Fort Bend Independent School District, Texas

New Issue Report

Ratings

Long-Term Issuer Default Rating	AA+

New Issue[a]

$60,000,000 Unlimited Tax School Building Bonds, Taxable Series 2018	AAA

Outstanding Debt

Unlimited Tax Bonds	AA+

[a]The 'AAA' rating is based on a guaranty provided by the Texas Permanent School Fund, which carries an insurer strength rating of 'AAA' from Fitch Ratings. The bonds' underlying rating, which reflects their credit quality before consideration of the guaranty, is 'AA+'.

Rating Outlook

Stable

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New Issue Summary

Sale Date: July 31 via negotiated sale.

Series: $60,000,000 Unlimited Tax (ULT) School Building Bonds, Taxable Series 2018.

Purpose: To purchase land, construct, and equip a career and technical education (CTE) center for the district, as well as to pay issuance costs.

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.

Analytical Conclusion

The 'AA+' IDR and ULT rating reflect the district's solid expenditure control, including moderate fixed carrying costs, which assists in maintaining the highest 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).

Key Rating Drivers

Revenue Framework: 'a'
Revenue gains have historically exceeded U.S GDP trends, due in large part to rapid enrollment growth. Fitch expects this trend will continue given solid projected enrollment growth, in line with the area's steady residential development. The district's legal ability to raise revenues is limited.

Expenditure Framework: 'aa'
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'
The long-term liability burden is estimated at 17% of 2016 resident personal income. Fitch expects additional capital needs stemming from the area's ongoing expansion will require future debt funding, but the liability burden should remain moderate, supported by continued growth in personal income.

Operating Performance: 'aaa'
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 expectation that reserves will remain sufficient to offset expected modest revenue volatility in an economic downturn.

Rating History (IDR and ULT)

Rating	Action	Outlook/ Watch	Date
AA+	Affirmed	Stable	7/25/18
AA+	Affirmed	Stable	4/23/18
AA+	Affirmed	Stable	9/7/17
AA+	Affirmed	Stable	7/8/13
AA+	Revised	Stable	4/30/10
AA	Affirmed	Stable	1/20/04
AA	Upgraded	Stable	10/30/00
AA-	Assigned	—	7/01/99

Rating Sensitivities

Increasing Long-term Liability Burden: The combined debt and pension burden of the district has been trending higher and is approaching 20% of personal income. While not currently expected, further increases in the components of this key driver that push the metric much beyond 20% would produce an overall credit profile inconsistent with the current rating and could lead to negative rating action.

Credit Profile

The district's service area is about 70% developed and its tax base is predominately residential. Wealth levels are above average. Enrollment and 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 about 2% annual enrollment growth. TAV expanded by a somewhat less rapid 6% in fiscal 2018, reaching nearly $38 billion. 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 recent energy sector contraction.

The Houston metropolitan area, including Fort Bend County, experienced widespread, massive flooding during Hurricane Harvey in late August 2017. Post-Harvey, management reports about 3,000 homes in the district were materially impacted by the storm with rebuilding currently underway throughout the county. Given the district's estimated 2016 population of roughly 442,000, the affected homes represent a relatively small percentage of districtwide housing stock. A recent tax base reappraisal requested by the district is expected to result in some modest TAV loss for fiscal 2018 (about $97 million or less than 1% of fiscal 2018 TAV) and a manageable $1.3 million reduction to the district's property taxes. Management conservatively anticipates more subdued TAV growth in fiscal 2019 at 3%.

Revenue Framework

Funding for public schools in Texas is provided by a combination of local (property tax), state and federal resources. Property taxes provided about 60% of the district's operating revenue in fiscal 2017, followed by state aid at 38%. The state budgets the majority of instructional activity through the Foundation School Program (FSP), which uses a statutory formula to allocate school aid taking into account each district's property taxes, projected enrollment, and amounts appropriated by the legislature in the biennial budget process. The Tier 1 component of the FSP provides districts a certain level of operational funding, and the basis for most Tier 1 allotments is called the basic allotment. The basic allotment is a per pupil dollar amount that multiplied by average daily attendance (and adjusted for specific district and student characteristics) produces a district's Tier 1 allotment.

Revenue growth is largely a function of enrollment. The district is the seventh largest school district in the state based on enrollment, which is estimated at about 76,000 students as of April 2018, slightly above the fiscal 2018 budget.

