

North East Independent School District, Texas

Unlimited Tax Bonds New Issue Report

Ratings

New Issue

Unlimited Tax Refunding Bonds,
Series 2016^a AAA

Outstanding Debt

Unlimited Tax Bonds AA+

^aBased on a guaranty provided by the Texas Permanent School Fund, whose insurer financial strength is rated 'AAA' by Fitch Ratings. The bonds' underlying rating, reflecting the credit quality before consideration of the guaranty, is 'AA+'.

Rating Outlook

Stable

Related Research

Fitch Rates North East ISD, TX ULTs 'AAA' PSF/'AA+' Underlying; Outlook Stable (March 2016)

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New Issue Details

Sale Information: \$35,535,000 Unlimited Tax Refunding Bonds, Series 2016, via negotiation the week of March 7.

Security: An unlimited ad valorem tax levied against all taxable property in the North East Independent School District (North East ISD, or the district). The bonds are secured further by the Texas Permanent School Fund guaranty.

Purpose: To refund outstanding obligations for savings.

Final Maturity: Aug. 1, 2020.

Key Rating Drivers

Sound Operating Performance: North East ISD has maintained reserve adequacy through the most recent recession and state funding cuts. Fitch Ratings anticipates the district will maintain structural balance and a healthy financial cushion based on strong expenditure flexibility.

Large, Diverse Area Economy: The San Antonio economy is broad and expanding, as evidenced by population and employment growth. Per capita wealth is above state and national averages.

Stable Economy and Demographic Profile: The district's position within the greater San Antonio economy promotes solid employment growth, low regional unemployment and a median household income above state and national averages.

Manageable Long-Term Liabilities: Fitch expects the district's debt to remain elevated based on new issuance plans. Moderate carrying costs for annual debt service, pension and other post-employment benefit (OPEB) contributions reflect state support for retiree benefit costs.

Rating Sensitivities

Strong Operating Performance: The rating is sensitive to the district's structural balance and sound reserves that mitigate state funding uncertainties.

Manageable Long-Term Liabilities: A material increase in long-term liabilities, although not expected, could pressure the current rating.

Rating History

Rating	Action	Outlook/ Watch	Date
AA+	Assigned	Stable	3/4/16

Credit Profile

North East ISD is one of the 10 largest school districts in Texas, with a fiscal 2016 enrollment of 67,780. The district serves an urban-suburban population of about 430,000 in north and northeast Bexar County, including portions of San Antonio. Fitch rates both Bexar County and San Antonio GO bonds 'AAA'/Stable.

Consistent Operating Performance, Healthy Reserves

North East ISD has maintained sound reserves throughout the most recent recession and the state funding cuts that occurred in the fiscal years 2012–2013 biennium. The district manages expenditures within each budget cycle based on available resources and retains adequate expenditure flexibility, primarily through staffing levels. The district's maintenance and operations tax rate of \$1.04 is at the statutory cap and can only be increased with voter approval; the district reports no immediate plans to approach voters for an increase in the rate.

The district completed fiscal 2015 with a nearly \$1 million operating surplus after transfers (0.2% of spending) and \$112.6 million of unrestricted reserves (22.1% of spending). Fitch anticipates a similar performance in fiscal 2016 based on year-to-date results.

General Fund Summary

(\$000, Audited Fiscal Years Ended Aug. 31)

	2011	2012	2013	2014	2015
Revenues	488,231	483,372	471,329	493,327	511,662
Expenditures	468,687	455,165	471,911	490,393	507,868
Operating Surplus/(Deficit)	19,544	28,207	(582)	2,934	3,794
Net Transfers	(1,758)	(1,134)	(2,294)	(2,693)	(2,813)
Net Surplus/(Deficit)	17,786	27,073	(2,876)	241	981
Total Fund Balance	89,681	116,754	113,879	114,119	115,100
As % of Expenditures and Transfers Out	19.1	25.6	24.0	23.1	22.5
Unrestricted Fund Balance	87,642	114,580	111,582	111,720	112,645
As % of Expenditures and Transfers Out	18.6	25.1	23.5	22.6	22.1

Note: Numbers may not add due to rounding.

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, dated Feb. 2, 2016). 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.

