# FITCH RATES PEARLAND ISD, TX'S ULTS 'AAA' PSF/'AA' UNDERLYING; OUTLOOK STABLE

Fitch Ratings-Austin-08 February 2016: Fitch Ratings has assigned an 'AAA' rating to the following unlimited tax (ULT) bonds of Pearland Independent School District, Texas (the district):

--$43.1 million ULT refunding bonds series 2016.

The 'AAA' long-term rating on the bonds is based on a guarantee provided by the Texas Permanent School Fund (PSF), whose bond guarantee program is rated 'AAA' by Fitch. For additional information on the Texas PSF rating, please see Fitch's Aug. 5, 2015 press release, 'Fitch Affirms Texas Permanent School Fund at 'AAA'; Outlook Stable', available at 'www.fitchratings.com'.

The bonds are scheduled for sale Feb. 9 via negotiation. Proceeds will be used to refund a portion of the district's outstanding ULT bonds for debt service savings.

Fitch also assigns an underlying 'AA' rating to the series 2016 bonds and affirms its 'AA' underlying rating on $198.6 million of outstanding ULT debt.

The Rating Outlook is Stable.

SECURITY

The bonds are payable from an unlimited ad valorem tax levied against all taxable property within the district.

KEY RATING DRIVERS

SOUND FINANCIAL PERFORMANCE: Management's conservative budget practices typically result in positive operating performance. The district maintains sound liquidity and reserves.

DIVERSE REGIONAL ECONOMY: The district benefits from its close proximity to the strong and diverse Houston metropolitan statistical area (MSA). Wealth levels are above average and unemployment is low.

MATURING DISTRICT WITH STABLE GROWTH: Previously rapid population and enrollment growth have slowed as the district approaches build-out. Tax base gains have been steady.

WEAKER DEBT PROFILE: The debt profile is characterized by high overall debt and a moderate rate of amortization. High debt levels are offset somewhat by modest post-employment benefit liabilities.

RATING SENSITIVITIES

HIGH DEBT LEVELS: The rating is sensitive to maintenance of budgetary balance and solid reserve levels, which mitigate credit concerns over very high debt and capital pressures.

CREDIT PROFILE

Pearland ISD is located just south of Houston's outer loop, mostly in Brazoria County. The district experienced high population growth before 2010 which has moderated in recent years, resulting in a 2015 population of 106,745.

MANAGEMENT PRACTICES SUPPORT HEALTHY FINANCES

The district maintains a sound financial profile with general fund reserve levels in excess of its formal fund balance policy. The district's policy is to maintain reserves equivalent to three months (25%) of expenditures, which Fitch views as prudent.

Audited results for fiscal 2015 were essentially balanced in contrast to a budgeted $10.4 million operating deficit. Unrestricted general fund balance ended the year at a healthy $47.4 million, 31% of spending. Liquidity was strong at over three months of spending.

The fiscal 2016 budget was adopted with a drawdown of $8.3 million (5% of budgeted spending), inclusive of conservative revenue and expenditure assumptions. Positive year-to-date budget performance supports management projections that reserves will remain at the current healthy level.

The district plans to draw down general fund balance in fiscal 2017 by up to $5 million for facility construction. Fitch expects that the district will maintain reserves in compliance with its fund balance policy through conservative budget practices and sound financial management policies.

RESIDENTIAL COMMUNITY WITH ACCESS TO HOUSTON

The district is located in a rapidly growing residential and commercial area of the Houston MSA, with access to major transportation arteries and the nearby Houston medical complex. The City of Pearland (GO bonds rated 'AA' by Fitch with a Stable Outlook) is located partially within the district, and has experienced strong employment growth over the past decade. The city's unemployment rate of 3.6% for November 2015 is well below state and national rates. District wealth and educational attainment are notably high in comparison with the region, state, and nation.

TAV growth occurred at a compound annual rate of 3.4% over the past five fiscal years, holding stable through the recession. Near-term growth is expected to continue at a moderate pace, given strong regional reassessment trends and some commercial and residential construction underway. FloWorks International, an industrial pipe and fitting supplier, recently broke ground on its new office and distribution facility, and is poised to become the district's largest taxpayer. The top ten taxpayers currently comprise a low 4.3% of TAV.

The district's external demographer projects steady annual enrollment growth of 2% - 3% over the near term, with the district reaching build-out around 2023 - 2024.

