

RatingsDirect®

Texas Southmost College District; Junior/Community College

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Texas Southmost College District; Junior/Community College

Credit Profile

Texas Southmost Coll Dist

Unenhanced Rating

A(SPUR)/Positive

Outlook Revised

Rationale

Standard & Poor's Ratings Services revised its outlook to positive from negative and affirmed the 'A' long-term rating and underlying rating (SPUR) on Texas Southmost College District (TSCD), Texas' existing revenue bonds. In addition, we withdrew the rating on the series 2005 student union revenue bonds.

The positive outlook reflects our view of the substantial progress made on the financial, operational, and enterprise risks identified during our last review as a result of the dissolution of the partnership with the University of Texas Brownsville (UTB). While it is unusual for us to revise an outlook to positive from negative, we believe that in addition to the progress made as a stand-alone entity, the terms negotiated with UTB were very favorable to TSCD and will likely result in a substantial increase in financial resources. The fiscal 2014 audit will be the first year that TSCD will operate as a separate entity -- enrollment, tuition, state appropriations, and the expense base will be entirely representative of just TSCD. We expect that the surpluses on a full-accrual basis that have supported the rating will continue in order for the college district to move to the 'A+' category.

More specifically, the rating reflects our opinion of TSCD's:

- Strong financial resources for the rating category with fiscal 2013 adjusted unrestricted net assets equal to 33.8% of adjusted operating expenses and 160% of total revenue debt;
- History of modest surpluses on a full-accrual basis;
- Diverse revenue stream with tuition, state appropriations, and property taxes;
- Strong growth in its tax base, coupled with flexibility in its voted operating tax rate and a diverse economic base; and
- Nimble management team.

Partly offsetting the aforementioned strengths is our view of the district's:

- Lack of a long-term enrollment trend as a stand-alone entity, although this is partly mitigated by increases in spring 2014 enrollment and an expected increase in fall 2014, and
- Lack of formal policies related to long-term financial planning and debt management although management reports that it is starting a master facility plan.

TSCD was established in 1926; in 1991, the Texas legislature approved the partnership with UTB and the college district, whereby both entities operated with a consolidated administrative and academic structure under the direction of UTB. In 2011, the TSCD and the University of Texas System (of which UTB is a campus) voted to dissolve the

existing partnership, and since then, each institution has cooperated to achieve separate accreditation and a targeted partnership termination by 2015. The transition teams of both institutions achieved operational separation in fall 2013.

During 2013, management addressed many of the enterprise and financial profile risks that, at the time of our review, the outcomes of which were still unknown. Since then, the college district had its first full year of enrollment, and although the institution is smaller, it is showing promising signs of growth. Tuition and fees have also been set lower than its competition and provide the college district with some flexibility. The college also received its first appropriation as a stand-alone institution, and while lower in terms of a nominal amount relative to when it was combined with UTB, it is comparable on a per-FTE basis. TSCD has also been able to attract many of the faculty from UTB, which had a reduction in force.

In our view, the most important risk of dissolution was determining the property sharing because this could have had implications for the revenue bonds. The terms of the settlement agreement signed by both TSCD and the University of Texas System in January 2014 were favorable to TSCD we believe. UT acquired about 51.5 acres from the joint campus; a long-term ground lease of about 18 acres from the U.S. International Boundary and Water Commission; and the University Boulevard Classroom Building (constructed with TSCD general obligation -- GO -- bonds), the University Boulevard Library (constructed with TSCD GO bonds), and the Student Union Building (constructed with TSCD revenue bonds). TSCD students will continue to have full access to the library. In addition, UT conveyed to TSCD the former National Guard Armory Building, as well as the Science, Engineering, and Technology Building, which was constructed on land leased from TSCD . Management reports that bond council determined that the swap of the buildings constructed with GO bonds is of equal value and satisfied the replacement of the value. TSCD will continue to pay the GO debt service on that. TSCD also received a cash payment of just more than \$29 million. Per management, a portion of the cash payment was used to defease the student union bonds, and about \$22 million will be added to the unrestricted net assets of the college in fiscal 2014. In additionally, UTB is leasing several TSCD buildings; conversely, TSCD has leased space in UTB's Life and Health Science Building. The agreement also calls for cooperative use of parking lots, as well as other ancillary agreements, including the agreement that UTB students will continue to pay the wellness center fee that secures the wellness center bonds.

