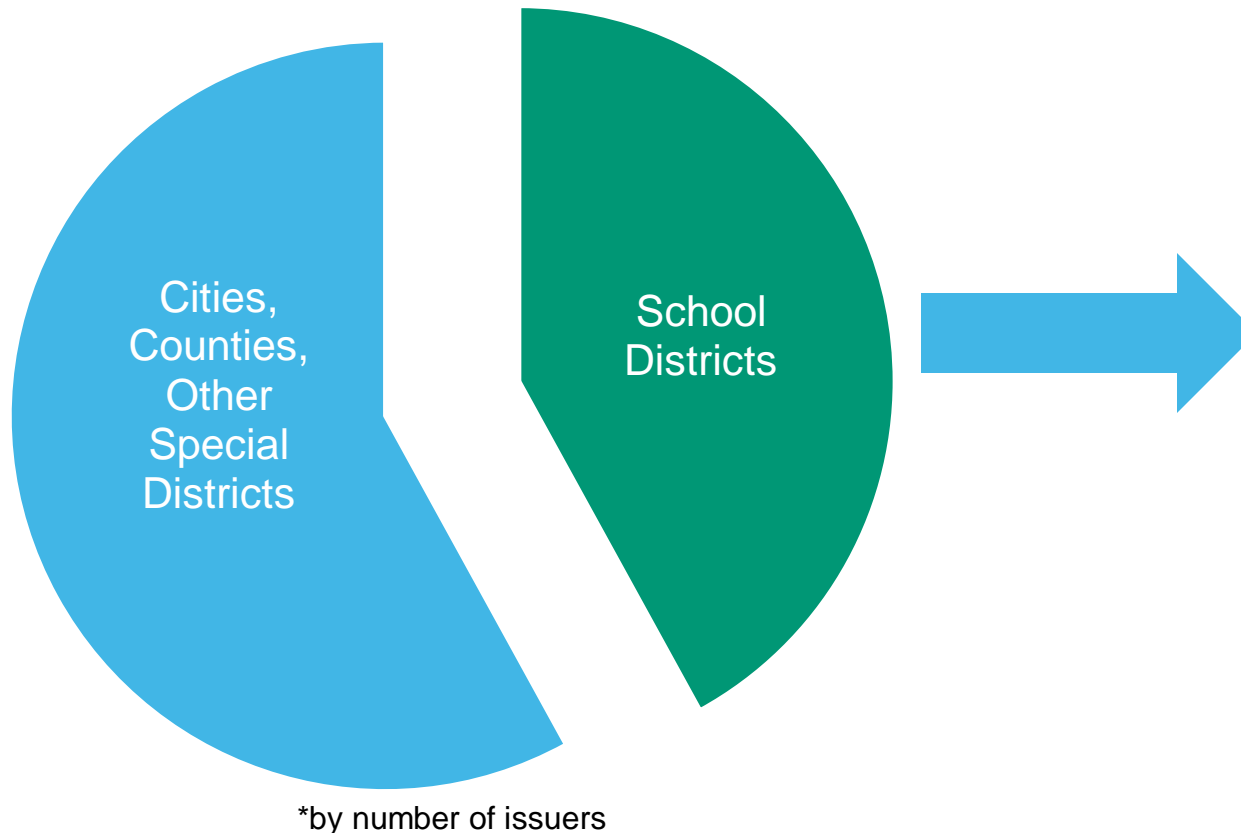
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US K-12 Public
School Districts
Methodology

Recognizing unique characteristics of schools

Fundamental operations are primary driver of credit

Local government issuers* rated under current General Obligation, Lease & K12 methodologies



RATING METHODOLOGY

Table of Contents:

INTRODUCTION	1
SCOPE OF THIS METHODOLOGY	2
SECTOR OVERVIEW	2
SCORECARD FRAMEWORK	3
DISCUSSION OF THE SCORECARD FACTORS	4
FACTOR: LEVERAGE (30% WEIGHT)	10
NOTCHING FACTORS	13
OTHER CONSIDERATIONS	17
ASSIGNING ISSUER-LEVEL AND INSTRUMENT-LEVEL RATINGS	21
KEY RATING ASSUMPTIONS	21
LIMITATIONS	21
APPENDICES	23
MOODY'S RELATED PUBLICATIONS	45

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US K-12 Public School Districts Methodology

Introduction

In this rating methodology, we explain our general approach to assessing credit risk for US public school districts that provide education or educational services, typically from pre-kindergarten or kindergarten through 12th grade (K-12), including the qualitative and quantitative factors that are likely to affect rating outcomes in this sector.

