Fitch Ratings

Fitch Affirms Texas Southmost College District's Ltd Tax Bonds & Notes at 'AA-'; Outlook to Stable

Ratings   Endorsement Policy

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Fitch Ratings-Austin-28 July 2014: Fitch Ratings affirms the following Texas Southmost College District, Texas (TSC or the district) ratings:

--$52.6 million outstanding limited tax bonds at 'AA-';
--$11.5 million outstanding maintenance tax notes at 'AA-'.

The Rating Outlook is revised to Stable from Negative.

SECURITY

The bonds and maintenance tax notes are direct obligations of the district payable from a continuing direct annual ad valorem tax on all taxable property within the limits prescribed by law. The bonds are subject to the district's limit of $0.50 per $100 of taxable assessed value (TAV). The tax notes are subject to a separate limit of $0.35 per $100 of TAV. The district's total tax rate cannot exceed $0.85 per $100 TAV.

KEY RATING DRIVERS

STOUT CUSHION UNDERPINS INDEPENDENT OPERATIONS: The revision to a Stable Outlook reflects Fitch's viewpoint that the district is presently well-positioned to continue its evolution as a stand-alone institution while maintaining satisfactory finances. Spending remains closely aligned to revenue trends. Management has expanded operations carefully and expects to end the first year of independent operations with break-even results. Sizeable reserves at year-end are largely a result of one-time sale of property. A balanced budget for fiscal 2015 is projected.

STABLE TAX BASE: The rating incorporates the district's modestly growing and relatively diverse tax base.

ENROLLMENT TRENDS MIXED: Enrollment reached an all-time low at the start of fiscal 2014, but has since strengthened. Offsetting a portion of Fitch's credit concern is TSC's singular position to provide the programs and cost structure of a typical community college, which should be attractive to local students The district expects additional students in fiscal 2015 with its new early college high school program, which appears reasonable to Fitch. Fitch will continue to monitor the district's enrollment trends as a key credit factor.

BORDER ECONOMY: Unemployment remains high and exceeds state and national levels despite solid year-over-year employment growth. Income levels have grown rapidly, but remain well below average, which provides practical limitations to the district's tax and tuition-raising flexibility.

LONG-TERM LIABILITIES MODERATE: Overall debt levels are moderate. Property negotiations recently finalized with UT-Brownsville (UTB) afford TSC with some start-up and intermediate-term capital flexibility. Carrying costs are presently manageable and are expected to remain so over the near term, although Fitch notes they will rise along with TSC's evolution as an independent operating entity.

NO RATING DIFFERENTIAL: Fitch does not distinguish between the maintenance tax notes and limited tax ratings given the district's ample taxing margin.

RATING SENSITIVITIES

BALANCED, STABLE FINANCIAL OPERATIONS: The 'AA-' rating incorporates Fitch's expectation that the district will experience some additional operating and enrollment pressures as it develops as a stand-alone institution. The rating remains sensitive to shifts in fundamental credit characteristics, including the preservation of sound finances and reserves that provide important financial flexibility. However, the Stable Outlook reflects Fitch's expectation that material shifts are unlikely.

CREDIT PROFILE

TSC is a two-year comprehensive, open enrollment community college located on the Texas-Mexico border, which has operated jointly with UTB since 1991. The district is presently in the process of fully unwinding this long-term academic and operational partnership with UTB by 2015 after both parties decided to dissolve the partnership in 2011.

SOUND FINANCIAL POSITION

Financial performance in fiscal 2013 that remained tempered by the existing partnership cost structure with UT-Brownsville (UTB) resulted in solidly positive operations, comparable to the prior year. A positive 11% operating margin was recorded despite some increase to TSC staffing levels. This was largely due to the district realizing further, significant reduction in its operating costs from to the unwinding of the partnership. Through the partnership, UTB provided all academic and support services for both institutions while the district compensated UTB with financial support and facilities. Total expenses declined about 24% on a year-over-year basis. Contract payments to UTB constituted almost 65% of total expenses in fiscal 2013, which was down from 78% the prior year. Available funds to expenses rose to 43% in fiscal 2013, nearly double the prior year's 24%. This positive performance was despite the year's large student loss recorded due in part to the sharpened identification of each institution's respective student body for future funding purposes as TSC neared independent operations. Enrollment attributed to TSC fell by a large 43% to about 3,180 full-time student equivalents (FTSE), down from roughly 5,570 the prior year.

The district also realized a shift in its key revenue streams in fiscal 2013 as net tuition revenue declined as the primary revenue source and provided a nearly equal contribution at 34% with property tax revenue. Year-over-year revenue trends also fell by 23%, comparable to the aforementioned expenditure decline. Fitch would expect to see the district's key revenue streams (property tax, tuition/fee, and state funding) evolve somewhat further as a result of reporting independent operations beginning in fiscal 2014. TSC's previous partnership agreement required maintaining tuition in line with UTB; the district implemented a 1/3 reduction in its cost of full-time tuition/fees with the start of its ability to set tuition/fees independently in the fall 2013 semester (fiscal 2014).

TSC's revenue stream will also favorably capture some additional revenue diversity in the near term with federal, non-operating revenues (largely Pell Grant) received for low-income students that is currently recorded by UTB. Fitch expects much of TSC's student population will qualify for the Pell Grant as most receive some form of financial aid, comparable to many other Texas community colleges. However, this may create some susceptibility over time to shifts in the level of federal support for this discretionary program and the possibility of reduced student eligibility that could influence future enrollment trends. The Pell Grant program was exempt from automatic, across-the-board, sequestration cuts for fiscal 2014, but the program is not protected in subsequent years.