Outlook

The positive outlook reflects our expectation that, during the next two years, enrollment will continue to grow, operations will be positive on a full-accrual basis, and financial resources will increase. We expect TSCD to maintain operating surpluses despite the smaller enrollment and state appropriation base, and that progress will continue in relation to the stand-alone accreditation. We would view positively the creation of formal long-term planning and budgeting.

We could return the outlook to stable if enrollment is below projections and results in a deficit on a full-accrual basis, or if additional revenue debt is issued that would weaken financial resources.

Enterprise Profile

Organization

Texas Southmost College District is in the Rio Grande Valley in Cameron County, which contains the Los Fresnos Independent School District, Brownsville Independent School District, and Point Isabel Independent School District. Fall 2013 was TSCD's first year of enrollment as a stand-alone entity, and a total of 2,632 FTE students enrolled. Management reports that this was on target with its projection. Spring enrollment, which typically declines for most community college, actually increased 12%, and management expects a 15% increase for fall 2014. We believe that enrollment could have some variability as the college right sizes, and it is also contingent on the local economy. However, two positive factors could provide long-term stability in our view. Currently, the district is the low-cost provider in the area with a tuition of about \$4,000 for the 2014-2015 academic year (based on 30 credit hours), which we believe could make it an attractive option, particularly for an area with low wealth and income indicators. Second, as UTB merges with University of Texas Pan American in 2015 and becomes the University of Texas at the Rio Grande Valley (UTRGV), it may reevaluate its admission requirements. As an open admission institution, TSCD will potentially be a transfer-student provider to the UTRGV and will also admit those students who are not academically qualified to attend.

Management

TSCD is governed by the elected seven-member board of trustees that are charged with policymaking and supervisory functions. Dr. Tercero was hired by the board of trustees in 2011 and has nimbly lead the institution through the transition since then.

The finance department, in our opinion, maintains adequate policies in some, but not all, key areas. Officials monitor the budget monthly and make adjustments as needed. The district has a written, in-depth, and conservative investment policy, and it makes monthly updates to the governing body. However, management does not have a formal debt-management policy, which we do not view as a best practice. Currently, the district lacks a capital improvement plan; however, management reports that it intends to complete a formal master plan in 2014. While management made progress on the short-term objectives relative to becoming a stand-alone institution, we believe that long-term budgeting and financial planning is important for TSCD's operational stability.

Financial Profile

Operations

Historically, the district has had positive operations on a full-accrual basis. For fiscal 2013, TSCD continued to operate within the partnership with UTB -- all state appropriations and tuition and fees collected by the college are remitted to UTB. For fiscal 2013, TSCD posted a \$5.6 million surplus, similar to prior years. Management reports that fiscal 2014 operations will be similar to fiscal 2013. The maintenance of the positive operations on a full-accrual basis beyond fiscal 2014, when TSCD will be a stand-alone entity, will be key in our analysis of an upgrade. Fiscal 2013 operating revenues were diverse, in our view, with tuition and fees comprising 35.3%, state appropriations comprising 21.5%, and property taxes comprising 35.4%.

The college received \$27.97 million in appropriations for the 2010-2011 biennium and \$22.31 million for the 2012-2013 biennium. Management reports that it was able to absorb the reduction in state appropriations through cost containments and increased tuition revenues. As state appropriations are based on enrollment, the appropriation for the 2014-2015 biennium decreased relative to the enrollment decline as a stand-alone entity. It received \$6.8 million for each year of the biennium. We expect management to make the necessary budget adjustments as it right sizes the college.