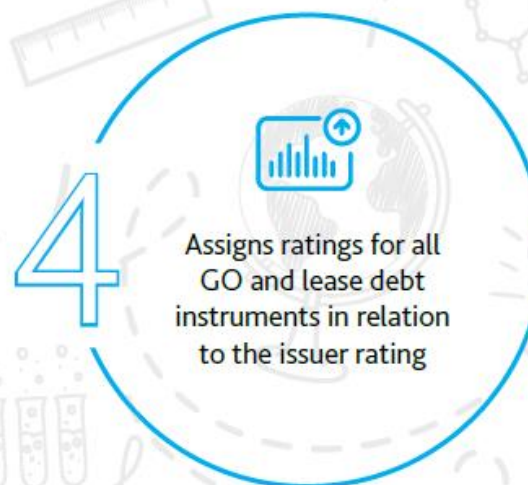
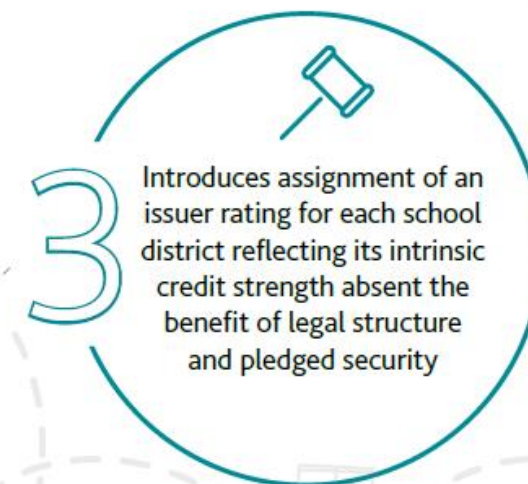
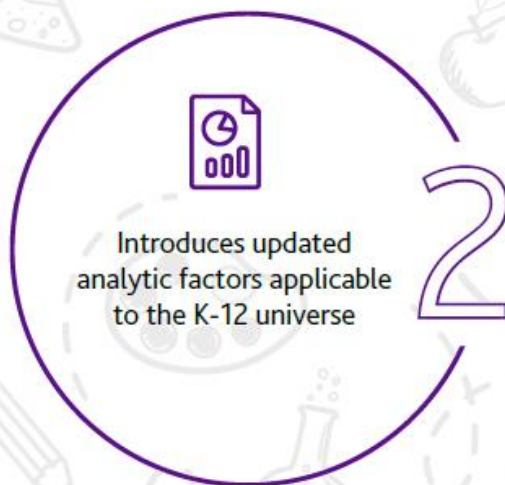
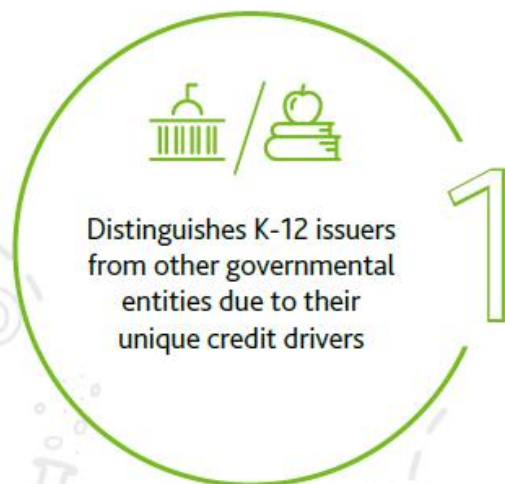
We discuss the scorecard used for this sector. The scorecard¹ is a relatively simple reference tool that can be used in most cases to approximate credit profiles in this sector and to explain, in summary form, many of the factors that are generally most important in assigning issuer-level ratings to issuers in this sector. The scorecard factors may be evaluated using historical or forward-looking data or both.

We also discuss other considerations, which are factors that are assessed outside the scorecard, usually because the factor's credit importance varies widely among the issuers in the sector or because the factor may be important only under certain circumstances or for a subset of issuers. In addition, some of the methodological considerations described in one or more cross-sector rating methodologies may be relevant to ratings in this sector.² Furthermore, since ratings are forward-looking, we often incorporate directional views of risks and mitigants in a qualitative way.

As a result, the scorecard-indicated outcome is not expected to match the actual rating for each issuer.

Our presentation of this rating methodology proceeds with (i) the scope of this methodology; (ii) a sector overview; (iii) the scorecard framework; (iv) a discussion of the scorecard factors; (v) other considerations not reflected in the scorecard; (vi) the assignment of issuer-level and instrument-level ratings; (vii) methodology assumptions; and (viii) limitations. In Appendix A, we describe how we use the scorecard to arrive at a scorecard-indicated outcome. Appendix B shows the full view of the scorecard factors, sub-factors, weights and thresholds. Appendix C describes our approach for assigning instrument ratings for K-12 school districts.