Fort Bend ISD's average annual revenue gains have been strong at 3.3% over the past 10 years ending in fiscal 2017, exceeding both U.S GDP and inflation. Fitch anticipates general fund revenue performance will maintain a continued trend of robust growth given the likelihood of steady enrollment gains over time. Expected, periodic increases to per pupil funding levels in the state's school finance system will contribute to this trend.

Related Research

Fitch Rates Fort Bend ISD (TX) Taxable Ser 2018 ULT Sch Bldg Bonds 'AA+' Underlying / 'AAA' PSF (July 2018)

Fitch Rates Fort Bend County, TX $59.2MM ULT Bonds 'AA+'; Outlook Stable (Jan. 2018)

Related Criteria

U.S. Public Finance Tax-Supported Rating Criteria (April 2018)

The adopted fiscal 2018 tax rate for operations is $1.06 per $100 TAV. The district has independent control over only a very small portion of its operating revenues, and must seek voter approval per state statute in order to further increase its operating tax rate. However, this limitation as a factor in the revenue framework assessment is somewhat offset by the recognition of K-12 education as fundamentally a state responsibility and the strong foundation of state support for education funding.

Expenditure Framework

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. Instruction is the district's largest spending obligation at about 64% of operational spending in fiscal 2017. 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 advantage is tempered by the district's need to maintain a competitive salary structure in the large Houston MSA employment base to recruit and retain highly educated professionals.

The district's carrying costs are moderate at about 12% of fiscal 2017 governmental spending. Fitch expects these fixed costs will slowly climb going forward as a result of current and future debt plans, but remain moderate based on commensurate growth in the district's total expenses as well as low retiree benefit costs that reflect state funding of the majority of this expense.

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 area 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 17% of 2016 resident personal income, and Fitch expects it will remain in this range over the intermediate term as future growth in liabilities should stay aligned with a likely continuation of robust population gains and increased income levels.

The district's debt service tax rate of $0.26 per $100 TAV in fiscal 2018 preserves healthy flexibility below the state-imposed $0.50 per $100 TAV cap for new money issuance. The district presently maintains about $33 million in bonding capacity from its 2007 and 2014 authorizations, and expects to continue a phased borrowing approach to limit tax rate impact. The district may approach voters for its next ULTGO bond authorization in November 2018 in order to fund prioritized capital needs that are expected to provide sufficient facility capacity over the next three to four years.

The district participates in the Texas Teachers Retirement System (TRS), a cost-sharing multiple-employer pension system. Under GASB 67 and 68 reporting, TRS's assets covered 78% of liabilities as of fiscal 2017, a ratio that falls to a Fitch-estimated 62% using a more conservative 6% investment return assumption. The state assumes the majority of TRS employer contributions and net pension liability on behalf of school districts, except for small amounts that state statute requires districts to assume. The proportionate share of the system's net pension liability paid by the district is less than 1% of personal income.

Operating Performance

Fitch judges the district's financial resilience in a moderate economic decline scenario to be consistent with an 'aaa' assessment. For details, see Scenario Analysis, page 5.

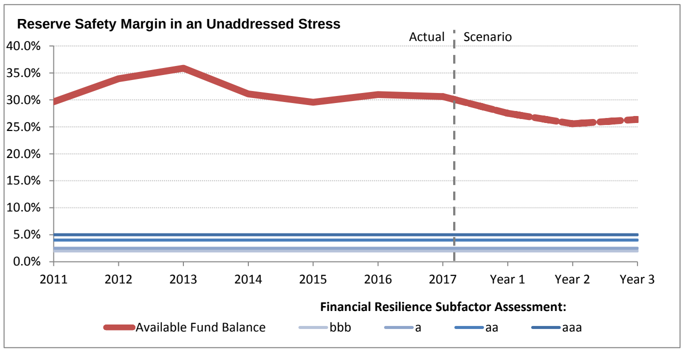
District finances have historically been strong and stable. Formal adopted fiscal policies include maintaining 25% or 90 days of the next year's operational spending in unrestricted general fund reserves and limiting the use of fund balance reserves for non-recurring expenditures. Fitch's expectation that the district will continue to adhere to these policies is reinforced by recent financial performance and conservative budgeting.

