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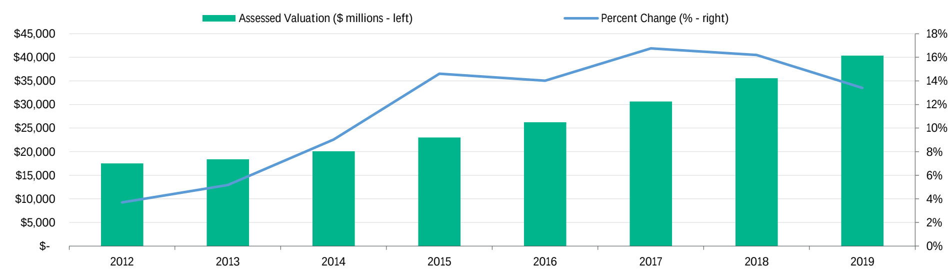
Frisco Independent School District, TX

Update to credit analysis

Summary

Frisco ISD's (Aa1 stable) credit profile benefits from its large and diverse tax base located in the Dallas-Fort Worth metro area that continues to expand at a rapid pace, strong wealth and resident income indices, as well as healthy reserve position after a trend of surplus operations driven by strong management and conservative budgeting. Challenges of the profile include a high debt burden with additional borrowing plans, which are both attributable to ongoing rapid student enrollment growth.

Exhibit 1
Large tax base has doubled since fiscal 2014; growth expected to continue



Source: Frisco ISD, TX

Credit strengths

» Large, affluent tax base in rapidly growing Dallas-Fort Worth metropolitan area

» Healthy reserves after long trend of surplus operations

» Strong management and conservative budgeting

Credit challenges

» High debt burden

» Significant additional borrowing plans

» Slow principal amortization

Rating outlook

The stable outlook reflects the expectation that the district's financial operations and reserves will remain healthy over the next several years given strong proactive management.

In addition, continued growth is expected in the district's tax base given new development, an affluent population, and its location within a growing metropolitan area.

Factors that could lead to an upgrade

- Substantial decrease in debt burden
- Continuing trend of materially improved reserves alongside a growing budget

Factors that could lead to a downgrade

- Additional borrowing without corresponding tax base growth
- Significant tax base contraction
- Erosion of available reserves

Key indicators

Exhibit 2

Frisco Independent School District, TX	2014	2015	2016	2017	2018
Economy/Tax Base					
Total Full Value ($000)	$20,072,774	$23,005,772	$26,230,140	$30,621,651	$35,570,550
Population	184,480	195,013	206,200	229,282	256,078
Full Value Per Capita	$108,807	$117,970	$127,207	$133,555	$138,905
Median Family Income (% of US Median)	175.9%	179.6%	179.6%	179.6%	179.6%
Finances					
Operating Revenue ($000)	$447,819	$486,700	$565,925	$616,707	$674,449
Fund Balance ($000)	$162,526	$171,878	$208,748	$239,859	$299,879
Cash Balance ($000)	$199,257	$207,235	$232,099	$282,430	$343,940
Fund Balance as a % of Revenues	36.3%	35.3%	36.9%	38.9%	44.5%
Cash Balance as a % of Revenues	44.5%	42.6%	41.0%	45.8%	51.0%
Debt/Pensions					
Net Direct Debt ($000)	$1,589,668	$1,846,898	$1,937,849	$1,996,272	$1,993,666
3-Year Average of Moody's ANPL ($000)	$213,259	$238,368	$292,135	$362,072	$416,700
Net Direct Debt / Full Value (%)	7.9%	8.0%	7.4%	6.5%	5.6%
Net Direct Debt / Operating Revenues (x)	3.5x	3.8x	3.4x	3.2x	3.0x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	1.1%	1.0%	1.1%	1.2%	1.2%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	0.5x	0.5x	0.5x	0.6x	0.6x

Operating Revenues, Fund Balance, and Cash Balance are the General and Debt Service Funds Combined
Source: Frisco ISD, TX; Moody's Investors Service

Profile

Frisco Independent School District is located approximately 25 miles north of the City of Dallas (A1 stable), in Collin and Denton counties (each Aaa stable) and mainly serves the City of Frisco (Aaa stable). The district provides comprehensive education for students from pre-kindergarden through 12th grade. Fiscal 2019 enrollment is 60,581 students.