Overview of the methodology



Issuer and debt instrument ratings



Issuer Rating

Fundamental credit quality

+



Instrument Considerations

Evaluation of debt instrument characteristics

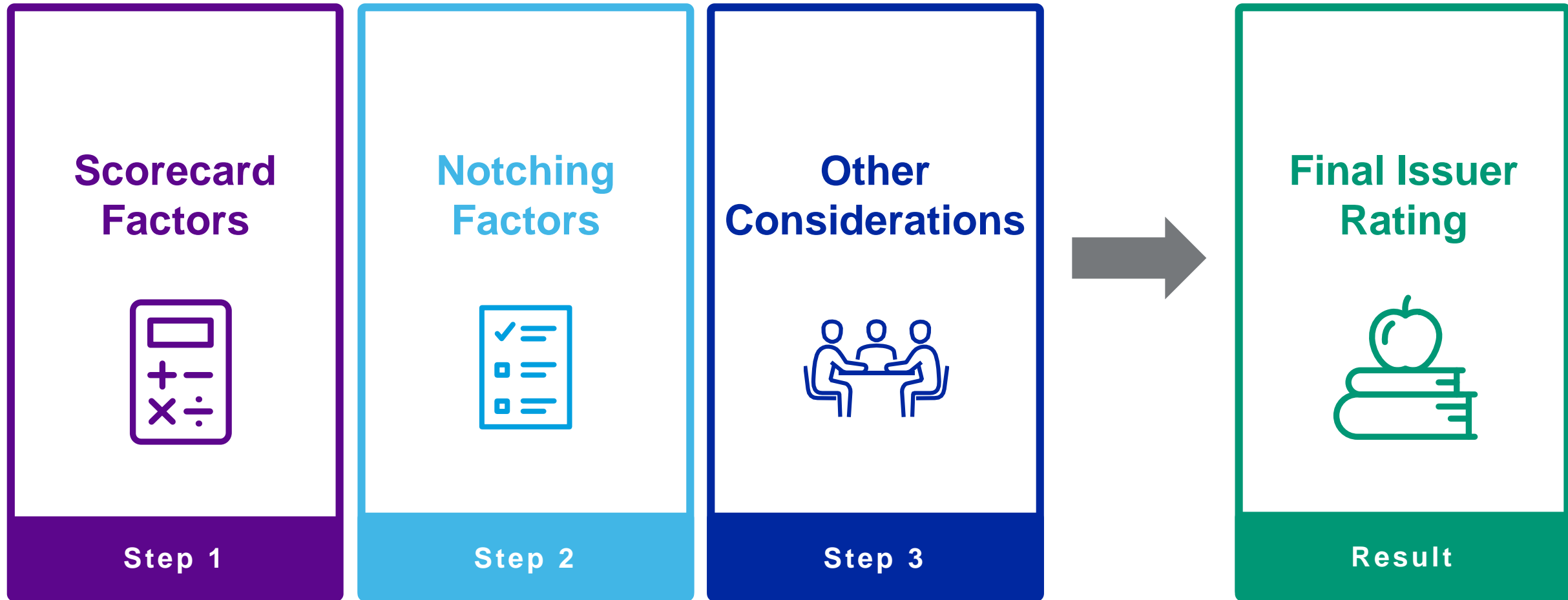
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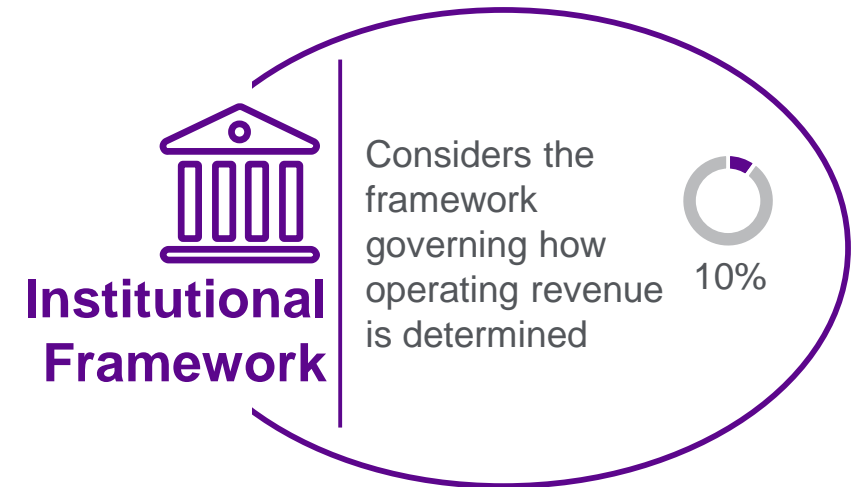
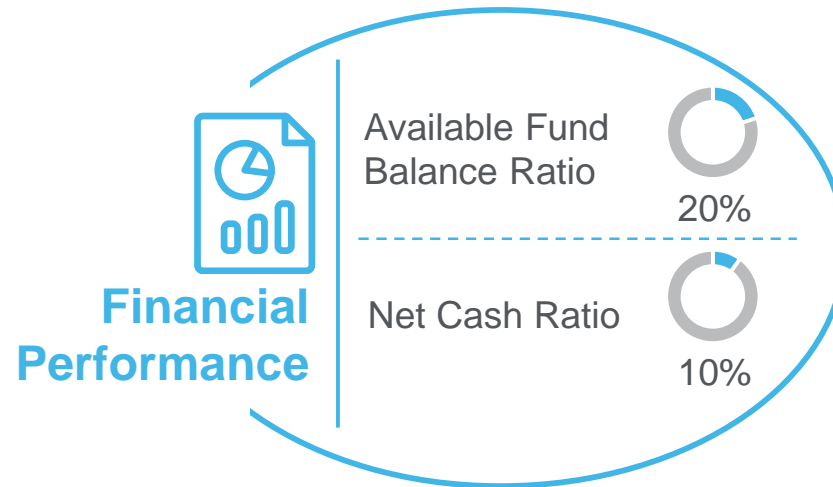
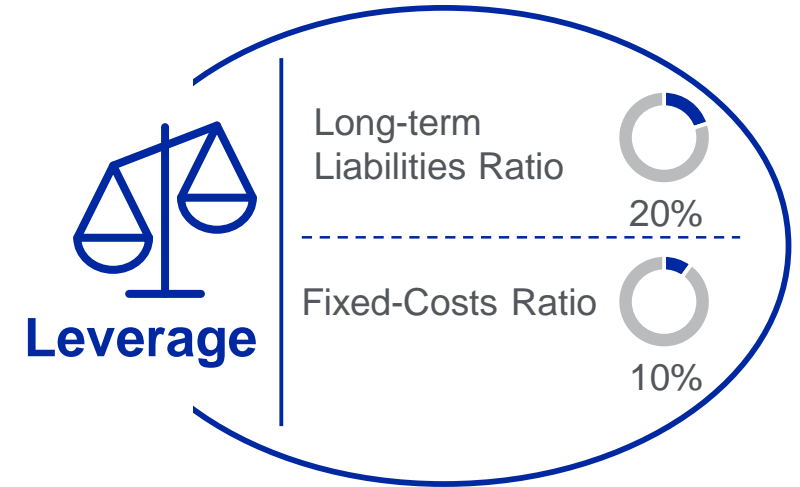
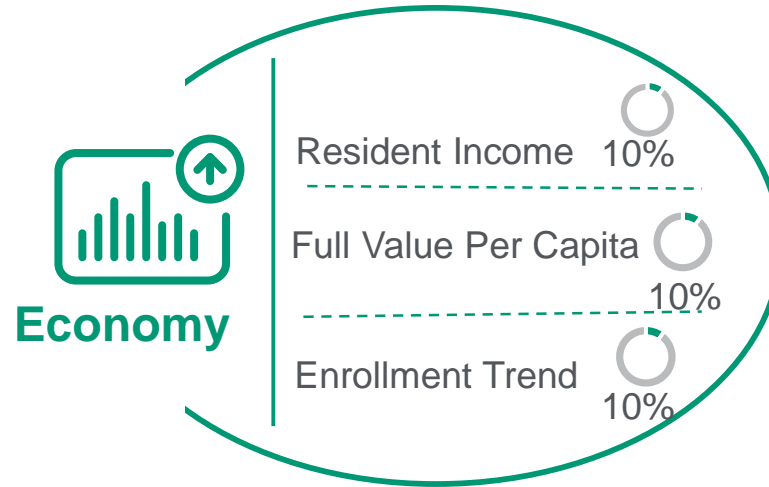
Debt Instrument Rating

