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Ratings

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Summary:

Fort Bend Independent School District, Texas; CP; General Obligation; School State Program

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Credit Profile		
US$60.0 mil unltd tax sch bldg bnds (Taxable) ser 2018 dtd 07/15/2018 due 08/15/2048		
Long Term Rating	AAA/Stable	New
Underlying Rating for Credit Program	AA+/Stable	New

Rationale

S&P Global Ratings assigned its 'AAA' long-term program rating and 'AA+' underlying rating to Fort Bend Independent School District, Texas' series 2018 unlimited-tax school building bonds. At the same time, S&P Global Ratings affirmed its 'AA+' long-term rating and underlying rating on the district's existing general obligation (GO) debt and its 'A-1+' rating on the district's commercial paper (CP) notes outstanding. The outlook, where applicable, is stable.

Revenue from an unlimited ad valorem tax levied on all taxable property in the district secures the bonds as well as the district's GO debt and CP notes outstanding. Official are using proceeds to provide funding for the construction of a career and technical center.

The program rating reflects our assessment of the district's qualification for, and the guarantee provided by, the Texas Permanent School Fund (PSF) bond guarantee program. The program provides the security of a permanent fund of assets the district could use to meet debt service on bonds guaranteed by the program. (For more information, please see our report published Jun. 8, 2018, on RatingsDirect.)

The underlying rating reflects our opinion of the district's:

- Access to the Houston metropolitan statistical area's (MSA) deep and diverse economy, resulting in ongoing economic growth;
- Strong to very strong income and extremely strong wealth levels; and
- Very strong finances.

Partly offsetting the above strengths, in our view, is the district's high overall net debt burden on a per capita basis, with future debt-supported capital needs.

Economy

Fort Bend Independent School District serves an estimated population of 426,939. In our opinion, median household effective buying income (EBI) is very strong at 154% of the national level, but per capita EBI is strong at 128%. The district's total $37.6 billion market value in 2018 is very strong, in our view, at $88,108 per capita. Net taxable assessed value (AV) grew by a total of 17.9% since 2016 to $37.6 billion in 2018. Roughly 2.2% of net taxable AV comes from the 10 largest taxpayers, representing a very diverse tax base in our opinion.

The district, one of the largest in the state, is located just southwest of Houston, with boundaries that encompass Sugar Land, Missouri City, Arcola, Meadows Place, and parts of Houston. The area served by the district is primarily residential, with employment opportunities available to residents locally and throughout the Houston MSA. Officials report that development throughout the district is continuing, with residential growth expected to result in sustained, though more modest, taxable value growth, largely as a result of Hurricane Harvey.

Hurricane Harvey, which made landfall southwest of the district on Aug. 25, 2017, led to historic levels of rainfall and widespread flooding throughout the Houston area, resulting in a two-week interruption of the district's school year. Following the storm, the district requested a disaster reappraisal for tax year 2017 (fiscal 2018). Officials report that nearly 3,000 properties submitted claims for the reappraisal process, accounting for a $97 million decline in AV for fiscal 2018. Despite the loss in taxable values related to the storm damage, officials report that preliminary AV for fiscal 2019 shows a 4.3% increase to $39.3 billion. While the 4.3% growth rate is more modest than those in prior years, officials report that new construction throughout the Houston area has slowed as existing properties damaged by the storm are repaired. We believe that the district will continue to experience tax base growth over the next two years, though likely at a more moderate level than that experienced prior to Hurricane Harvey.

Finances

A wealth equalization formula, based on property values and average daily attendance (property wealth per student), determines state funding for all school districts. Therefore, increases or decreases in average daily attendance (enrollment) can lead to corresponding movements in the amount of state revenue a district receives. In 2018, enrollment came in at 75,808 students.

District enrollment has grown by an average annual rate of 1.7% from 2014 to 2018; however, management is conservatively projecting annual enrollment growth of approximately 1% for the next three years (through fiscal 2021). Officials report that Hurricane Harvey had no appreciable impact on enrollment for fiscal 2018, with actual enrollment coming in better than budgeted. However, one campus--Juan Seguin Elementary--remains closed as a result of damage from Harvey, but it is projected to reopen for the fiscal 2019 school year. Operating 75 campuses, the district continues to build additional facilities to accommodate sustained enrollment growth. The district has committed to building new campuses to promote environment sustainability and is seeking Leadership in Energy and Environmental Design certification for new campuses being constructed.

The district's available fund balance of $175.9 million is very strong in our view, at 30% of general fund expenditures at fiscal year-end (June 30) 2017. The district reported a surplus operating result of 0.5% of expenditures in 2017. The district depends primarily on property taxes for general fund revenue (60.1%), followed by state aid (37.5%).

