S&P Global Ratings

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Summary:

Frisco Independent School District, Texas; General Obligation; School State Program

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Credit Profile		
US$175.87 mil unltd tax rfdg bnds ser 2020 due 02/15/2041		
Long Term Rating	AAA/Stable	New
Underlying Rating for Credit Program	AA+/Stable	New
Frisco Indpt Sch Dist unltd tax sch bldg bnds		
Long Term Rating	AAA/Stable	Current
Underlying Rating for Credit Program	AA+/Stable	Affirmed
Frisco Indpt Sch Dist GO		
Long Term Rating	AA+/Stable	Affirmed
Frisco Indpt Sch Dist PSF/CRS		
Long Term Rating	AAA/Stable	Current
Underlying Rating for Credit Program	AA+/Stable	Affirmed

Rating Action

S&P Global Ratings assigned its 'AAA' long-term rating and 'AA+' underlying rating to Frisco Independent School District (ISD), Texas' $175 million taxable series 2020 unlimited-tax refunding bonds. At the same time, S&P Global Ratings affirmed its 'AA+' long-term rating and underlying rating on the district's existing unlimited-tax general obligation (GO) debt. The outlook is stable.

Revenue from unlimited ad valorem taxes on all taxable property within the district secures the GO bonds. Bond proceeds will be used for various capital improvement projects throughout the district, including the construction of schools, purchase of land, and renovations of existing facilities.

The 'AAA' program rating reflects our view of the district's eligibility for the Texas Permanent School Fund (PSF) bond guarantee program. The program provides the security of a permanent fund of assets that the district could use to meet debt service on bonds guaranteed by the program. (For more information on the program rating, please see our report on the Texas PSF, published June 7, 2019, on RatingsDirect.)

Credit overview

The district is located approximately 25 miles north of Dallas, in a high-growth area along the Dallas North and Sam Rayburn tollways. Continued economic expansion has resulted in sustained assessed valuation (AV) and enrollment growth while contributing to significant capital needs and a sizable debt burden. However, strong financial management practices have enabled the district to manage its capital program while sustaining positive financial results. Although officials report no appreciable slowdown in construction activity, the COVID-19-driven economic recession has arrived. (See "An Already Historic U.S. Downturn Now Looks Even Worse," published April 16, 2020.)

However, with property taxes substantially collected for the year and no indication of state funding disruption, we believe that the district has sufficient financial flexibility, combined with strong management practices, to weather any near-term pressures. While we continue to monitor events related to COVID-19, we do not expect them to affect the district's ability to pay debt service or maintain its financial position through our outlook horizon.

The 'AA+' underlying rating reflects our view of the district's:

- Participation in the Dallas-Fort Worth metroplex's deep and diverse economy;
- Rapid economic growth, resulting in increasing property value and enrollment;
- Very strong resident income and wealth levels;
- Very strong finances; and
- Strong financial management policies under our financial management assessment methodology.

Partly offsetting the above strengths, in our view, are the district's elevated overall debt profile and plans for additional debt issuance.

The stable outlook on the program rating reflects our assessment of the Texas PSF's strength and liquidity.

The stable outlook on the underlying rating reflects our assumption that, despite the COVID-19 driven economic recession, the district will maintain its very strong financial position while the tax base remains stable.

Environmental, social, and governance factors

Our rating and analysis incorporate our view of the health and safety risk posed by the COVID-19 pandemic, which we believe could pressure budgets in the short term. Overall, we consider the district's social risks in line with that of the sector. We also analyzed the district's environmental and governance risks relative to its credit factors, and we determined that both are in line with our view of the sector standard.

Stable Outlook

Downside scenario

We could lower the rating if the district's finances deteriorate substantially to levels no longer comparable with those of peers or if additional debt issuance further increases its high overall debt per capita.

Upside scenario

Although we are unlikely to do so within the next two years, we could raise the underlying rating if tax base growth were to improve substantially, moderating debt ratios to levels we consider commensurate with those of higher-rated peers, with all else remaining stable.

Credit Opinion

Economy

Frisco ISD serves an estimated population of 293,209. Median household effective buying income is 179% of the national average, and per capita effective buying income is 149% of the national average, both of which we consider very strong. The district's total $40.3 billion market value in 2019 is extremely strong, in our view, at $137,613 per capita. The 10 largest taxpayers make up an estimated 4.8% of net taxable AV, which we consider very diverse.