Placed relative to issuer rating

Arriving at the issuer rating



Arriving at the issuer rating – Step 1



Scorecard Factor: Economy

FACTOR

Economy (30%)

Sub-factor	Sub-factor Weight	Aaa	Aa	A	Baa	Ba	B	Caa	Ca
Resident Income (MHI Adjusted for RPP / US MHI)* ¹	10%	≥ 120%	100 - 120%	80 - 100%	65 - 80%	50 - 65%	35 - 50%	20 - 35%	< 20%
Full Value per Capita (Full Valuation of the Tax Base / Population)* ²	10%	≥ \$180,000	\$100,000 - \$180,000	\$60,000 - \$100,000	\$40,000 - \$60,000	\$25,000 - \$40,000	\$15,000 - \$25,000	\$9,000 - \$15,000	< \$9,000
Enrollment Trend (Three-Year CAGR in Enrollment)* ³	10%	2 - 4%	0 - 2% or > 4%	(2) - 0%	(5) - (2)%	(8) - (5)%	(11) - (8)%	(14) - (11)%	< (14)%

Scorecard Factor: Financial Performance

FACTOR

Financial Performance (30%)

Sub-factor	Sub-factor Weight	Aaa	Aa	A	Baa	Ba	B	Caa	Ca
Available Fund Balance Ratio (Available Fund Balance / Operating Revenue)* ⁴	20%	≥ 25%	17.5 - 25%	10 - 17.5%	5 - 10%	0 - 5%	(5) - 0%	(10) - (5)%	< (10)%
Net Cash Ratio (Net Cash / Operating Revenue)* ⁵	10%	≥ 25%	17.5 - 25%	10 - 17.5%	5 - 10%	0 - 5%	(5) - 0%	(10) - (5)%	< (10)%

Scorecard Factor: Institutional Framework

The state determines the bulk of the school district's operating revenue, generated from state or local sources.

