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Fitch Rates Fort Bend ISD, TX's Series 2017 A & B ULT Rfdg Bonds 'AA+' Underlying / 'AAA' PSF

Fitch Ratings-Austin-05 April 2017: Fitch Ratings has assigned an 'AAA' rating to Fort Bend Independent School District, Texas' (ISD; the district) unlimited tax (ULT) bonds as follows:

--$52 million ULT refunding bonds, series 2017A (green bonds);
--$47 million ULT refunding bonds, series 2017B.

The 2017A and 2017B bonds are scheduled for negotiated sale April 12. Proceeds from the sale of the bonds will be used to refund the district's outstanding commercial paper and pay issuance costs.

The 'AAA' long-term rating on the bonds is based on a guaranty provided by the Texas Permanent School Fund (PSF), whose bond guaranty program is rated 'AAA' by Fitch. (For more information on the Texas PSF see 'Fitch Affirms Texas PSF Rating at 'AAA'; Outlook Stable,' dated Aug. 5, 2015).

Fitch also assigns an 'AA+' underlying rating to the series 2017A and 2017B ULT bonds.

The Rating Outlook is Stable.

SECURITY
The bonds are payable from an unlimited property tax (ad valorem) pledge levied against all taxable property within the district. The bonds are also insured as to principal and interest repayment from a guaranty provided by the PSF.

KEY RATING DRIVERS

The 'AA+' ULT and Issuer Default Rating (IDR) reflect the area's sound economic underpinnings, the district's solid expenditure control that assists in maintaining a strong and stable reserve cushion, and moderate fixed carrying costs that allow the district a high level of fundamental financial flexibility throughout the economic cycle. Fitch expects strong revenue performance to be maintained going forward. The long-term liability burden is projected to grow in conjunction with the area's capital needs, but remain moderate over the intermediate term.

Economic Resource Base

The district service area spans a large 170 square miles in northeastern Fort Bend County (GO bonds rated 'AA+' with a Stable Outlook), in a rapidly growing residential and commercial sector of the Houston metropolitan statistical area (MSA).

Revenue Framework: 'a' factor assessment
Revenues have historically kept pace with the U.S. economy, due in large part to rapid enrollment gains. Fitch expects this revenue trend will continue given solid enrollment growth is projected for the district, in line with the area's steady residential development. The state school funding framework, underpinned by Texas' robust credit profile (GOs rated 'AAA'/Stable Outlook), ensures comparable, state-wide per pupil funding levels despite varying local property wealth.

Expenditure Framework: 'aa' factor assessment
Operational spending growth is likely to remain in line with revenue gains given the district's spending profile. The district can adjust its staffing and class sizes in order to control key expenditure items without affecting its educational goals. Fitch expects the district's carrying costs will increase in conjunction with future debt required to fund enrollment-driven capital needs, but remain moderate.

Long-Term Liability Burden: 'aa' factor assessment
The overall long-term liability burden is estimated at a moderate 14.5% of personal income. Fitch believes additional capital needs resulting from the area's ongoing expansion will require future debt funding and likely drive steady growth in this metric, although Fitch expects it to remain moderate, supported by continued growth in personal income.

Operating Performance: 'aaa' factor assessment
Preservation by the district of a strong and stable reserve cushion throughout the economic cycle is largely due to its sound expenditure flexibility. Fitch's 'aaa' assessment of financial resilience is based on the expectations that reserves will remain sufficient to offset expected modest revenue volatility in an economic downturn.

RATING SENSITIVITIES
Maintenance of Financial Flexibility: The rating is sensitive to material changes in the district's solid financial flexibility, which Fitch expects it to maintain throughout the economic cycle.

CREDIT PROFILE

The district's service area is about 70% developed and its tax base is predominately residential and diverse. Wealth levels are above average. Enrollment and taxable assessed value (TAV) growth moderated during the recession, but both ramped up with improvement in the economy. Large, master-planned residential developments and attendant commercial projects throughout the county continue to fuel TAV and population gains. Strong TAV gains since fiscal 2012 have outpaced a trend of 2% annual enrollment growth. TAV expanded by an additional 12% in fiscal 2017, due in part to rising reappraisals. Housing trends that drive district enrollment remain strong according to management and similar TAV growth is again anticipated for fiscal 2018. Nonetheless, Fitch believes TAV maintains some sensitivity to an overvalued housing market (for more information, see U.S. RMBS Sustainable Home Price Report, Fourth Quarter 2016 update, dated April 3, 2017, available on Fitch's website at www.fitchratings.com).

Major employment sectors include engineering, oil services and exploration, education, manufacturing, and healthcare. Easy access to Houston's employment base and the county's own growing economy has helped mitigate much of the impact of the energy sector contraction. County unemployment is up year-over-year, slightly above the state and U.S.

Revenue Framework
Funding for public schools in Texas is provided by a combination of local (property tax), state and federal resources. Property taxes provide slightly over half of the district's operating revenue, and state aid slightly under half. The state budgets the majority of instructional activity through the Foundation School Program (FSP), which uses a statutory formula to apportion school funding taking into account each district's property tax wealth and projected enrollment, district and student characteristics, and amounts appropriated by the legislature in the biennial budget process. The combination of local and state funding for operations meet a predetermined per pupil amount. Third-party funding support for operations stems from the long-standing commitment of the state to fund K-12 education. This revenue stream remains susceptible to changes in local enrollment trends and recessionary pressures on state revenues.