The district serves a rapidly growing suburban community approximately 25 miles north of Dallas. The district and surrounding area have benefited from the Dallas metroplex's northward expansion, resulting in healthy residential and commercial growth in the local economy and making the school district one of Texas' fastest-growing, with enrollment nearly doubling over the past decade. The population has increased by more than 8x since the 2000 U.S. Census. While taxable value has continued to grow, AV slowed slightly to 7.9% growth in fiscal 2020 following multiple years of double-digit growth. Officials attributed the decelerating growth trend to slower appreciation of existing home values (as approximately 60% of the district's tax base is single-family residential). While the district has not observed any appreciable slowdown in construction or declines in existing home values, it is forecasting that growth could be stunted as a result of the coronavirus-driven recession. For these reasons, the district is budgeting for a slower, 5% annual rate of growth for next year, before dropping to 2% and no growth the following two years, sequentially.

In addition to the various commuting opportunities to employment centers throughout the Dallas area, the district is now home to several significant corporate employers, namely Toyota's North American headquarters and large corporate campuses for JP Morgan Chase and Liberty Mutual. The district also reports that the Professional Golfers' Assn. (PGA) is relocating its offices to the district. The PGA campus will include the headquarters, a resort style hotel, and a golf course, and is scheduled to open in 2022. In addition, smaller projects continue throughout the district, particularly along the Dallas North Tollway. The district also reports a recent sale of a large tract of land in the northern portion of its boundaries that will be developed into a large residential subdivision. Although officials are aware of no significant layoffs or furloughs resulting from the recession, significant reductions in workforce could affect local income levels and reduce commercial property values, affecting the district AV. We believe that the local tax base will largely remain stable, though we will continue to monitor the effects of the pandemic-driven recession.

Finances

A wealth equalization formula, based on property values and average daily attendance (property wealth per student), determines state funding for all school districts. Therefore, increases or decreases in average daily attendance (enrollment) can lead to corresponding movements in the amount of state revenue a district receives. For the 2019-2020 school year, enrollment came in at 62,730 students.

The district operates 73 schools and special program facilities and employs more than 7,000, including over 4,000 teachers. Throughout the late 1990s and early 2000s the district saw enrollment growth of 10% to 30%, annually, but over the past decade enrollment growth has decelerated: Although the average annual increase since 2010 is approximately 6.3%, annual growth has been less than 5.0% for the past four years. Management attributes the moderation of growth to shifting demographics and a somewhat slower growth housing market. As home prices continue to rise, young families began to be priced out of the area (though officials report that this trend may be shifting somewhat, as 2020 saw growth in elementary-age students). Also, many established residents in older neighborhoods have remained in the city even as their children have graduated and moved out. Given these demographic shifts, officials expect enrollment growth to remain moderate over the next five years. Given the onset of the recession, officials have further dialed back their growth assumptions and are budgeting for 1,000 to 1,500 additional students for fiscal 2021.

The district's available fund balance of $206.3 million is very strong, in our view, at 39% of general fund expenditures at fiscal year-end (June 30) 2019. The district reported a surplus operating result of 8.3% of expenditures. Property taxes are the district's primary source of general fund revenue (81.4%), with state aid accounting for only 14.7% of revenue.

Despite continued growth stress, finances remain very strong, in our view, as a result of ongoing revenue growth and conservative budgeting. For fiscal 2019, the district was facing increased operating costs to open four campuses that were delayed from fiscal 2018, but was able to adopt a near-balanced budget. However, in the fall of 2018, voters approved a tax ratification election that increased the district's maintenance-and-operating levy to the maximum $1.17 per $100 of AV (from $1.04), while correspondingly lowering the interest and sinking rate to 27 cents (from 42 cents). This resulted in an overall total tax rate decrease of two cents to taxpayers. The increased tax rate, combined with taxable value growth, led to a nearly $100 million increase in property tax revenue that was partly offset by wealth recapture payments of $14 million. As a Chapter 49 (formerly Chapter 41) district, Frisco's property wealth per average daily attendance exceeds the local enrichment level allowed by the state. Locally derived property tax revenue that is received above this level must be sent to the state to be redistributed to districts that are considered "property poor." Despite the recapture payment, the district realized a $43.8 million surplus, of which $30.0 million was assigned for future employee compensation.