Our consideration of the district's available general fund balance includes fund balance committed for potential loss of state funding, totaling $49.4 million. In addition, the district maintains another $21.2 million in other discretionary available commitments.

For fiscal 2018, the district adopted a $12 million deficit budget, driven by a reduction in state aid combined with increased instructional costs. However, officials report that year-end results will likely reflect a general fund surplus. Included in the year-end estimates are revenue and expenditure impacts from Hurricane Harvey. The district expects to realize $10 million in estimated storm-related expenses, offset by $5.1 million in insurance reimbursements received during fiscal 2018. Although the district expects to receive additional insurance proceeds, as well as reimbursements from the Federal Emergency Management Agency (approximating $2.4 million), these reimbursements will not be realized until fiscal 2019 or later. On the revenue side, the $97 million in AV declines as part of the disaster reappraisal will result in an anticipated loss of $1.3 million in property tax collections. However, increased state funding in the form of both disaster-related grants and additional compensatory education funds will make up the loss in tax collections. Given the increased state funding and overall favorable budget-to-actual results, the district anticipates that the year will end with an operating surplus of up to $8 million.

The district's adopted budget for fiscal 2019 reflects an anticipated general fund reserve drawdown of nearly $6 million. Slower-than-historical AV growth, compounded by the disaster reappraisals, drove management to identify operating efficiencies and ways to limit expenditure growth. Despite the budgeted deficits, officials report that hurricane expenses will likely be relatively minimal, with any additional insurance proceeds, grants, or reimbursements offsetting the costs. Given historically positive budget-to-actual results, we believe that the district will maintain its very strong financial position despite the adopted fiscal 2019 budget.

Management

We consider the district's management practices good under our Financial Management Assessment (FMA) methodology, indicating our view that financial practices exist in most areas, but that governance officials might not formalize or monitor all of them on a regular basis.

Management bases revenue and expenditure assumptions on historical trend analysis and demographic projections provided by an external party. The district's formally adopted investment policy adheres to the Texas Public Funds Investment Act, and the district provides at least quarterly investment reports to the school board along with year-to-date budget-to-actual financial reports. The district has a formalized debt management policy that governs the issuance of various types of debt. It also has a formal reserve policy of maintaining reserves of at least 90 days' operating expenditures: two months in unassigned fund balance and one month in committed balance to protect against loss of state funding. The district's long-term capital and financial plans provide insight into its operations related to new facilities and funding levels.

Debt

We consider overall net debt moderately high at 9.4% of market value and high at $7,482 per capita. Amortization is average, with 52% of the district's direct debt scheduled to be retired within 10 years. Debt service carrying charges were 11.3% of total governmental fund expenditures excluding capital outlay in fiscal 2017, which we consider moderate.

Our estimates include accreted interest on capital appreciation bonds, which totaled about $5 million, according to 2017 audited figures. Following the current borrowing, the district will have approximately $33 million in authorized but unissued debt. Official's report that they will continue to use the CP program note proceeds to finance construction, with the remaining authorization being extinguished by the summer of 2019. The district reports that it will be approaching voters for additional authorization in November, 2018. While the district's capital plan identifies more than $1.7 billion in projects, officials report that the authorization request will be smaller, as the bond program would fund projects over a shorter time horizon. Despite the additional debt plans, we anticipate that the district's debt profile will not materially deteriorate, as we expect that debt will be issued as additional tax base growth allows.

The district has four series of variable-rate bonds outstanding. The series 2015A will be remarketed on Aug. 1, 2018, for a one-year term (expiring July 31, 2019) with an annual rate of 1.75% and a stepped rate of 7%. The 2015B bonds were remarketed on Aug. 1, 2017, for a two-year term with an annual rate of 1.35% and a stepped rate of 7%. A failed conversion or remarketing of either series does not constitute an event of default but would require the district to pay interest on the bonds at the higher, stepped rate, though there is no principal acceleration. The district's series 2017C and 2017D bonds are also variable-rate bonds. The series 2017C feature an initial rate period through July 31, 2020, and an initial rate of 1.35%, while the series 2017D have an initial rate period through July 31, 2021, at 1.5%. Both series contain similar provisions to the 2015A and 2015B, with a failed conversion or remarketing resulting in a stepped rate of 7%, with no principal acceleration. In our view, the small portion of variable-rate debt relative to the district's overall debt profile and available cash and reserves mitigates the risk of higher interest costs under a stepped rate associated with a failed remarketing on the variable-rate bonds. Approximately 16.1%, or about $167.8 million, of the district's total GO debt outstanding is variable rate. While the district may issue additional variable-rate debt in the future, officials will comply with their formal debt management policy, which limits variable-rate debt to 25% of total debt outstanding.

