

## CREDIT OPINION

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 Rate this Research

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# Sherman Independent School District, TX

## Update to credit analysis

### Summary

[Sherman Independent School District, TX's](#) (Aa3) credit profile is supported by its healthy financial position and long trend of stable financial operations. The profile is further supported by strong economic growth, driven by residential development and population growth. The credit profile is balanced by the district's elevated leverage metrics, which are expected to remain elevated for the next few years. The district's favorable enrollment trend and below average resident income profile are also incorporated in the credit profile.

### Credit strengths

- » Healthy financial reserves and liquidity
- » Continuing trend of taxable value growth
- » Trend of growing enrollment

### Credit challenges

- » Elevated long-term liabilities and fixed costs
- » Below average full value per capita and resident income profile

### Rating outlook

Moody's does not usually assign outlooks to local governments with this amount of debt.

### Factors that could lead to an upgrade

- » Material decline in leverage
- » Strengthening of full value per capita and resident income profile

### Factors that could lead to a downgrade

- » Material decline in fund balance or cash
- » Material increase in leverage

## Key indicators

Exhibit 1

### Sherman Independent School District, TX

	2018	2019	2020	2021	Aa Medians
<b>Economy</b>					
Resident income	86.0%	82.6%	N/A	N/A	120.3%
Full value (\$000)	\$3,088,349	\$3,252,640	\$3,675,348	\$4,052,300	\$3,767,803
Population	45,231	45,755	N/A	N/A	32,239
Full value per capita	\$68,279	\$71,088	N/A	N/A	\$110,286
Enrollment	7,497	7,405	7,545	7,503	4,353
Enrollment trend	1.5%	1.0%	0.7%	0.0%	0.1%
<b>Financial performance</b>					
Operating revenue (\$000)	\$75,346	\$83,730	\$91,825	\$97,041	\$70,864
Available fund balance (\$000)	\$34,096	\$36,214	\$40,989	\$33,513	\$17,424
Net cash (\$000)	\$29,728	\$32,994	\$30,649	\$34,118	\$20,807
Available fund balance ratio	45.3%	43.3%	44.6%	34.5%	26.1%
Net cash ratio	39.5%	39.4%	33.4%	35.2%	31.0%
<b>Leverage</b>					
Debt (\$000)	\$231,297	\$223,607	\$243,124	\$235,621	\$48,829
ANPL (\$000)	\$65,599	\$61,079	\$97,575	\$95,582	\$92,102
OPEB (\$000)	\$25,732	\$27,180	\$28,769	\$21,818	\$10,438
Long-term liabilities ratio	428.2%	372.5%	402.4%	363.8%	280.7%
Implied debt service (\$000)	\$5,599	\$17,042	\$16,303	\$17,411	\$3,402
Pension tread water (\$000)	\$1,733	\$2,444	\$2,728	N/A	\$3,018
OPEB contributions (\$000)	\$358	\$434	\$447	\$460	\$440
Fixed-costs ratio	10.2%	23.8%	21.2%	21.2%	11.9%

For definitions of the metrics in the table above please refer to the [US K-12 Public School Districts Methodology](#) or see the Glossary in the Appendix below. Metrics represented as N/A indicate the data were not available at the time of publication. The medians come from our most recently published [K12 Median Report](#).

Sources: US Census Bureau, Sherman Independent School District, TX's financial statements and Moody's Investors Service

## Profile

Sherman ISD is located approximately 60 miles north of [Dallas](#) (A1 stable) in [Grayson County](#) (Aa2). The district provides public K-12 education to about 7,800 students.

## Detailed credit considerations

### Economy

The district's economy will continue to grow and is supported by a growing population with new residential and industrial development. The tax base has grown at an average rate of 8.1% annually over the last five years, resulting in full value per capita that has grown to \$94,370, based on the district's fiscal 2022 full valuation of \$4.3 billion. The district is primarily residential and new residential development has been strong in recent years. The most recent demographic study shows numerous subdivisions in various stages of build out and projects the addition of over 3,500 single and multifamily homes over the next three to five years. In addition, [Texas Instruments, Incorporated](#) (Aa3 stable) will build up to four chip manufacturing plants in the city of Sherman, which could bring around 3,000 jobs. The district signed a Chapter 313 agreement (tax abatement agreement) with the company, which limits the assessed value of the projects against the district's operating levy but not the bifurcated debt service levy.

The local economy, primarily centered in the industrial and agricultural sectors, remains stable, though resident incomes remain below average with adjusted median family income at 82.6% of the US median. Population growth has also bolstered the local economy, as the district's population has grown from about 41,500 in 2010 to 45,750 in 2019. The district has moderate top taxpayer concentration, as the top 10 taxpayers comprise 18.1% of assessed value.

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Enrollment has been stable at around 7,500 students for the past few years, following previous years of moderate growth. Favorably, enrollment remained relatively stable in the 2020-2021 academic year (it declined just 0.6%), a year in which many districts had considerable enrollment loss because of the coronavirus pandemic. Fiscal 2022 enrollment as of October 21, 2021 is up 3.9% to 7,800. The district anticipates a return to annual growth of about 2% over the next few years.

