Pearland Independent School District's (TX)

New Issue: Moody’s assigns Aa2 underlying/ Aaa enhanced rating to Pearland ISD’s, TX $43.1M GO debt

Summary Rating Rationale
Moody’s Investors Service has assigned a Aa2 underlying rating to Pearland Independent School District’s (TX) $43.1 million Unlimited Tax Refunding Bonds, Series 2016. Concurrently, we have assigned a Aaa enhanced rating to the new series based on a guarantee from the Texas Permanent School Fund. Moody’s maintains the Aa2 rating and stable outlook on the district’s outstanding general obligation debt, which will total $305 million post-sale.

The Aa2 reflects the district’s well-managed financial operations which have resulted in healthy reserves and ample liquidity. The rating is also based on the continuing trend of growth in the district’s sizeable and diverse tax base, above average socioeconomic indices, and sustained enrollment growth. In addition, the rating incorporates somewhat elevated debt burden.

The Aaa enhanced rating is based on the rating of the PSF and the structure and legal protections of the transaction which provide for timely payment by the PSF if necessary. Moody’s currently rates the PSF Aaa. For additional information on the PSF, please see Moody’s rating update report dated June 23, 2015.

Credit Strengths
» Sizable tax base with continuing annual assessed valuation increases
» Conservative management contributing to operating surpluses and healthy reserves
» Above average socioeconomic profile
» Sustained enrollment growth

Credit Challenges
» High debt burden
» Education facilities face capacity issues

Rating Outlook
The stable outlook reflects our expectation that the district will continue to exhibit sound financial management and maintain a satisfactory General Fund reserve levels, despite budgeted use of reserves. The stable outlook also incorporates our expectation that despite
expected valuation growth, that the district’s debt burden will remain high over the medium term due to expressed needs for additional debt.

**Factors that Could Lead to an Upgrade**

- Trend of surplus operations resulting in stronger reserves
- Substantial growth in assessed valuation
- Moderation in debt burden

**Factors that Could Lead to a Downgrade**

- Significant erosion of reserve levels
- Substantial increases in debt burden without corresponding taxable value growth or coupled with a decline in taxable values
- Significant tax base contractions measure by assessed valuation declines

**Key Indicators**

| Source: Moody’s Investors Service |

<table>
<thead>
<tr>
<th>Exhibit 1</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>Economy/Tax Base</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Full Value ($000)</td>
<td>$5,568,475</td>
<td>$5,570,890</td>
<td>$5,613,572</td>
<td>$5,841,717</td>
<td>$6,168,441</td>
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<tr>
<td>Full Value Per Capita</td>
<td>$61,252</td>
<td>$59,347</td>
<td>$59,984</td>
<td>$60,139</td>
<td>$63,502</td>
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<tr>
<td>Median Family Income (% of US Median)</td>
<td>N/A</td>
<td>155.9%</td>
<td>155.9%</td>
<td>155.9%</td>
<td>155.9%</td>
</tr>
<tr>
<td>Finances</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Operating Revenue ($000)</td>
<td>$167,827</td>
<td>$147,859</td>
<td>$150,543</td>
<td>$169,506</td>
<td>$177,556</td>
</tr>
<tr>
<td>Fund Balance as a % of Revenues</td>
<td>20.3%</td>
<td>28.9%</td>
<td>35.6%</td>
<td>35.7%</td>
<td>35.2%</td>
</tr>
<tr>
<td>Cash Balance as a % of Revenues</td>
<td>27.7%</td>
<td>29.2%</td>
<td>32.9%</td>
<td>30.6%</td>
<td>30.1%</td>
</tr>
<tr>
<td>Debt/Pensions</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net Direct Debt ($000)</td>
<td>$318,326</td>
<td>$282,583</td>
<td>$249,831</td>
<td>$246,826</td>
<td>$267,992</td>
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<tr>
<td>Net Direct Debt / Operating Revenues (x)</td>
<td>1.9x</td>
<td>1.9x</td>
<td>1.7x</td>
<td>1.5x</td>
<td>1.5x</td>
</tr>
<tr>
<td>Net Direct Debt / Full Value (%)</td>
<td>5.7%</td>
<td>5.1%</td>
<td>4.5%</td>
<td>4.2%</td>
<td>4.3%</td>
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<tr>
<td>Moody’s - adjusted Net Pension Liability [3-yr average] to Revenues (x)</td>
<td>N/A</td>
<td>0.2x</td>
<td>0.2x</td>
<td>0.2x</td>
<td>0.3x</td>
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<tr>
<td>Moody’s - adjusted Net Pension Liability [3-yr average] to Full Value (%)</td>
<td>N/A</td>
<td>0.5%</td>
<td>0.5%</td>
<td>0.5%</td>
<td>0.7%</td>
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</table>

