FITCH UPGRADES FRENSHIP ISD, TX'S ULT BONDS TO 'AA'; OUTLOOK STABLE

Fitch Ratings-Austin-08 August 2018: Fitch Ratings has upgraded the following Frenship Independent School District, TX ratings to 'AA' from 'AA-':

--Issuer Default Rating (IDR);
-- $92.4 million unlimited tax (ULT) refunding bonds, series 2014, 2015A, 2015B;
--$234.8 ULT school building bonds, series 2008, 2010, 2014, 2014A.

The Rating Outlook is Stable.

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

ANALYTICAL CONCLUSION

The upgrade of the IDR and ULT bond rating to 'AA' from 'AA-' reflects Fitch's refinement in assessing the district's overlapping debt and the resulting improvement in the long-term liability burden assessment. The 'AA' IDR also reflects the district's growing economic resource base, solid expenditure flexibility, expectations for steady revenue growth and exceptionally strong gap-closing capacity. Continued enrollment growth is expected to require voter authorization for debt-financed capital spending in the medium term, but commensurate growth in the resource base should keep the long-term liability burden in the moderate range.

Economic Resource Base
The district is located in Lubbock County, serving a 2016 population of approximately 46,000. The local economy is anchored by the health, telecommunications and retail industries.

KEY RATING DRIVERS

Revenue Framework: 'a'
Revenue growth has been strong, averaging at a level in excess of the national GDP for the 10 years through fiscal 2017. Future growth will likely track enrollment growth given the state funding framework, with the district's independent legal ability to raise revenues limited by state law.

Expenditure Framework: 'aa'
Spending growth is expected to trend in line with to marginally above revenue growth. The moderate fixed-cost burden for debt service and retiree benefits reflects state support for long-term liabilities.

Long-Term Liability Burden: 'aa'
Fitch expects the long-term liability burden to remain moderate, reflecting strong state support for retiree benefits. Despite anticipated growth-related debt needs over the medium term, Fitch expects growth in the resource base to keep pace.

Operating Performance: 'aaa'
The combination of the district's expenditure flexibility and healthy reserve levels leave it well positioned to address cyclical economic downturns.

RATING SENSITIVITIES

Maintenance of Financial Flexibility: The rating is sensitive to material changes in the district's solid expenditure flexibility and high reserve levels, which Fitch expects it to maintain throughout the economic cycle.

CREDIT PROFILE

The 128-square mile district is located immediately to the west and southwest of Lubbock (GO bonds rated 'AA+' by Fitch, Stable Outlook), a regional economic hub in west Texas. A portion of the district lies within Lubbock's city limits, which has an estimated population of approximately 252,000. Average daily attendance (ADA) of approximately 9,160 students in fiscal 2018 has increased by compound average annual growth rate (CAGR) of 3.8% for the 10-year period ending fiscal 2018. TAV gains have also been steady, growing by a CAGR of over 6% over the same period due to the continued expansion in housing and retail construction. District residents' per capita per income is slightly above the state average but below the national average. The district's unemployment rate is historically lower than both the state and national averages.

Revenue Framework

Funding for public schools in Texas is provided by a combination of local (property tax), state and federal resources. 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 circumstances) produces a district's Tier 1 allotment.

District revenues have grown at a compounded annual growth rate of 5.9% over the last decade, performing well above national CPI and U.S. GDP growth over the 10 years through fiscal 2017. Fitch expects the natural pace of district revenue growth in future years to remain in line with historical performance, given current enrollment trends and expectations for additional enrollment gains in future years.

The district's independent legal ability to raise revenues is limited, as voter authorization is required to increase the maintenance and operations (M&O) tax rate. Such authorization was secured to increase the M&O tax rate to $1.06 per $100 TAV from $1.04 beginning in fiscal 2018. Additional voter authorization is required to further increase the M&O tax rate up to the statutory limit of $1.17. The district levies a separate, unlimited interest and sinking fund (I&S) debt service tax rate of $0.43 per $100 TAV, below the attorney general's statutory cap of $0.50 per $100 TAV that cannot be exceeded for new debt issuances.

Expenditure Framework

The district spends the bulk of its budget on instruction, which is common for school districts. The district also funds some annual capital outlay from general fund revenues for maintenance and repairs on facilities.

Fitch expects the natural pace of spending growth to remain in line with or slightly above revenue growth given anticipated enrollment growth.

The district's solid expenditure flexibility reflects substantial control over workforce costs and moderate carrying costs for debt service, pension and other post-employment benefits (OPEB), at approximately 14% of fiscal 2017 governmental spending. Carrying costs benefit from state-wide support for the vast majority of school district pension and OPEB costs.

Long-Term Liability Burden

The district's long-term liability burden is moderate at approximately 15% of personal income and is comprised mostly of the district's slow-amortizing outstanding debt load and overlapping debt. The metric includes a refinement in assessing the district's overlapping debt burden. Specifically, the refinement involves the netting out of substantial self-supporting debt for the district's largest overlapping debt issuer - the City of Lubbock. Despite anticipated growth-related debt needs over the medium term, Fitch expects commensurate growth in the resource base will keep the liability burden within the moderate range.

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 2016, 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. Like all Texas school districts, the district is vulnerable to future policy changes that shift more of the contributions and liabilities onto districts, as evidenced by a relatively modest 1.5% of salary contribution requirement, effective in fiscal 2015. The proportionate share of the system's net pension liability paid by the district is minimal.

Operating Performance

The district maintained a strong financial cushion through the last economic downturn. General fund balances grew steadily over this period, with the unrestricted fund balance reaching nearly $27 million or nearly 39% of spending in fiscal 2017. Fitch believes the district would use a combination of its solid expenditure flexibility and strong reserves to maintain a satisfactory reserve safety margin in a moderate economic decline scenario.

The district has demonstrated a strong commitment to supporting financial flexibility. Budgeting is conservative and management has been proactive in maintaining operational balance throughout economic cycles. The fiscal 2018 budget is balanced, although the district typically outperforms its budgeted projections.

Contact:

Primary Analyst
Jose Acosta
Senior Director
+1-512-215-3726
Fitch Ratings, Inc.
111 Congress Avenue
Austin, TX 78701

Secondary Analyst
Brittany Pulley
Analyst
+1-512-215-3734

Committee Chairperson
Steve Murray
Senior Director
+1-512-215-3729

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.

Media Relations: Sandro Scenga, New York, Tel: +1 212 908 0278, Email: sandro.scenga@fitchratings.com.

Additional information is available on www.fitchratings.com

Applicable Criteria
U.S. Public Finance Tax-Supported Rating Criteria (pub. 03 Apr 2018)
https://www.fitchratings.com/site/re/10024656

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