Related Criteria

[Exposure Draft: Incorporating Enhanced Recovery Prospects into U.S. Local Tax-Supported Ratings \(February 2016\)](#)

[Exposure Draft: U.S. Tax-Supported Rating Criteria \(September 2015\)](#)

[Tax-Supported Rating Criteria \(August 2012\)](#)

[U.S. Local Government Tax-Supported Rating Criteria \(August 2012\)](#)

Broad, Resilient San Antonio Economy

The district's 5.5% average annual tax base growth between fiscal years 2012 and 2016 mirrors the greater San Antonio regional economy. Job growth continues to support a favorable county unemployment rate of 3.5% as of December 2015, below the state (4.2%) and U.S. (4.8%) averages for the same period. The district's wealth as measured by personal income per capita trends above state and national averages.

The diverse metro economy features large employers in the insurance, government, healthcare, telecommunications, grocery, education and military sectors. The city of San Antonio also benefits from traditionally strong tourism and trade. IHS projects robust medium-term growth for the city, driven by professional/business services, education, health services and construction/mining.

Manageable Long-Term Liabilities

North East ISD received a strong 66% of voter support for its 2015 bond program, the fourth consecutive successful bond election in 12 years. The district plans to issue its remaining

\$500 million of authorization over the next three years, primarily for campus renovations. Management reports the district is more than 90% built out, lessening future facility and borrowing needs. Correspondingly, enrollment growth has slowed and officials anticipate modest annual increases of less than 1%.

Fitch anticipates the district's debt burden (6.5% of fiscal 2016 market value) to remain elevated over the near term considering current debt plans and an average principal amortization rate. The district plans to keep its fiscal 2016 interest and sinking fund (I&S) tax rate (\$0.375 per \$100 of taxable assessed value) flat for the next five years. This projection assumes annual tax base growth of between 2% and 4%, less than recent growth realized by the district. The I&S tax rate is comfortably below the \$0.50 statutory rate cap for new debt issuance.

The district's debt service burden consumed 13.2% of fiscal 2015 governmental expenditures. The district historically maintains a moderate amount of its debt portfolio in variable-rate unlimited tax bonds, currently estimated at about 15% of the total debt outstanding, well within the district's policy ceiling of 25%.

Terms of the district's three variable-rate bond series include one-to-five-year fixed-rate terms, a soft put to bondholders in lieu of liquidity support, and the option to reset the rate to a long-term fixed basis until final maturity. Fitch considers the risks associated with a failed remarketing (which would result in an elevated interest rate of up to 7%) manageable, based on assumed ready market access given the district's sound credit profile.

Debt Statistics

(\$000)	
This Issue	35,535
General Obligation Bonds	1,288,335
Total Direct Debt	1,323,870
Plus: Overlapping Debt	1,263,082
Total Overall Debt	2,586,952

Debt Ratios

Direct Debt Per Capita (\$) ^a	3,097
As % of Market Value ^b	3.3
Overall Debt Per Capita (\$) ^a	6,051
As % of Market Value ^b	6.5

^aPopulation: 427,521 (2016 estimate). ^bMarket value: \$39,539,115,801 (fiscal 2016). Note: Numbers may not add due to rounding.

Limited Pension, OPEB Obligations

The district participates in the Teacher Retirement System of Texas (TRS), a cost-sharing multiple-employer pension system. Under GASB 67 and 68, TRS' assets covered 83.3% of liabilities as of fiscal 2015, a ratio that falls to a Fitch-estimated 75.0% using a more conservative 7.0% return assumption. Contributions are determined by state statute, rather than actuarially, and historically have fallen short of the actuarial level. Recent reforms have lowered benefits and increased statutory contributions to improve plan sustainability over time.

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 fiscal 2015.

The district's proportionate share of the system's net pension liability is minimal, representing less than 0.5% of fiscal 2015 market value. The district's contributions currently are limited to 1.5% of salaries and the pension costs for salaries above the statutory maximum (total

contribution of \$12 million in fiscal 2015). Carrying costs for debt service, pensions and OPEB were moderate at 15% of fiscal 2015 governmental spending.

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 schoolchildren 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 intended 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.

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