Detailed credit considerations

Economy and tax base: favorable Dallas metroplex location and corporate presence fuels rapid growth

The district's tax base is expected to continue to experience strong growth over the medium term given ongoing development and its favorable location. Growing corporate presence and access to employment centers throughout the metroplex has fueled rapid tax base growth. Taxable assessed values (TAV) have doubled since fiscal 2014 to $40.4 billion in fiscal 2019. While growth slowed down during the most recent recession, taxable values increased an average of 15% annually over the last five years, with 13.4% growth in fiscal 2019. Taxpayer concentration is modest, with the top ten taxpayers accounting for 4.8% of taxable values.

Annual tax base growth is expected to continue at a slower, but still strong pace over the medium term because of continued commercial and residential development. The recent completion of the new Dallas Cowboys corporate headquarters and relocation of Toyota Motor Corporation's (Aa3 stable) North American headquarters to the City of Plano (Aaa stable) will continue to spur additional commercial development in the area. In addition, the district will benefit from the near-term relocation of the Professional Golfers' Association of America's headquarters. The relocation is expected to be accompanied by multiple golf courses, a 500 room hotel and conference center, as well as other mixed-used developments.

Per the US Census, the district's population has grown 323% in one decade to 163,063 in 2010. By 2018, population was estimated to have reached 285,933, or a significant 75.3% increase since the last census. The district's residential income indices are strong with the 2017 median family income equivalent to 178.9% of the nation (American Community Survey). The district's rapid enrollment growth (5.7% five-year average annual growth rate), attributed to the large population inflow, is expected to continue in the near term. In fiscal 2019, enrollment grew by 3.6% to 60,581 students and management expects to add roughly 1,800 students annually over the next several years. Ongoing enrollment growth is expected to continue the trend of significant capital needs and debt issuances over the medium term.

Financial operations and reserves: stable operations and healthy reserves

Strong financial management demonstrated by a trend of surplus operations and robust budgeting and planning will continue supporting the district's healthy financial position. The district recently increased its target for minimum general fund reserves to 20% from 15% of annual expenditures. Despite increasing costs from rapid enrollment growth, the district has consistently exceeded the 20% target.

Since fiscal 2012, the district has favorably generated seven consecutive operating surpluses adding roughly $120 million to total general fund balance. Fiscal year 2018 audited statements exhibited a sizeable $29.6 million surplus, increasing the total general fund balance to $162.8 million, or a healthy 32% of revenues. The surplus was driven by additional state-aid revenues driven by strong student enrollment and positive expenditure variances. Fiscal 2018 general fund operations were primarily funded by local property taxes (76.3%) and state revenues (23.2%). Inclusive of the district's debt service fund, operating fund balance totaled $240.8 million, or a healthy 39% of total revenues.

After a successful tax ratification election in November 2018, the district anticipates a sizable surplus in fiscal 2019 similar to the prior year given the additional tax revenue. The increase in the maintenance and operations levy to $11.70 per $1,000 of assessed value, which is the statutory limit, boosted tax revenues by approximately $45 million. The district expects to net roughly $30 million of that increase with the remaining $15 million being recaptured by the state. If realized, the surplus would increase total general fund balance to roughly $197 million, or a solid 36.6% of budgeted revenues.

Given the district's strong wealth-per-student trajectory, chapter 41 (or wealth recapture) payments are expected to increase to approximately $50 million for fiscal 2020, which reduces some of the district's financial flexibility. Despite this growing pressure, management plans to adopt balanced budgets, and we anticipate the district to maintain healthy reserves in line within targeted amounts over the long term.