Local economy

The tax base has increased by 2.7% annually since fiscal 2009 to \$11.1 billion in fiscal 2013. We believe the tax base is very diverse, with the 10 leading taxpayers accounting for just 2.7% of total AV. The district, in our opinion, has significant flexibility in its operating tax rate levy, as the maintenance and operations tax rate has a voter-imposed limit of 35 cents per \$100 of AV. Currently, the operating and debt service tax rates are 10.1075 cents and 6.186 cents, respectively.

Financial resources and debt

Unrestricted net assets (UNA) continues to increase, and at fiscal year-end Aug. 31, 2013, the district had \$15.5 million in UNA, an increase from \$12.1 million in 2012 and \$7.8 million in 2011. Including debt service reserves, UNA improved to \$26.8 million, which is equal to 33.8% of operating expenses, a strong 160% of revenue debt, and an adequate 32% of total debt, including GO debt. For fiscal 2014, \$20 million will be added to the UNA as part of the land agreement with UT. Management reports that this money will remain in UNA until the master facilities plan is complete. We believe this increase in UNA would improve already strong financial resources.

The district has \$67.5 million of GO bonds and \$16.7 million of revenue bonds. This includes the defeasance of the series 2005 revenue bonds (about \$5 million) in early 2014. As part of the dissolution agreement, UTB agrees to continue to pay the dedicated fee that secures the wellness center bonds. The fiscal 2013 coverage for the wellness center bonds is 2.3x maximum annual debt service and will likely increase slightly for fiscal 2014 given the increase in enrollment. The series 2006 revenue bonds are secured by 25% of tuition, bookstore revenue, parking revenues, and investment income. Management reports that tuition pledged includes that from TSCD students only, and TSCD management has made arrangements with UTB for the bookstore and parking. Fiscal 2013 coverage remained adequate at 1.7x maximum annual debt service, which is consistent with expectations for fiscal 2014. There is a restricted fund balance for the wellness center revenue bonds that covers more than three years of debt service, which provides an additional resource. Revenue debt remains manageable in our view, with a maximum annual debt service equal to approximately 3.1% of fiscal 2013 expenses. TSCD does not expect to issue new money revenue or GO debt within the next two years.

Related Criteria And Research

Related Criteria

USPF Criteria: Higher Education, June 19, 2007

Ratings Detail (As Of June 9, 2014)

Texas Southmost Coll Dist

Ratings Detail (As Of June 9, 2014) (cont.)		
<i>Unenhanced Rating</i>	NR(SPUR)	Withdrawn
Texas Southmost Coll Dist (Wellness Ctr)		
<i>Unenhanced Rating</i>	A(SPUR)/Positive	Outlook Revised

Many issues are enhanced by bond insurance.

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Texas Southmost College District; General Obligation

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Related Criteria And Research

Texas Southmost College District; General Obligation

Credit Profile		
Texas Southmost Coll Dist GO <i>Unenhanced Rating</i>	AA-(SPUR)/Stable	Outlook Revised
Texas Southmost Coll Dist GO <i>Long Term Rating</i>	AA-/Stable	Outlook Revised

Rationale

Standard & Poor's Ratings Services revised its outlook to stable from negative due to the substantial progress Texas Southmost College District (TSCD) has made in regard to the successful dissolution of its partnership with the University of Texas Brownsville (UTB), as well as the projected increase in TSCD's financial resources.

At the same time, Standard & Poor's affirmed its 'AA-' long-term rating and underlying rating (SPUR) on TSCD's general obligation (GO) debt.

The rating reflects our opinion of the district's:

- Deep and diverse property tax base, centered around Brownsville, which is coterminous with Cameron County;
- Low tax rate, providing significant taxing flexibility based on the district's large and growing \$11.3 billion total assessed value (AV);
- Diverse revenue stream comprising tuition, state appropriations, and property taxes; and
- Limited capital needs, coupled with a low overall net debt burden.

Offsetting rating factors include:

- Low wealth and income levels;
- Financial and operational risk as the district becomes a stand-alone institution; and
- Lack of formal management policies related to long-term financial planning and debt management although management reports it is starting a master facility plan.

The district's ad valorem property tax levy for operations and maintenance (O&M) secures the bonds. The district's O&M tax rate has a voter-imposed limit of 35 cents per \$100 of AV. Currently, the operating and debt service tax rates are 10.1596 cents and 6.1339 cents per \$100 of AV, respectively.