In November of 2016, the district, with the issuance of the series 2016A CP notes, authorized and entered into a CP program of up to $100 million in principal outstanding. The 'A-1+' rating on the CP notes is based on the strong underlying rating on the district, reflecting sufficient issuer liquidity to mitigate any potential acceleration, with over $293 million in cash and liquid investments (as of fiscal 2017) or $93 million in authorized but unissued GO debt that the district can use to take out the notes. A revolving credit agreement with JP Morgan Bank N.A., effective Nov. 3, 2016, and expiring Nov. 1, 2019, also provides liquidity support for the notes. The revolving credit agreement total commitment covers both principal and interest on the notes, up to $107.4 million, with an initial maximum interest rate of 10% per year for a period of 270 days. Under the terms of the revolving credit agreement, following an event of default, the revolving credit agreement provider could issue a notice instructing the dealer and issuing paying agent to cease further note issuance; otherwise, upon certain events of default, the revolving credit agreement provider could terminate its commitment under the agreement and declare any borrowed funds under the agreement immediately due and payable.

Pension and other postemployment benefit liabilities

The district paid its full required contribution of $12.5 million toward its pension obligations in fiscal 2017, or 1.3% of total governmental expenditures. The district also contributed $2.7 million, or 0.3% of total governmental expenditures, toward its other postemployment benefit (OPEB) obligations in fiscal 2017. Combined pension and OPEB carrying charges totaled 1.6% of total governmental fund expenditures in 2017.

The district participates in the Texas Teachers' Retirement System (TRS), a state-managed, cost-sharing, defined benefit multiemployer pension plan. Using updated reporting standards in accordance with Governmental Accounting Standards Board Statement Nos. 67 and 68, the district's net pension liability for fiscal 2017 (as of the August 2016 actuarial valuation) was $148.6 million. The plan maintained a funded level of 78.0%, using the plan's fiduciary net position as a percentage of the total pension liability. The district made its full required contribution, which is statutorily determined. The district also provides retiree health insurance through TRS-Care, a cost-sharing, multi-employer, defined benefit, postemployment health care plan administered by TRS. Given the low pension and OPEB carrying charges, largely attributed to the special funding situation whereby the state picks up the majority of annual benefit costs, we do not expect pension and OPEB expenses to pressure the district's finances.

Outlook

The stable outlook on the 'AAA' rating reflects our view of the strength of the Texas PSF guarantee, based on the fund's assets and performance.

The stable outlook on the underlying rating reflects our expectation that, given the district's location and participation within the Houston MSA, the expanding economy will allow for continued long-term growth in the tax base, which will provide management significant flexibility to implement its bond program without material changes to the district's debt ratios and reserves. Furthermore, despite near-term fiscal pressures attributed to Hurricane Harvey, we believe that the strong management team will allow the district to maintain its very strong financial position. Given the above, we do not expect to change the rating during our two-year outlook horizon.

Upside scenario

Although we are unlikely to do so, we could consider raising the underlying rating if the district were able to fully benefit from the tax base expansion, resulting in more locally sourced revenue and strong financial performance, combined with a significant moderation of debt metrics to levels commensurate with those of higher-rated peers.

Downside scenario

Should economic growth fall off, causing debt levels to rise or financial reserves to deteriorate significantly, we could lower the rating.

Ratings Detail (As Of July 26, 2018)		
Fort Bend Indpt Sch Dist var rate unltd tax sch bldg rmktd 8/1/2015 bnds ser 2015A dtd 07/15/2015 due 08/01/2040		
Long Term Rating	AAA/Stable	Rating Assigned
Underlying Rating for Credit Program	AA+/Stable	Rating Assigned
Fort Bend Indpt Sch Dist CP		
Short Term Rating	A-1+	Affirmed
Fort Bend Indpt Sch Dist GO		
Long Term Rating	AA+/Stable	Affirmed
Fort Bend Indpt Sch Dist PSF/CRS		
Long Term Rating	AAA/Stable	Current
Underlying Rating for Credit Program	AA+/Stable	Affirmed
Fort Bend Indpt Sch Dist PSF/CRS		
Long Term Rating	AAA/Stable	Current
Underlying Rating for Credit Program	AA+/Stable	Affirmed
Fort Bend Indpt Sch Dist PSF/CRS		
Long Term Rating	AAA/Stable	Current
Underlying Rating for Credit Program	AA+/Stable	Affirmed
Fort Bend Indpt Sch Dist PSF		

Ratings Detail (As Of July 26, 2018) (cont.)		
Underlying Rating for Credit Program	AA+/Stable	Affirmed
Long Term Rating	AAA/Stable	Current

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.