The district closed fiscal 2017 with unrestricted general fund reserves at $182.3 million or roughly 31% of spending. Management anticipates a slim operating surplus at fiscal 2018 year-end that improves upon a similarly-sized deficit budgeted, due in large part to the timing of one-time revenues received and expenditures recorded in the fiscal year related to post-Harvey recovery. The proposed fiscal 2019 $635 million general operating budget incorporates a modest use of fund balance (about $6 million or 1% of spending), although Fitch expects the district will likely again modestly outperform budget-based historical fiscal performance.

Fort Bend Independent School District (TX)

Scenario Analysis

v. 2.0 2017/03/24



Analyst Interpretation of Scenario Results:

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 solid expenditure flexibility and a portion of its ample reserve cushion to preserve a high level of financial flexibility through a typical economic cycle. Modest historical revenue volatility also contributes to the district's highest level of financial resilience.

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 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.

Scenario Parameters:	Year 1	Year 2	Year 3
GDP Assumption (% Change)	(1.0%)	0.5%	2.0%
Expenditure Assumption (% Change)	2.0%	2.0%	2.0%
Revenue Output (% Change)	(1.0%)	3.1%	4.8%
Inherent Budget Flexibility	Midrange		

Revenues, Expenditures, and Fund Balance	Actuals							Scenario Output		
	2011	2012	2013	2014	2015	2016	2017	Year 1	Year 2	Year 3
Total Revenues	469,192	467,172	486,864	536,078	557,846	594,531	596,914	590,945	609,465	638,725
% Change in Revenues	-	(0.4%)	4.2%	10.1%	4.1%	6.6%	0.4%	(1.0%)	3.1%	4.8%
Total Expenditures	460,201	451,194	470,560	507,017	559,652	576,388	595,008	606,908	619,047	631,428
% Change in Expenditures	-	(2.0%)	4.3%	7.7%	10.4%	3.0%	3.2%	2.0%	2.0%	2.0%
Transfers In and Other Sources	116	339	104	147	1,610	1,131	1,619	1,603	1,653	1,733
Transfers Out and Other Uses	-	-	-	29,235	-	7,045	733	747	762	778
Net Transfers	116	339	104	(29,088)	1,610	(5,914)	887	856	891	955
Bond Proceeds and Other One-Time Uses	-	-	-	-	-	-	-	-	-	-
Net Operating Surplus(+)/Deficit(-) After Transfers	9,107	16,317	16,408	(27)	(196)	12,228	2,792	(15,108)	(8,691)	8,253
Net Operating Surplus(+)/Deficit(-) (% of Expend. and Transfers Out)	2.0%	3.6%	3.5%	(0.0%)	(0.0%)	2.1%	0.5%	(2.5%)	(1.4%)	1.3%
Unrestricted/Unreserved Fund Balance (General Fund)	136,542	153,034	168,804	166,810	165,395	180,722	182,292	167,184	158,493	166,746
Other Available Funds (Analyst Input)	-	-	-	-	-	-	-	-	-	-
Combined Available Funds Balance (GF + Analyst Input)	136,542	153,034	168,804	166,810	165,395	180,722	182,292	167,184	158,493	166,746
Combined Available Fund Bal. (% of Expend. and Transfers Out)	29.7%	33.9%	35.9%	31.1%	29.6%	31.0%	30.6%	27.5%	25.6%	26.4%

Reserve Safety Margins	Inherent Budget Flexibility				
	Minimal	Limited	Midrange	High	Superior
Reserve Safety Margin (aaa)	16.0%	8.0%	5.0%	3.0%	2.0%
Reserve Safety Margin (aa)	12.0%	6.0%	4.0%	2.5%	2.0%
Reserve Safety Margin (a)	8.0%	4.0%	2.5%	2.0%	2.0%
Reserve Safety Margin (bbb)	3.0%	2.0%	2.0%	2.0%	2.0%

Notes: Scenario analysis represents an unaddressed stress on issuer finances. Fitch's downturn scenario assumes a -1.0% GDP decline in the first year, followed by 0.5% and 2.0% GDP growth in Years 2 and 3, respectively. Expenditures are assumed to grow at a 2.0% rate of inflation. Inherent budget flexibility is the analyst's assessment of the issuer's ability to deal with fiscal stress through tax and spending policy choices, and determines the multiples used to calculate the reserve safety margin. For further details, please see Fitch's US Tax-Supported Rating Criteria.

The ratings above were solicited and assigned or maintained at the request of the rated entity/Issuer or a related third party. Any exceptions follow below.