**Detailed Rating Considerations**

**Economy and Tax Base; Continued Growth Expected**

The district’s tax base will continue to experience modest growth over the medium term due to its available land for development, but the district anticipates to reach build-out by 2019. Pearland ISD, located approximately 20 miles south of the City of Houston (Aa2/negative), is primarily situated in Brazoria County (Aa1/NOO), with a portion spanning into Harris County (Aaa/stable). The City of Pearland (Aa2/stable) serves as a suburb of Houston. The district’s tax base is primarily residential, with some commercial and industrial presence. Double-digit annual economic expansion that the district experienced in the early 2000’s gave way to more modest growth beginning with the recession. Between the 2000 fiscal year and 2015 the tax base contracted only once by a nominal 0.4% in fiscal 2011, a result of damage from Hurricane Ike. Assessed values increased by 4.7% to $6.5 billion in fiscal 2016 from fiscal 2015. On average, assessed values grew 3% annually over the five-year period through fiscal 2016. The district’s tax base is diverse, with the

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top ten taxpayers accounting for only 4.3% of fiscal 2016 assessed valuation. The top ten taxpayers consist of oil field equipment
companies, multifamily apartment complexes, utility providers, and retail companies.

The district’s population has increased by a significant 61.6% to 93,154 in 2010 since the 2000 U.S. Census. Management estimates
2014 population at 97,137, equivalent to 4.3% growth since 2010. Per the 2013 American Community Survey, socioeconomic
indicators are well above national medians, with per capita income and median family income at 128.9% and 155.9% of the nation,
respectively. Enrollment levels continue to grow with an annual average increase of 2.7% to 21,137 students over the past five years
through fiscal 2016. Management expects enrollment trends to be in line with the estimated economic expansion and to continue at
a similar pace over the near term. A recently completed demographic study estimates enrollment to reach 23,087 in fiscal 2025. With
existing capacity of 23,274, we believe the district’s facilities may require additional capacity to serve the expected growth.

Financial Operations and Reserves; Healthy Reserve Position
The district will likely maintain healthy reserves in the future, despite the budgeted draws on General Fund balances. Historically, the
district’s finances have been balanced as a result of prudent budgeting practices and strong expenditure control.

Following five years of operating surpluses, the General Fund ended fiscal 2015 with an operating deficit of $106,000. The deficit was
attributable to mid-year budget revisions and appropriations related to technology upgrades across campuses and the purchase of
portable buildings due to increased enrollment. Despite the slight deficit the 2015 year-end results brought the General Fund available
balance to $47.4 million, a strong 35.2% of General Fund revenues, and above the board’s adopted policy of 3 months of expenditures
in reserve. Looking to fiscal 2016, the district budgeted a deficit of $8.2 million but reportedly due to increased revenues and below
expected expenditures management reports maintenance of current reserve levels. Budgeting a deficit and reporting positive end of
year results has been the trend for the past few years, although management has expressed intention to spend down fund balance on
capital expenditures. Given the district’s budgeting history, we expect that the district will be able to maintain its strong reserve levels
and that capital needs will be funded from realized annual surpluses.

The district levies a property tax of $10.40/$1000 of assessed value for maintenance and operations (O&M), which is below the
maximum levy of $11.70/$1000 that can be levied with voter approval. The district has no plans to increase their O&M levy. Fiscal
2015 General Fund revenues were largely derived from state aid (56.5%) and local property taxes (42.7%).