### Financial operations

The financial position is a strength of the credit profile and will remain healthy over the next few years. The district generated a \$5.3 million general fund surplus in fiscal 2021 (audited; June 30 FYE), adding to a long trend of operating surpluses. The surplus was primarily driven by federal stimulus aid and various expenditures that were lower than budgeted. Available general fund balance grew to \$33.5 million, equal to a strong 42.8% of general fund revenue. Available operating fund balance, inclusive of the debt service fund, totaled 34.5% of operating revenue. Property taxes accounted for 60% of fiscal 2021 operating revenue and state aid accounted for 39%.

The fiscal 2022 general fund budget was adopted with a \$3.4 million deficit to address deferred maintenance and replacement of certain items. The district has plans to continue to spend down a portion of fund balance over the next couple of years. However, future spending plans are partially mitigated by the district's allocation of \$13.3 million in ESSER III federal funding, in addition to \$5.9 million in ESSER II funding, which the district plans to use evenly over the next two to three years. The district has an informal policy of maintaining three months of expenditures in reserves, and it should continue to meet that going forward.

### Liquidity

Like fund balance, liquidity will remain healthy but will decline in the near term as some general fund reserves are spent. General fund cash totaled \$19.8 million at fiscal 2021 year-end, equal to 25.3% of revenue. When including the debt service fund, total operating fund cash was \$34.1 million or 35.2% of combined revenue.

### Leverage

Leverage is elevated and will remain elevated over the next few years given slow amortization of outstanding debt and future debt issuance plans. Including debt and adjusted pension and OPEB liabilities, the district's long-term liabilities total 363.8% of operating revenue, which is higher than the state and national Aa3 medians. Related fixed costs are also elevated at 21.2% of operating revenue. The district anticipates approaching voters for additional authorization within the next 3 years to address elementary school capacity needs. Continued tax base and revenue growth will keep the debt burden manageable, in addition to the district's proactive approach of prepaying debt when funds are available.

### Legal security

The GOULT bonds are secured by a dedicated ad valorem tax levied by the district on all taxable property without limitation as to rate or amount. The GOULT bonds are further payable by the Texas Permanent School Fund's commitment to pay debt service if necessary.

### Debt structure

Following the sale, the district will have \$197.9 million of outstanding GOULT debt, of which approximately 33% of principal will be retired over the next 10 years.

Most of the debt portfolio consists of fixed interest rate bonds. However, approximately 13% of the total outstanding debt is variable rate. The variable rate bonds (Series 2018B) were issued in an initial rate mode coinciding with a term maturity and they do not have an external liquidity provider. At the remarketing date the bonds are subject to mandatory tender to be funded with remarketing proceeds. The bonds were remarketed on August 1, 2020 and the current term rate period expires July 31, 2023. In the event of a failed remarketing existing investors will continue to hold the bonds and the interest rate will step up to 7%.

### Debt-related derivatives

The district is not party to any interest rate swaps or other derivative agreements.

### Pensions and OPEB

The pension burden continues to grow but remains manageable. Texas School Districts receive substantial pension cost support from the state. Without this cost support, most districts' Moody's-adjusted net pension liabilities (ANPLs), which are attributable to their proportionate shares of the Teacher Retirement System of Texas (TX TRS), would roughly triple. Texas school districts report their

pension liabilities with a lag. The district's fiscal 2020 financial reporting reflects its share of the TX TRS' ANPL as of August 2019. Based on the TX TRS system in aggregate, we project that the district's ANPL will rise by 12% in fiscal 2021, driven in part by declining market interest rates, before falling by around 14% in fiscal 2022 due to very strong investment performance.

The fiscal 2021 Moody's Adjusted Net Pension Liability (using a 2.66% discount rate based on the FTSE pension liability index) totaled \$95.6 million, which is equal to 98.5% operating revenue and 2.4% of taxable value. In fiscal 2021, the district made \$1.8 million in pension contributions, net of contributions from the state.

The district funds other post-employment benefits (OPEB) on a pay-as-you-go basis; the fiscal 2021 contribution was \$460,000 or just 0.5% of operating fund revenue. The Moody's Adjusted Net OPEB Liability was \$21.8 million in fiscal 2021, which is equal to 22% operating revenue and 0.5% of taxable value.

## ESG considerations

### Environmental

The district's exposure to rising environmental risks is moderate compared to peers nationwide. According to data from Moody's affiliate Four Twenty Seven, the district has high exposure to heat stress and water stress, and low exposure to extreme rainfall. Favorably, federal and state governments help mitigate these exposures. The State of Texas (Aaa stable) has taken action to help mitigate water stress risk within its borders by issuing general obligation debt through the Texas Water Development Board (TWDB) since the 1950s to finance a variety of water conservation and supply projects. The risks are also mitigated by a history of state and federal disaster aid, which has provided substantial reimbursement to Texas local governments in the event of disasters.

### Social

Social considerations are material to most school district ratings, with factors such as demographics, labor force, income and education influencing the district's economy, demographic, financial and leverage trends. The district's resident incomes are below state and national medians though housing is affordable. Poverty is slightly elevated with 15.7% of the population below the poverty line. The unemployment rate in Grayson County was 4.1% in September 2021, which is below the state and national rates of 4.9% and 4.6%, respectively.