FACTOR

Institutional Framework (10%)

Institutional Framework	Aaa	Aa	A	Baa	Ba	B
State-Determined Revenue Framework: The state determines the bulk of the school district's operating revenue, which is generated from state or local sources.	The state provides or allows for regular, sizable increases to the bulk of the school district's revenue; the state never decreases, holds flat or delays the school district's revenue; and the school district can generate meaningful additional locally determined operating revenue.	The state provides or allows for regular, predictable increases to the bulk of the school district's revenue; and the school district can generate meaningful additional locally determined operating revenue.	The state provides or allows for increases to the bulk of the school district's revenue, although the timing or amount of the increases may vary or the state sometimes holds this revenue flat, modestly reduces this revenue or occasionally delays disbursements; and the school district can generate meaningful additional locally determined operating revenue.	The state provides or allows for increases to the bulk of the school district's revenue, although the timing or amount of the increases may vary or the state sometimes holds this revenue flat, modestly reduces this revenue or occasionally delays disbursements; or the school district cannot generate meaningful additional locally determined operating revenue.	The state rarely provides or allows for increases to the bulk of the school district's revenue, sometimes reduces revenue without advance notice or often delays disbursements for prolonged periods.	The state does not provide or allow for increases to the bulk of the school district's revenue and frequently reduces revenue without advance notice or delays disbursements for more than one fiscal year.

Scorecard Factor: Leverage

FACTOR

Leverage (30%)

Sub-factor	Sub-factor Weight	Aaa	Aa	A	Baa	Ba	B	Caa	Ca
Long-term Liabilities Ratio ((Debt + Adjusted Net Pension Liabilities + Adjusted Net Other Post-Employment Benefits) / Operating Revenue) ^{*6}	20%	≤ 125%	125 - 250%	250 - 400%	400 - 550%	550 - 700%	700 - 850%	850 - 1,000%	> 1,000%
Fixed-Costs Ratio (Adjusted Fixed Costs / Operating Revenue) ^{*7}	10%	≤ 15%	15 - 20%	20 - 25%	25 - 30%	30 - 35%	35 - 45%	45 - 55%	> 55%

Arriving at the issuer rating – Step 2

Notching Factors

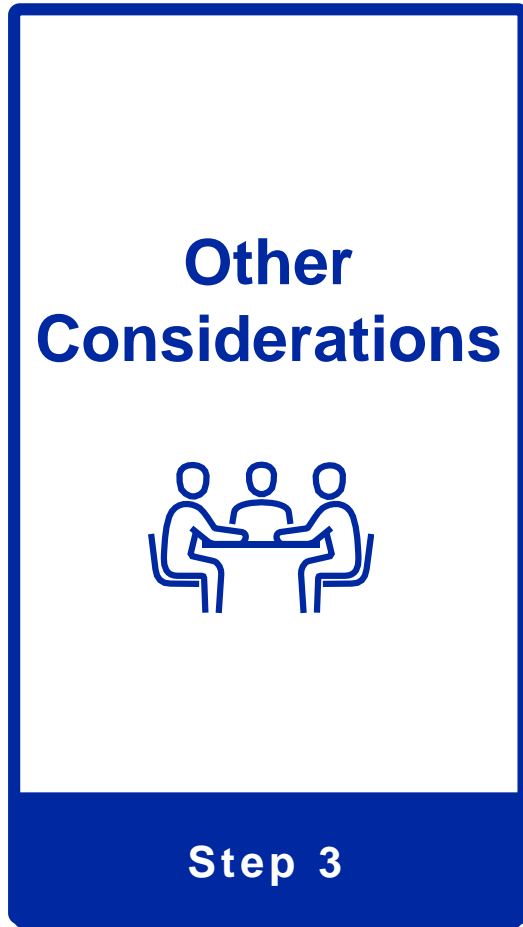


Step 2

Quantitative factors: result is Scorecard-Indicated Outcome

Notching Factors	Notching Ranges
Additional Strength in Local Resources	0 to +2
Limited Scale of Operations	-1 to 0
Weak Financial Reporting	-2 to 0
Potential Cost Shift to or from the State	-1 to +1
Potential for Significant Change in Leverage	-2 to +1.5

Arriving at the issuer rating – Step 3



Examples of qualitative Other Considerations:



Environmental, Social and Governance

Exposure to natural disaster risk may influence credit strength. The risk of teacher strikes are an example of a social consideration. Weak or opaque governance can negatively affect school performance.



Competitive Considerations

Academic performance measures may result in competitive strength. The risk of future enrollment losses to charter schools or other open-enrollment public schools may not already be reflected in the scorecard.