For fiscal 2020, the district's adopted budget reflected an anticipated $12 million surplus. The budget includes a lower maintenance-and-operating tax rate, as required by House Bill 3, of $1.068 per $100 of AV. Changes under House Bill 3 also resulted in lower recapture payments, with budgeted costs of only $4.4 million. Subsequent to the adoption of the budget, the district amended the budget to provide a one-time stipend, in January, to staff amounting to $5.6 million of the $30.0 million reserved the prior year. Furthermore, with the governor's ordered closure of schools in March, the district transitioned to distance learning. While the district faced increasing costs associated with the closure of schools as a result of COVID-19, it also realized some savings (with utility savings and by not having to utilize substitute teachers). Despite this use of reserves for staff stipends, the district expects that the closure of schools will actually result in a net savings and now expects to realize a nearly $20 million surplus.

For fiscal 2021, the district has not yet adopted its budget, but the district's proposed budget reflects another expected surplus. While state funding for fiscal 2021 is not expected to change, the district is concerned about funding status for the state's next biennium (fiscal years 2022 and 2023). Given these concerns, the district has committed to continue building fund balance to ensure adequate flexibility. Given the district's strong management practices and policies, conservative assumptions continue to be incorporated into the budget and we believe that the district will continue the long trend of surplus operations, maintaining its very strong financial profile despite the recession and uncertain funding picture over the medium term.

Management

We consider the district's management practices strong under our financial management assessment methodology, indicating our view that financial practices are strong, well embedded, and likely sustainable.

Key practices include management's:

- Preparation of budgets based on expenditure trends, appraisals and estimates, and enrollment projections from internal and external demographers;
- Quarterly long-term financial updates to the school board, with budget-to-actual reports created monthly for use by the administration;
- In-depth and conservative investment policy, with quarterly investment reports to the board;
- Debt management plan that addresses the types of debt that can be issued, the allowable purposes for that debt, and the debt portfolio's composition;
- Capital improvement plan that is updated at least annually; and
- Formal policy of maintaining year-end general fund balance at a minimum 15% of expenditures, coupled with a higher informal target of 20% to 25%.

Debt

Overall net debt is moderate, in our opinion, at 5.9% of market value, but high at $9,251 per capita. With 31% of the district's direct debt scheduled to be retired within 10 years, amortization is slow. The debt service carrying charge was 18.9% of total governmental fund expenditures excluding capital outlay, which we consider elevated, in fiscal 2019.

The district maintains approximately $636 million in authorized but unissued debt, with another $2 billion in debt already outstanding. The district plans to issue the remaining authorization over the next seven years, as capacity needs and tax base growth allow. We understand that the district has no privately placed or direct purchase debt outstanding, and that all of the district's debt outstanding is fixed-rate obligations. Given the future capacity needs and debt plans, we believe the district's debt profile will remain elevated.

Pension and other postemployment benefits (OPEB) liabilities

- We do not view pension and OPEB liabilities as an immediate source of credit pressure for Frisco ISD, as required contributions account for a small portion of total governmental expenditures and are not expected to materially increase over the next few years.
- Under a special funding situation, the state contributes a sizable share of the employer contribution and carries responsibility for its proportionate share of the unfunded liability.

Frisco ISD participated in the following plans, as of Aug. 31, 2019:

- Teacher Retirement System (TRS), 75% funded with a proportional share of the net pension liability equal to $170.5 million
- Texas Public School Retired Employees Group Insurance Program (TRS-Care), which provides health insurance coverage to members of the TRS pension plan. TRS-Care is 3% funded and the district has a proportionate share of the net OPEB liability of $189.4 million.

In fiscal 2019, the district paid its full required contribution of $11.7 million, or 1.6% of total governmental expenditures, toward its pension obligations. The district also paid $2.8 million, or 0.4% of total governmental expenditures, toward its OPEB obligations. Pension and OPEB carrying charges totaled 1.9% of total governmental fund expenditures.

Given that contributions are done on a statutory basis that is typically lower than the actuarially determined contribution, last year's TRS contributions were materially lower than both static funding and minimum funding progress. However, legislative changes increasing contribution rates will likely improve both funding metrics, though some assumptions remain a credit concern. For more information, see "Pension Spotlight: Texas," published Feb. 25, 2020. Likewise, contributions to TRS-Care have not met actuarial recommendations and we believe that the liability and contributions will continue to grow. However, given the special funding situation, we believe that the district's postemployment benefit costs will remain manageable.

Related Research

Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020