BALANCED RESULTS PROJECTED; STOUT RESERVES MAINTAINED

The primary operating budget of $30.4 million was adopted as balanced for fiscal 2014, supported by the key revenues streams of property taxes ($10.7 million), tuition and fees ($9.2 million), and state funding ($7.7 million). Year-to-date tuition and fee revenues are reportedly about 5% below budget based on enrollment trends, although management anticipates associated budgetary expenditure savings and increased property tax collections will sufficiently offset to realize break-even results at fiscal 2014 year-end.

Enrollment is assumed by management to have reached its lowest point; FTSE totaled 2,632 in the fall of 2013 or about 17% less what was recorded the prior year. Fitch however does take comfort that importantly, the district realized immediate growth in student headcount of about 585 or nearly 16% growth the next semester, which is in contrast to typical fall-spring semester enrollment cycles.

The property agreement between UTB and TSC was finalized in mid-fiscal 2014. It resulted in a large one-time pay-out of approximately $29 million to TSC for the sale of properties and various facilities and is a significant portion of the $38 million in unrestricted reserves projected by fiscal 2014 year-end (about 75% of total fiscal 2014 budgeted spending). Fitch believes this stout reserve cushion provides important cash flow flexibility given the likelihood of near-term operating and enrollment pressures.

The preliminary fiscal 2015 budget is under consideration. Management indicates a balanced budget is to be presented to the board and the operating tax rate (roughly $0.10 per $100 TAV in fiscal 2014) is expected to be adopted at a nominally stable tax rate, well below the locally-imposed operating tax cap of $0.35 per $100 AV. The district expects additional students from its new early college high school program in five local high schools that should boost state funding to TSC at a relatively modest cost.

TSC is presently accredited jointly with UTB and is pursuing accreditation as a separate institution given the unwinding of the partnership. District officials report both internal and external experts assisting TSC in this process as well as an established timeline with which to accomplish this objective. Fitch believes this plan appears reasonable and thus, does not expect accreditation to become a credit issue.

SOME CAPITAL FLEXIBILITY

The recently finalized property settlement between TSC and UTB addressed all of the shared campus facilities, land, and back rent owed by UTB to the district. The settlement also provides capital flexibility to the district. Some key facilities such as science labs, the library, and recreation center will be shared between the two institutions over the intermediate term with the greater portion of operating costs attributable to UTB given its larger enrollment base. TSC has entered into various two to four year lease options for UTB's use of certain facilities at a cost of approximately $2.4 million annually. TSC maintains some flexibility within the leases to readjust its portion of facility usage periodically if enrollment growth necessitates.

MODERATE LONG-TERM LIABILITIES

The district has no near-term new money debt plans given these property agreements and management believes it will have sufficient near-term facility capacity to accommodate further enrollment growth. UTB is proceeding with its plans to become part of a new UT institution that joins UTB and UT Pan American (UT Rio Grande Valley or UTRGV) into a unified academic university, which may open up additional facility capacity over the intermediate to longer term. UTRGV is expected to open in the fall of 2015 and management indicates branch campuses are expected to be maintained in Brownsville and Edinburg.

Overall debt levels are moderate at about $2,440 per capita and 4.4% of market value due to substantial issuance by the city of Brownsville and Brownsville ISD. Principal payout of the district's tax-supported debt is above average at 68% of principal retired within the next 10 years. Another $16.7 million in revenue bonds issued by TSC for previous facility needs are also outstanding (not rated by Fitch). Carrying costs for debt service (net of self-supporting debt) was manageable at 13.2% of total expenses in fiscal 2013.

The college participates in the state-administered Teachers Retirement System of Texas (TRS) for pension and other post-employment benefit (OPEB). TRS is a cost-sharing, multiple-employer plan in which the state has historically provided the bulk of the employer's annual pension contribution. The college's annual contribution to TRS is determined by state law as is the contribution for the state-run post-employment benefit healthcare plan.

TSC's direct pension costs have historically been negligible given the very minimal staffing necessitated by the partnership agreement. Fitch expects this liability to increase over the near term given the additional faculty and staffing required for independent operations, but remain moderate. This is despite legislative changes that balance more of the state's funding responsibility on Texas community colleges. The employer's pension contribution is now shared at 50% with the state as of the 2014-2015 biennium.

MODEST TAX BASE GROWTH IN BORDER ECONOMY

The taxing district encompasses approximately 530 acres in the eastern portion of Cameron County and includes all of the Brownsville, Los Fresnos and the Port Isabel Independent School Districts (ISD). Most students reside within the district. TAV gains have been modest at no more than 2% annually beginning in fiscal 2010. Management reports a slightly stronger 4% TAV gain is anticipated in fiscal 2015 based on preliminary values. Concentration among the top 10 taxpayers remains minimal.

The area economy is based on agriculture, fishing, manufacturing, trade and tourism, and has benefited from its trade links with Mexico. Cameron County population has realized ongoing expansion since 2000, growing at an average annual rate of 2%. Area demographic trends favor the district, characterized by a relatively young population base. County unemployment remains persistently high despite year-over-year decline, exceeding the state (5.3%) and U.S. levels (6.8%) at 8.8% in March 2014. Wealth levels remain low, comparable to other border communities, at roughly 40% below state and national averages, but have grown rapidly since 2007.

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In addition to the sources of information identified in Fitch's Tax-Supported Rating Criteria, this action was additionally informed by information from Creditscope, IHS Global Insight, and the Texas Municipal Advisory Council.

Applicable Criteria and Related Research:
--'Tax-Supported Rating Criteria' (Aug. 14, 2012);
--'U.S. Local Government Tax-Supported Rating Criteria' (Aug. 14, 2012).

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Additional Disclosure
Solicitation Status