Extraordinary State Support

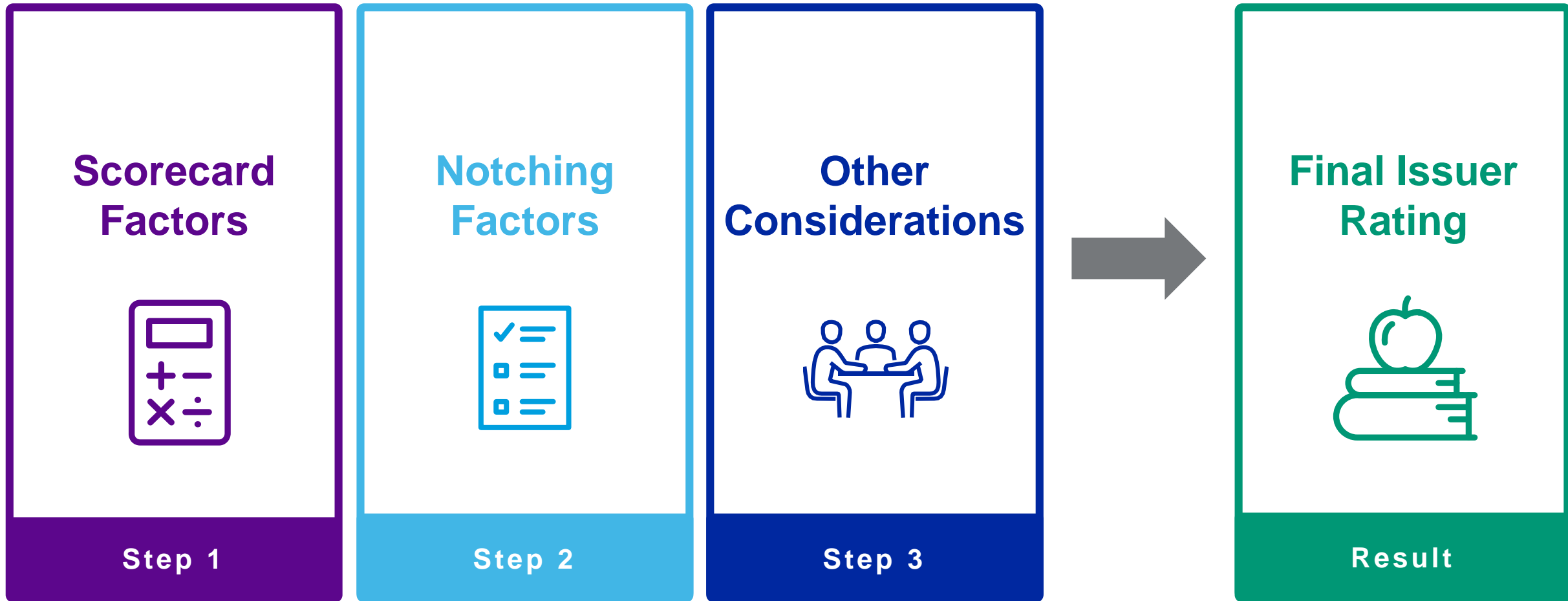
State may provide meaningful financial or managerial support, bolstering a weak fundamental credit profile.

Other Considerations

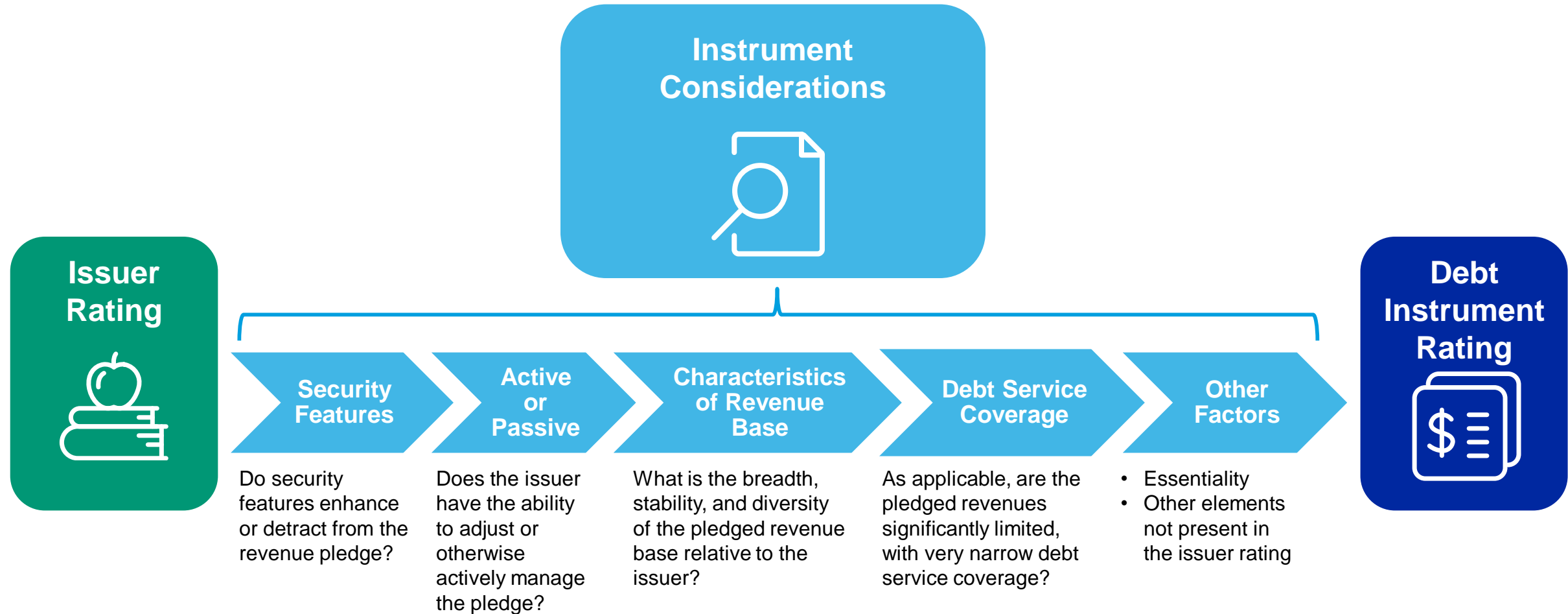
These considerations are qualitative and only relevant to certain issuers