Revenue growth is primarily a function of enrollment. The district is the seventh largest school district in the state based on enrollment, which is estimated at about 74,000 students in fiscal 2017.

Fort Bend ISD's average annual revenue gains have been strong at 3.8% over the past 10 years ending in fiscal 2016, keeping pace with U.S. GDP and exceeding inflation. Fitch expects future general fund revenue performance will reflect continued, robust growth trends given expectations of steady enrollment gains and further, periodic increases to per pupil funding levels in the state's school finance system.

The district's tax rate for operations is at the legal limit of $1.04 per $100 TAV. The district has independent control over only a very small portion of its operating revenues. Per state statute, the district cannot increase its operating property tax levy further unless it receives voter approval. Management indicates the district expects to pursue a $0.02 per $100 TAV increase to its operating tax rate in a November 2017 tax ratification election, which should be accompanied by at least a comparable decrease in the debt service tax rate.

Expenditure Framework

Instruction is the district's largest spending obligation at about 65% of operational spending in fiscal 2016. Individual, one-year employment contracts for the majority of the workforce and the ability to exceed mandated class sizes for certain grade levels in times of fiscal stress allow the district sound expenditure flexibility. This is tempered by the district's need to maintain a competitive salary structure in the large and accessible Houston MSA employment base to recruit and retain highly educated professionals.

Fitch expects the district's natural spending pace will remain equal to or slightly exceed revenue gains based on its current expenditure trends and the enrollment-based state funding formula.

The district's carrying costs are moderate at about 13% of fiscal 2016 governmental spending. Fitch expects these fixed costs will slowly rise going forward as a result of current and future debt plans, but remain moderate based on growth in the district's operations and debt service as well as low retiree costs that reflect primary state funding of this expense.

Financial exigency, a Texas Education Agency prerequisite for terminating contracted employees, was proactively declared by the district in fiscal 2010 and 2011 in order to address recessionary state funding cuts. This special status allowed the district to eliminate nearly 500 positions in order to close a $22 million budget gap.

Long-Term Liability Burden

The district's long-term liability burden is driven predominately by overlapping debt levels that are a result of ongoing, rapid population expansion and funding of the resulting capital needs. The district's pension liability is modest as the state pays the majority of the district's employer pension costs. The liability burden is moderate at an estimated 14.5% of 2015 personal income, and Fitch expects it will remain in this range over the intermediate term as future growth in liabilities should stay aligned to a likely continuation of robust population gains and increased income levels.

The district maintains its debt service tax rate at $0.30 per $100 TAV, preserving healthy flexibility below the state-imposed $0.50 per $100 TAV cap for new money issuance in the event of future TAV stagnation or decline.

Voters strongly approved a $484 million ULTGO bond authorization in 2014 to fund the first phase of the district's prioritized capital needs after a facilities master plan identified the need for 11 new schools and facility improvements, estimated to cost roughly $818 million.

The district presently maintains about $348 million in bonding capacity from its 2007 and 2014 authorizations, and expects to continue its phased approach in using the authorization over the next few years in order to limit tax rate impact. The district is considering approaching voters for its next ULTGO bond authorization in 2018.

Pension and other post-employment benefit (OPEB) liabilities (largely healthcare benefits) are limited because of the district's participation in the state pension program administered by the Teachers Retirement System of Texas (TRS). TRS is a cost-sharing, multiple-employer plan for which the state provides the bulk of the employer's annual pension contribution. Recent reforms have lowered benefits and increased statutory contributions in order to improve plan sustainability over time.

Under GASB 67 and 68, the district reports its share of the TRS net pension liability (NPL) at $141.6 million in fiscal 2016, with fiduciary assets covering approximately 78% of total pension liabilities at the plan's 8% investment rate (approximately $214 million, or 71% based on a more conservative 7% investment rate assumption). The NPL adjusted for a 7% interest rate assumption remains small at roughly 1% of personal income. The district also provides OPEB through the state-run, post-employment benefit healthcare plan.

Participants' required pension contributions are based on a statutory formula that consistently falls short of the actuarially-determined amount. Fitch therefore expects there will be modest growth in the NPF even if investment returns meet assumed rates, although not outside of expectations for the 'aa' long-term liability burden assessment given how small the pension liability is relative to overall debt.

Operating Performance

Fitch judges the district's financial resilience in a moderate economic decline scenario to be consistent with an 'aaa' assessment. Fitch expects the district would use its strong gap-closing capacity to preserve a high level of financial flexibility through the economic cycle. Historically modest revenue volatility also contributes to the district's superior financial resilience.

Fitch believes management presently maintains prudent guidelines and caps for its debt management tools. The district keeps a moderate amount of its debt portfolio in variable-rate unlimited tax bonds, at no more than 25% of the total outstanding and authorized debt, the district's policy limit.

District finances have historically been strong and stable. Formal adopted fiscal policies include maintaining 25% or 90 days of the next year's operational spending in unrestricted general fund reserves, adopting balanced budgets, and limiting the use of fund balance reserves for non-recurring expenditures. Fitch's expectation that the district will continue to adhere to these policies is reinforced by recent financial performance and conservative budgeting. The district closed fiscal 2016 with unrestricted general fund reserves at nearly $181 million or 31% of spending. Higher than budgeted enrollment to date in fiscal 2017 supports management's expectation of break-even operations at year-end.

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Additional information is available on www.fitchratings.com

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis and InvestorTools.

Applicable Criteria
U.S. Tax-Supported Rating Criteria (pub. 18 Apr 2016) (https://www.fitchratings.com /site/re/879478)

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