ELEVATED DEBT RATIOS

The district's overall debt burden represents a high $5,825 per capita and 8.4% of market value, driven by overlapping city and municipal utility district (MUD) debt. Debt service comprised a moderate 10% of governmental spending in fiscal 2015 after factoring in state support for debt service. The amortization rate is moderate with 58% of debt retiring in 10 years.

Management anticipates seeking voter authorization as early as fall 2016 to add new classrooms. In the meantime, the district maintains facility flexibility in its ability to move portable classrooms and shift school attendance zones. The district's fiscal 2016 debt service tax rate of $0.376 per $100 of TAV maintains sufficient margin below the state's $0.50 statutory cap for new debt issuance.

The district participates in the Teacher Retirement System of Texas (TRS), a cost-sharing multiple employer plan. The state assumes the vast majority of Texas school districts' net pension liabilities and the corresponding employer contributions. However, like all Texas school districts, the district is vulnerable to future policy changes by the state as evidenced by a relatively modest 1.5% of salary contribution requirement effective fiscal year 2015. Legislative changes in 2013 increased the state's annual contributions, although it remains to be seen whether this improves TRS's ratio of assets to liabilities over time.

Under GASB 68, the district reports its share of the TRS net pension liability (NPL) at $16.3 million, with plan fiduciary assets covering 83.25% of total pension liabilities at the plan's 8% investment return rate assumption (approximately 75% based on a more conservative 7% rate assumption). The NPL represents approximately 0.3% of the district's fiscal 2015 market value. Carrying costs for the district (debt service, pension, OPEB costs, net of state support) totaled a moderate 13% of governmental fund spending in fiscal 2015, largely reflective of state support.

TEXAS SCHOOL DISTRICT LITIGATION

A Texas district judge ruled in August 2014 that the state's school finance system is unconstitutional. The ruling, which was in response to a consolidation of six lawsuits representing 75% of Texas school children and was the second such ruling in the past two years, found the system inefficient, inequitable, and underfunded. The judge also ruled that local school property taxes are effectively a statewide property tax due to lack of local discretion and therefore are unconstitutional.

The Texas attorney general has appealed the judge's latest ruling to the state supreme court. If the state school finance system is ultimately found unconstitutional, the legislature would likely follow with changes to the system to restore its constitutionality. Fitch would consider any changes that include additional funding for schools and more local discretion over tax rates to be a credit positive.

Contact:

Primary Analyst
Shane Sellstrom
Analyst
+1-512-215-3727
Fitch Ratings, Inc.
111 Congress Ave., Suite 2010
Austin, TX 78701

Secondary Analyst
Rebecca Moses
Director
+1-512-215-3739

Committee Chairperson
Amy Laskey
Managing Director
+1-212-908-0568

Media Relations: Elizabeth Fogerty, New York, Tel: +1 (212) 908 0526, Email: elizabeth.fogerty@fitchratings.com.

Additional information is available at 'www.fitchratings.com'.

Fitch recently published exposure drafts of state and local government tax-supported criteria (Exposure Draft: U.S. Tax-Supported Rating Criteria, dated Sept. 10, 2015 and Exposure Draft: Incorporating Enhanced Recovery Prospects into U.S. Local Tax-Supported Ratings). The drafts include a number of proposed revisions to existing criteria. If applied in the proposed form, Fitch estimates the revised criteria would result in changes to less than 10% of existing tax-supported ratings. Fitch expects that final criteria will be approved and published in the first quarter of 2016. Once approved, the criteria will be applied immediately to any new issue and surveillance rating review. Fitch anticipates the criteria to be applied to all ratings that fall under the criteria within a 12-month period from the final approval date.

In addition to the sources of information identified in the applicable criteria specified below, this action was informed by information from CreditScope, Lumesis, and the Municipal Advisory Council of Texas.

Applicable Criteria
Exposure Draft: Incorporating Enhanced Recovery Prospects into US Local Tax-Supported Ratings (pub. 02 Feb 2016)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=875108
Exposure Draft: U.S. Tax-Supported Rating Criteria (pub. 10 Sep 2015)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=869942
Tax-Supported Rating Criteria (pub. 14 Aug 2012)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=686015
U.S. Local Government Tax-Supported Rating Criteria (pub. 14 Aug 2012)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=685314