LIQUIDITY
At the end of fiscal 2015, the General Fund cash position was $39.2 million, which represented a healthy 25.9% of General Fund
revenues. Inclusive of the Debt Service Fund, the combined operating funds cash position was $53.5 million, representing 30.1% of the
operating funds revenue.

Debt and Pensions; Elevated Debt Burden
Despite projected assessed valuation growth, we expect the district’s direct debt burden to remain elevated given additional borrowing
plans. The district’s debt burden is elevated at 4.1% of 2016 assessed valuation and 1.5 times fiscal 2015 operating funds revenues,
which include the General Fund and the Debt Service Fund. These figures exclude a portion of debt service covered with state
aid revenues. State aid covered approximately 13.7% of debt service in fiscal 2015. Currently, the district has no additional bond
authorization though has expressed plans to approach voters in 2016 or 2017 for additional authority.

DEBT STRUCTURE
All of the district’s debt is fixed rate. Principal amortization is below average, with 53% retired within ten years.

DEBT-RELATED DERIVATIVES
Pearland ISD is not a party to any derivative agreements.

PENSIONS AND OPEB
Pearland ISD participates in the Teacher Retirement System of Texas (TRS), a multiple-employer plan administered by the state. We
determined Pearland ISD’s share of liability for the state-run TRS in proportion to its contributions to the plan. Moody’s three year
average adjusted net pension liability (ANPL) for the district (2012-2014), under current methodology for adjusting pension data, is
$44.8 million, or 0.25x of operating revenues.
Moody’s ANPL reflects certain adjustments we make to improve comparability of reported pension liabilities. The adjustments are not intended to replace the district’s reported liability information, but to improve comparability with other rated entities. For more information on Moody’s insights on employee pensions and the related credit impact on companies, governments and other entities across the globe, please visit Moody’s on Pensions at www.moodys.com/pensions.

**Management and Governance**

Texas school districts have an institutional framework score of “Aa,” or strong. Revenues, which are highly predictable, are determined by the state funding formula that takes into account local taxes and state aid. School districts maintain moderate revenue-raising flexibility. Although property tax rates (typically $10.40) are under the state-mandated cap of $11.70 per $1,000 of assessed value, districts are dependent on enrollment growth to drive additional revenue. Expenditures, which primarily consist of personnel and facility operational costs, are highly predictable. Districts have a moderate degree of flexibility to make cuts given the lack of unions within the state.

**Legal Security**

The bonds are secured by an annual ad valorem tax levied against all taxable property in the district without legal limitation as to rate or amount.

**Use of Proceeds**

Proceeds of the current sale will be used to refund certain maturities of the district’s outstanding debt for estimated net present value savings of 8%, with no extension of final maturity.

**Obligor Profile**

Pearland ISD is located in northeast Brazoria County (Aa1/NOO). The district is predominately residential and serves the City of Pearland (Aa2/STA), which is located 15 miles south of downtown Houston (Aa2/NEG). The population of the district as of 2014 was approximately 97,137. As of the 2015 school year, student enrollment was 21,137.

**Methodology**

The principal methodology used in the underlying rating was US Local Government General Obligation Debt published in January 2014. The principal methodology used in the enhanced rating was Rating Transactions Based on the Credit Substitution Approach: Letter of Credit-backed, Insured and Guaranteed Debts published in December 2015. Please see the Rating Methodologies page on www.moodys.com for a copy of these methodologies.

**Ratings**

<table>
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<th>Issue</th>
<th>Rating Type</th>
<th>Sale Amount</th>
<th>Expected Sale Date</th>
<th>Rating Description</th>
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<tr>
<td>Unlimited Tax Refunding Bonds, Series 2016</td>
<td>Underlying LT</td>
<td>$43,080,000</td>
<td>02/08/2016</td>
<td>General Obligation</td>
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<tr>
<td>Unlimited Tax Refunding Bonds, Series 2016</td>
<td>Enhanced LT</td>
<td>$43,080,000</td>
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<td>General Obligation</td>
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Source: Moody’s Investors Service
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