LIQUIDITY

At the end of fiscal 2018, general fund cash of $206.9 million represented 40.7% of revenues. Inclusive of the district's debt service fund, liquidity totaled $343.9 million, or a strong 51% of total revenues. No significant draws or decreases in liquidity are anticipated in the near-term, and cash levels will likely remain healthy over the near term.

Debt and pensions: high debt burden with additional capital needs

Given plans for additional near term borrowing and slow principal amortization, the district's debt burden will remain high as enrollment growth continues to drive the district's capital needs. Inclusive of the current issuance, the district's very high net direct debt burden (5% of fiscal 2019 TAV) reflects the rapid enrollment growth which has required consistent debt issuances to finance the construction and expansion of district facilities. The district's $2.70 per $1,000 of AV tax rate as well as Tax Increment Financing revenues are projected to be sufficient to service the district's current debt service levels.

Post sale, the district will have $711 million in authorized, unissued debt. Management reports plans to continue to issue annually, but will reevaluate plans if enrollment growth subsides. Future reviews will focus on the relationship between outstanding debt and assessed value as both grow. Significant additional borrowing absent corresponding growth in full value, or debt structures with significantly ascending debt service schedules, could negatively affect the district's credit quality.

DEBT STRUCTURE

All of the district's $2 billion in debt is fixed rate and amortizes over the long term. Principal amortization is slow with only 30% retired in the next ten years.

DEBT-RELATED DERIVATIVES

The district is not party to any interest rate swaps or other derivative agreements.

PENSIONS AND OPEB

The district participates in the Texas Teachers Retirement System (TRS) pension plan, where the State of Texas makes the majority of the employer pension contributions on behalf of districts annually. Given this support, budgetary pressure associated with the plan is expected to remain minimal in the near term despite a recent reduction of the plan's assumed rate of investment return to 7.25% from 8.00%. Discount rate reductions typically signal future contribution increases, which can lead to potential budgetary pressure (see "Lower investment return assumption for Texas' teacher pensions is positive, but signals likely cost hikes" for more information).

Moody's adjusted net pension liability (ANPL) for the district, under our methodology for adjusting reported pension data, is $455 million. This liability is equal to a manageable 0.7 times annual operating revenues in fiscal 2018, including the general and debt service funds. The three-year average of the district's ANPL to operating revenues is 0.6 times and 1.2% of the district's full valuation.

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 contribution information, or the reported liability information of the state-wide cost-sharing plans, but to improve comparability with other rated entities.

Total fixed costs including debt service, pension contributions, and OPEB were an elevated 22.1% of fiscal 2018 operating revenues. Annual debt service expenditures alone represented a significant 20.2% of operating revenues. The fixed cost burden would increase slightly to 22.4% of revenues if the district were to make its "tread water" payment, which highlights the district's underfunding of pension contributions of 0.3% of operating revenues ($1.5 million) in fiscal 2018. The "tread water" indicator measures the annual government contributions required to prevent reported net pension liabilities from growing, under reported assumptions.

Management and governance: conservative management team

The district is governed by a seven-member board of trustees. The board performs policy- making and supervisory functions and delegates administrative responsibilities to the superintendent of schools, who is the chief administrative officer of the district. The district benefits from strong financial management reflected in consistent operating surpluses, conservative budgeting and robust reserves.

Texas School Districts have an Institutional Framework score of Aa, which is high compared to the nation. Institutional Framework scores measure a sector's legal ability to increase revenues and decrease expenditures. Property taxes, one of the sector's major revenue sources is subject to a cap of $10.40 per 1,000 of assessed value, which can be overriden at the local level to $11.70 (with voter approval). The voter approved levy override provides for additional revenue-raising flexibility. Unpredictable revenue fluctuations tend to be minor, or under 5% annually. Across the sector, fixed and mandated costs are generally greater than 25% of expenditures. Texas is a Right to Work state, providing significant expenditure-cutting ability. Unpredictable expenditure fluctuations tend to be minor, under 5% annually.

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