- Environmental, Social and Governance Considerations
- Economic Concentration
- Other Demographic Considerations
- Competitive Considerations
- Local Support for Public Education
- Unusual Strengths or Weaknesses Related to Budgets or Liquidity
- Management Strategy
- Financial Controls
- Extraordinary State Support
- Related Local Governments
- Unusual Risk or Benefit Posed by Long-Term Liabilities
- Outsized Contingent Liability Risk
- Expected Decline or Improvement in Debt Service Coverage
- History of Missed Debt Service Payments
- Event Risk

Arriving at the issuer rating

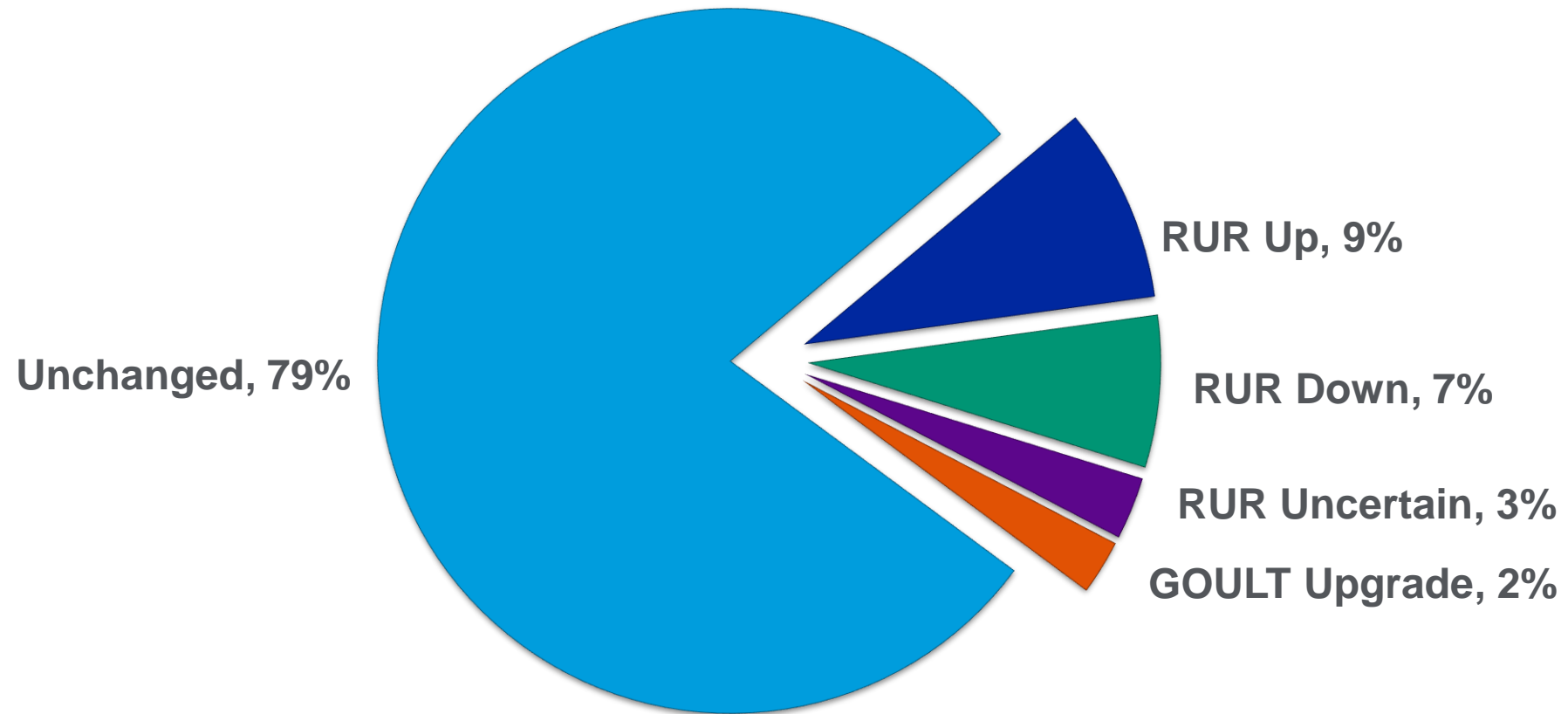


Arriving at the debt instrument rating



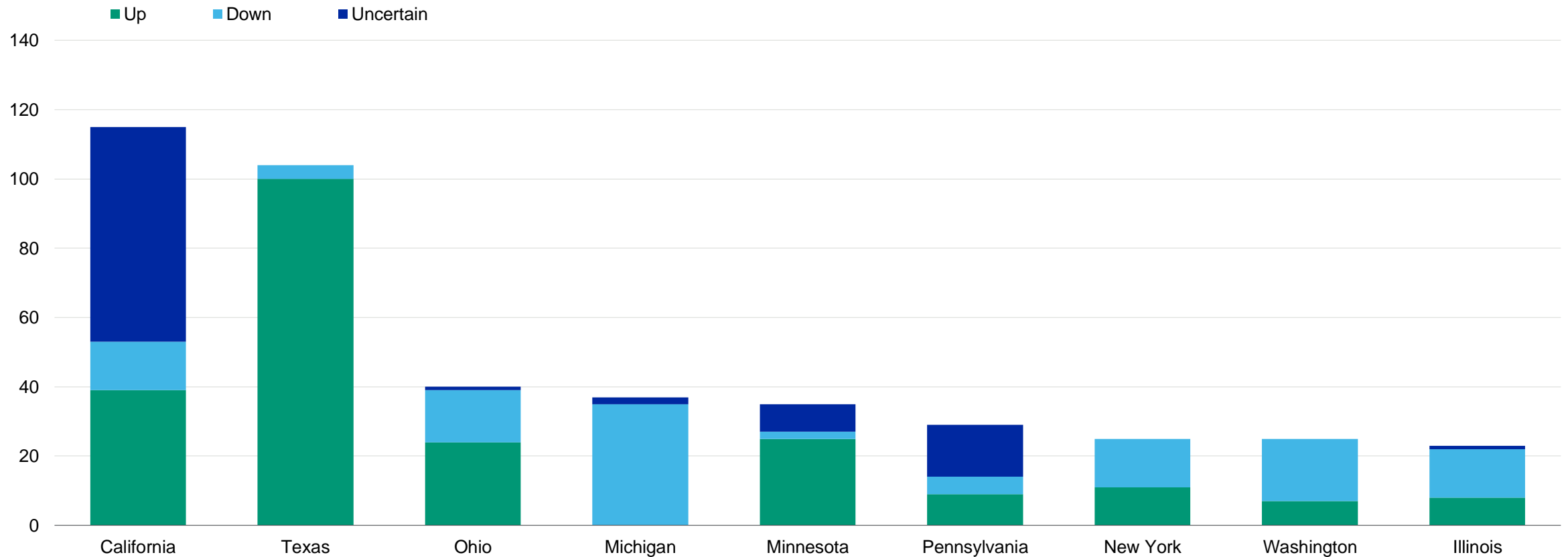
Ratings for roughly 80% of districts unchanged

Rated universe of approximately 3,400 districts



Ratings impact by state

Only 9 states had greater than 20 ratings placed under review



Most common review themes



**Review
Up**

Growing enrollment

Strong finances

Low leverage / fixed costs

Small tax base*

High leverage / fixed costs

Lower MHI after RPP adjustment

Weak financial reporting

Declining enrollment



**Review
Down**

**Compared to the GO methodology, a small tax base is less of a rating drag.*

Overweighting on very negative sub-factors also drove numerous downward reviews.

Happening now

- » Resolution of rating reviews ongoing