Since 1991, per the partnership agreement with the UTB, Texas Southmost College (TSC) offered courses to students at the freshman and sophomore levels, as well as continuing education courses, and UTB initially offered courses for juniors, seniors, and graduates. The two institutions shared facilities, faculty, and administration. TSC provided UTB with a contractual payment to UTB for faculty services, which stopped in fiscal 2014. State support, in the form of appropriations, was made individually to each institution. In 2011, the TSCD and UTB voted to dissolve the existing partnership, and since then, each institution has cooperated so that each would achieve separate accreditation and a

targeted partnership termination by 2015. The transition teams of both institutions achieved operational separation in the fall of 2013.

During 2013, management addressed many of the enterprise and financial profile risks that, at the time of our most recent review, the outcomes of which were still unknown. Since then, TSCD had its first full year of enrollment and though the institution is smaller, it is showing promising signs of growth. Tuition and fees have also been set lower than its competition and provide the college district with some flexibility. The college retained its first appropriation as a stand-alone institution, and while lower in terms of a nominal amount, relative to when it was combined with UTB, it is comparable on a per full-time equivalent (FTE) basis. TSCD has also been able to attract many of the faculty from UTB, which had a reduction in force.

In our view, the most important risk of dissolution was determining the property sharing because this could have had implications for the revenue bonds. The terms of the settlement agreement signed by both TSCD and the University of Texas System in January 2014 were favorable to TSCD we believe. UT acquired about 51.5 acres from the joint campus; a long-term ground lease of about 18 acres from the U.S. International Boundary and Water Commission; and the University Boulevard Classroom Building (constructed with TSCD GO bonds), the University Boulevard Library (constructed with TSCD GO bonds), and the Student Union Building (constructed with TSCD revenue bonds). TSCD students will continue to have full access to the library. In addition, UT conveyed to TSCD the former National Guard Armory Building, as well as the Science, Engineering, and Technology Building, which was constructed on land leased from TSCD. Management reports that bond council determined that the swap of the buildings constructed with GO bonds is of equal value and satisfied the replacement of the value. TSCD will continue to pay the GO debt service on that. TSCD also received a cash payment of just more than \$29 million. Per management, a portion of the cash payment was used to defease the student union bonds, and about \$22 million will be added to the unrestricted net assets of the college in fiscal 2014. In addition, UTB is leasing several TSCD buildings; conversely, TSCD has leased space in UTB's Life and Health Science Building. The agreement also calls for cooperative use of parking lots, as well as other ancillary agreements, including the agreement that UTB students will continue to pay the wellness center fee that secures the wellness center bonds.

Texas Southmost College District (TSCD) is in the Rio Grande Valley, in Cameron County, which contains Los Fresnos Independent School District, Brownsville Independent School District, and Point Isabel Independent School District. Fall 2013 was TSCD's first year of enrollment as a stand-alone entity with a total of 2,632 FTE students enrolled. Management reports that this was on target with their initial projection. Spring enrollment, which typically declines for most community colleges, actually increased by 12%, and management expects a 15% increase for the fall of 2014. We believe that enrollment could have some variability as the college right sizes, and it is also contingent on the local economy. However, we believe two positive factors could provide long-term stability. Currently, the district serves as the low-cost provider in the area, which makes it an attractive option, particularly with an area of low wealth and income indicators. As an open admissions institution, TSCD will potentially be a transfer student provider to the UTRGV and will also admit those students who are not academically qualified to attend UTRGV.

The tax base has increased by 1.6% annually since fiscal 2010 to \$11.3 billion in fiscal 2014. We believe the tax base is very diverse, with the leading taxpayers accounting for just 2.0% of total AV. County per capita income levels are low

at 54% of the national average, respectively. District market value is adequate, in our opinion, at roughly \$50,770 per capita.