### Governance

The district is governed by a seven-member board of trustees. Policymaking and supervisory functions are the responsibility of, and are vested in, the board. The board delegates administrative responsibilities to the superintendent of schools, who is the chief administrative officer of the district. Support services are supplied by consultants and advisers.

Texas school districts have an Institutional Framework score of Aa. The state controls school district revenue through an equalized funding formula consisting of a combination of local property taxes and state aid. The state allows for regular and predictable increases to total funding for school districts. Property tax revenue growth is capped at 2.5% annually, but school districts can approach voters for mill levy overrides that can generate meaningful additional locally determined operating revenue.

## Rating methodology and scorecard factors

The US K-12 Public School Districts Methodology includes a scorecard, a tool providing a composite score of a school district's credit profile based on the weighted factors we consider most important, universal and measurable, as well as possible notching factors dependent on individual credit strengths and weaknesses. Its purpose is not to determine the final rating, but rather to provide a standard platform from which to analyze and compare school district credits.

Exhibit 2

### Sherman Independent School District, TX

	Measure	Weight	Score
<b>Economy</b>			
Resident Income (MHI Adjusted for RPP / US MHI)	82.6%	10.0%	A
Full value per capita (full valuation of the tax base / population)	94,370	10.0%	A
Enrollment trend (three-year CAGR in enrollment)	0.0%	10.0%	Aa
<b>Financial performance</b>			
Available fund balance ratio (available fund balance / operating revenue)	34.5%	20.0%	Aaa
Net cash ratio (net cash / operating revenue)	35.2%	10.0%	Aaa
<b>Institutional framework</b>			
Institutional Framework	Aa	10.0%	Aa
<b>Leverage</b>			
Long-term liabilities ratio ((debt + ANPL + adjusted net OPEB) / operating revenue)	363.8%	20.0%	A
Fixed-costs ratio (adjusted fixed costs / operating revenue)	21.2%	10.0%	A
<b>Notching factors</b>			
Potential for significant change in leverage	0.50		
Scorecard-Indicated Outcome			Aa3
<b>Assigned Rating</b>			<b>Aa3</b>

Sources: US Census Bureau, Sherman Independent School District, TX's financial statements and Moody's Investors Service

## Appendix

Exhibit 3

### Key Indicators Glossary

	Definition	Typical Source*
<b>Economy</b>		
Resident income	Median Household Income (MHI), adjusted for Regional Price Parity (RPP), as a % of the US	MHI: American Community Survey (US Census Bureau) RPP: US Bureau of Economic Analysis
Full value (\$000)	Estimated market value of taxable property accessible to the district	State repositories, district's audited financial reports, offering documents or continuing disclosure
Population	Population of school district	American Community Survey (US Census Bureau)
Full value per capita	Full value / population of school district	
Enrollment	Student enrollment of school district	State data publications
Enrollment trend	3-year Compound Annual Growth Rate (CAGR) of Enrollment	State data publications; Moody's Investors Service
<b>Financial performance</b>		
Operating revenue (\$000)	Total annual operating revenue in what we consider to be the district's operating funds	Audited financial statements
Available fund balance (\$000)	Committed, assigned and unassigned fund balances in what we consider to be the district's operating funds	Audited financial statements
Net cash (\$000)	Net cash (cash and liquid investments minus short-term debt) in what we consider to be the district's operating funds	Audited financial statements
Available fund balance ratio	Available fund balance / Operating Revenue	Audited financial statements
Net cash ratio	Net Cash / Operating Revenue	Audited financial statements
<b>Leverage</b>		
Debt (\$000)	District's direct gross debt outstanding	Audited financial statements; official statements
ANPL (\$000)	District's pension liabilities adjusted by Moody's to standardize the discount rate used to compute the present value of accrued benefits	Audited financial statements; Moody's Investors Service
OPEB (\$000)	District's net other post-employment benefit (OPEB) liabilities adjusted by Moody's to standardize the discount rate used to compute the present value of accrued benefits	Audited financial statements; Moody's Investors Service
Long-term liabilities ratio	Debt, ANPL and OPEB liabilities as % of operating revenue	Audited financial statements, official statements; Moody's Investors Service
Implied debt service (\$000)	Annual cost to amortize district's long-term debt over 20 years with level payments	Audited financial statements; official statements; Moody's Investors Service
Pension tread water (\$000)	Pension contribution necessary to prevent reported unfunded pension liabilities from growing, year over year, in nominal dollars, if all actuarial assumptions are met	Audited financial statements; Moody's Investors Service
OPEB contributions (\$000s)	District's actual contribution in a given period, typically the fiscal year	Audited financial statements; official statements
Fixed-costs ratio	Implied debt service, pension tread water and OPEB contributions as % of operating revenue	Audited financial statements, official statements, pension system financial statements

\*Note: If typical data source is not available then alternative sources or proxy data may be considered. For more detailed definitions of the metrics listed above please refer to the [US K-12 Public School Districts Methodology](#).

Source: Moody's Investors Service

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