 - Analysts conducting discussion with each issuer
 - Ratings will be resolved through rating committee and communication through press release
- » Districts not on review were assigned Issuer Ratings last month
- » [moodys.com/k12](https://www.moodys.com/k12)

4

National Medians

National medians by year

Medians by year	2019
Economy	
Resident income	108.4%
Full Value per capita	93,277
Enrollment trend	-0.3%
Financial performance	
Available fund balance ratio	23.1%
Net cash ratio	27.8%
Leverage	
Long-term liabilities ratio	289.6%
Fixed-costs ratio	12.3%

National medians by rating

Medians by rating	Aaa	Aa	A	Baa	Ba and below
Economy					
Resident income	168.9%	121.7%	97.0%	87.6%	82.8%
Full Value per capita	191,404	104,849	76,753	72,174	38,279
Enrollment trend	0.3%	-0.1%	-0.5%	-1.3%	-2.3%
Financial performance					
Available fund balance ratio	26.8%	25.4%	21.5%	9.2%	3.6%
Net cash ratio	38.6%	30.4%	25.9%	10.4%	8.6%
Leverage					
Long-term liabilities ratio	220.4%	284.4%	296.7%	346.8%	260.8%
Fixed-costs ratio	9.9%	11.6%	13.1%	16.5%	9.9%

5

Questions

A nighttime photograph of a city skyline, likely Hong Kong, featuring numerous illuminated skyscrapers. In the foreground, a complex multi-level highway interchange is visible with light trails from moving vehicles. The sky is dark with some clouds.

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