Outlook

The stable outlook reflects our expectation that, during the next two years, we expect TSCD to maintain operating surpluses, despite the smaller enrollment and state appropriation base, and that progress continues in relation to the stand-alone accreditation. We believe the outlook will remain stable over the next two years as we do not expect to see significant changes in the district's financial position or economy. If we were to see a significant decline in the district's financial position, or if additional debt were issued, putting pressure on operations, we could lower the rating. Conversely, if the district were to experience a substantial increase in wealth and income levels and significant tax base growth, we could raise the rating.

Management

We consider Texas Southmost College District's financial management practices "standard" under our financial management assessment (FMA) methodology, indicating that the finance department maintains adequate policies in some, but not all, key areas. Management has not identified how revenue and expenditure assumptions will be determined. Officials monitor the budget monthly and make adjustments as needed. The district has a written, in-depth, and conservative investment policy, and it makes monthly updates to the governing body. Management does not have a debt management policy. The district lacks a capital improvement plan. The district does not have a long-term financial plan, nor has management identified changes to revenues and expenditures as they separate from UTB. A formal reserve policy does not exist; management, however, informally targets reserves of at least \$2 million of operating expenditures for cash-flow purposes.

Financial Profile

Historically, the district has had positive operations on a full-accrual basis. For fiscal 2013, TSCD continued to operate within the partnership with UTB -- all state appropriations and tuition and fees collected by the college were remitted to UTB. For audited fiscal 2013, TSCD posted a \$5.6 million surplus, similar to prior years. Management reports that fiscal 2014 operations will be similar to fiscal 2013. The maintenance of positive operations on a full-accrual basis beyond fiscal 2014 when TSCD will be a stand-alone entity will be key in our analysis of an upgrade.

Fiscal 2013 audited operating revenues were diverse, in our view, with tuition and fees constituting 35.3% of revenues, state appropriations making up 21.5%, and property taxes 35.4%.

The district received \$29.97 million in appropriations for the 2010-2011 biennium and \$22.31 million for the 2012-2013 biennium. Management reports that it was able to absorb the reduction in state appropriations through cost containments and increased tuition revenues. As state appropriations are based on enrollment, the appropriation for the 2014-2015 biennium decreased relative to the enrollment decline as a stand-alone entity. It received \$6.8 million for each year of the biennium. We expect management to make the necessary budget adjustments as it right sizes the college.

Unrestricted net assets (UNA) continue to increase and, at the end of fiscal 2013, totaled \$15.5 million, an increase from \$12.1 million in fiscal 2012 and \$7.8 million in fiscal 2011. For fiscal 2014, management projects adding roughly \$22 million to the UNA as part of the settlement agreement with UTB. Management reports that this money will remain in UNA until the master facilities plan is complete. We believe this increase in UNA would improve already strong financial resources.

Debt

The district's debt burden, in our view, remains low at roughly \$1,781 per capita and moderate at 3.5% of market value. We consider amortization rapid, with 66% of principal retired after 10 years. In addition to its GO bonds and limited tax notes outstanding, the district has roughly \$16.7 million of revenue bonds outstanding, which are payable from operating revenues but not from property tax revenues. Officials do not plan to approach the electorate for additional bonding authority at this time.

The district provides pension benefits for all of its full-time employees through the statewide Teacher Retirement System, a cost-sharing, multiple-employer defined-benefit public employee retirement system. Contribution requirements are not actuarially determined but are established and amended by the Texas legislature. Historically, the state has paid the district's postemployment benefits and retirement costs. The district does not provide postemployment benefits.

Related Criteria And Research

Related Criteria

USPF Criteria: GO Debt, Oct. 12, 2006

Ratings Detail (As Of June 25, 2014)		
Texas Southmost Coll Dist GO (MBIA) (National) <i>Unenhanced Rating</i>	AA-(SPUR)/Stable	Outlook Revised
Texas Southmost Coll Dist GO (AGM) <i>Unenhanced Rating</i>	AA-(SPUR)/Stable	Outlook Revised
Texas Southmost Coll Dist GO (AMBAC) <i>Unenhanced Rating</i>	AA-(SPUR)/Stable	Outlook Revised

Many issues are enhanced by bond insurance.

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