Austin Independent School District, Texas
New Issue Report

Ratings

Long Term Issuer Default Rating  
AA+

New Issue  
$220,315,000 Unlimited Tax School Building and Refunding Bonds, Series 2019  
AAA

Outstanding Debt  
Unlimited Tax Bonds  
AA+

* The 'AAA' rating is based on a guaranty provided by the Texas Permanent School Fund, which carries an insurer financial strength rating of 'AAA' from Fitch Ratings. The bonds' underlying rating, which reflects their credit quality before consideration of the guaranty, is 'AA+'.

Rating Outlook  
Stable

New Issue Details

Sale Date: March 12, via negotiation.

Series: $220,315,000 Unlimited Tax (ULT) School Building and Refunding Bonds, Series 2019

Purpose: Proceeds will be used to construct and equip school facilities, to refund outstanding commercial paper issued for capital projects, and to pay related costs of issuance.

Security: An unlimited ad valorem tax pledge levied against all taxable property within the Austin Independent School District (Austin ISD, or the district). The series 2019 bonds are further secured by the Texas Permanent School Fund (PSF) bond guaranty program.

Analytical Conclusion

The 'AA+' Issuer Default Rating (IDR) reflects the district's high level of operating flexibility and anticipated financial resilience through the economic cycle due to a combination of its solid budgetary control and reserves. Fitch Ratings expects future district revenue gains to remain strong given continued economic and resource base expansion. Long-term liabilities and fixed costs may increase as a result of future debt issuances but are expected to remain within Fitch's low to moderate range.

Economic Resource Base: The district primarily serves the city of Austin (GO bonds rated 'AAA/Stable'), with an enrollment base of about 81,650 students as of fiscal 2018, down about 2% from the year prior. Most of the district's revenues are local property taxes.

Key Rating Drivers

Revenue Framework: 'a'
Fitch believes revenue growth prospects remain strong despite the ongoing, projected enrollment decline. As a property-rich district under Chapter 41 of the Texas Education Code, revenue trends have largely tracked increasing property values. The district lacks the ability to independently increase operating revenues.

Expenditure Framework: 'aa'
The pace of spending growth should remain more or less aligned with revenues over time given the district's spending profile. Sound expenditure flexibility is a result of moderate carrying costs that benefit from substantial state funding of retiree costs and the district's ability to adjust its labor costs, if needed.

Long-Term Liability Burden: 'aaa'
The long-term liability burden is estimated at a low 7% of 2017 personal income. Fitch expects it will remain consistent with an 'aaa' assessment as future growth in long-term liabilities should be balanced against additional population and economic expansion.

Operating Performance: 'aaa'
Underpinning the district's high level of operating flexibility is solid budgetary control, the strength of its existing financial cushion and limited historical revenue volatility. Budgetary management is being challenged, but Fitch believes the district's operating cushion would remain in line with an 'aaa' financial resilience assessment in a moderate economic decline.

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https://app.fitchconnect.com/search/research/article/RPT_10061988?t=true
Rating History (IDR and ULT Bonds)

<table>
<thead>
<tr>
<th>Rating</th>
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<tbody>
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<td>Affirmed</td>
<td>Stable</td>
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<tr>
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<td>4/30/10</td>
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<tr>
<td>AA</td>
<td>Affirmed</td>
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<td>6/13/08</td>
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<tr>
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Rating Sensitivities

**Maintenance of Financial Flexibility:** The IDR and ULT bond rating are sensitive to the district's ability to regain structural budgetary balance over the medium term while maintaining a reserve safety margin consistent with an 'aa' financial resilience assessment. A modest but steady annual enrollment decline is projected to be sustained, and Fitch expects this now-established trend will be met with the necessary operational and capital right-sizing by management.

Credit Profile

Austin continues to be one of the top performing U.S. metro area economies. The city is the state capital and home to the University of Texas at Austin (University of Texas System; rated 'AAA'/Stable Rating Outlook by Fitch), as well as six other colleges and universities. The large state government and higher education employment base historically has provided a stabilizing presence and economic buffer during downturns. The city’s highly educated workforce and availability of major research facilities continues to attract and support expansion of technology firms. Tourism has also become a growing economic driver. Further population and job gains should drive additional economic and tax base expansion within district boundaries.

The district's property tax base is diverse and predominately residential. Taxable assessed valuation (TAV) has registered consistently strong annual gains; a gain of nearly 12% brought fiscal 2019 TAV to $115 billion. Fitch expects this trend will be sustained given a robust housing market and further residential, retail and commercial development that is underway or planned.

In contrast, modest annual declines in the Austin ISD enrollment base have occurred over the past six years despite efforts by the district to offset the erosion with enhanced marketing and new academic programs. Management primarily attributes issues of housing affordability for young families as the key cause for continued erosion of the district's enrollment base, in addition to expanded charter school presence. The district's most recent demographic study projects additional declines through fiscal 2024.

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 district and student characteristics), produces a district's Tier 1 allotment. The state of Texas' (AAA IDR/Stable Rating Outlook) favorable revenue growth prospects bode well for K-12 funding in the medium term.

Most of Austin ISD's revenues (about 93%) come from local property taxes. Fiscal 2018 general fund revenue totaled nearly $1.3 billion, up about 9% from the prior year. Austin ISD's average annual revenue gains have been strong and above U.S GDP, at 4.3% over the 10 years ended in fiscal 2017, despite the weak enrollment performance (annual average growth of less than 1%) over the same time period. Recent modest, annual enrollment declines began in fiscal 2014 and have been sustained at about 1%-2% annually despite various district
initiatives. Fitch believes natural revenue growth prospects will remain strong given the likely continuation of further tax base gains and despite the ongoing, projected enrollment decline.

The adopted fiscal 2019 tax rate for operations is just under $1.08 per $100 of TAV. The district has independent legal ability over only a very small portion of its operating revenues and must seek voter approval per state statute to further increase its operating tax rate.

Expenditure Framework

Instruction accounted for about 36% of operational spending in fiscal 2018. As a property-rich district under Chapter 41 of the Texas Education Code, a sizeable portion of the district's operating tax levy is recaptured by the state for distribution to less wealthy school districts. These payments totaled $540 million, or about 41% of fiscal 2018 spending.

Fitch expects the pace of spending growth, absent policy action, should remain more or less aligned to revenues over time based on the district's current expenditure profile. Growth in Chapter 41 payments mirror changes in TAV growth and, therefore, revenue trends.

Much of the district's spending is related to its educational mission and offers some flexibility with respect to staffing and salary adjustments. The district's solid expenditure flexibility reflects strong legal control of labor costs and headcount. This is tempered by the district's need to maintain a competitive salary structure in the Austin-Round Rock MSA employment base to recruit and retain highly educated professionals. The three-year contracts that underpin employment for about 40% of the workforce do not enable collective bargaining or contain wage or benefit provisions, and otherwise provide a measure of stability for the district in a labor environment of high attrition. Limiting to a degree the district's expenditure flexibility is its large and growing Chapter 41 recapture payment, which constrains how much of its total revenue (net of the recapture payment) can be spent on operations.

Fixed carrying costs — the combination of total annual debt service, the annual pension funding amount, and the annual actual spending for other post-employment benefits (OPEB), net of state support — have consistently consumed a relatively modest portion (7% in fiscal 2018) of governmental spending, driven primarily by debt service. Fitch expects these fixed costs will slowly rise going forward as a result of current and future debt plans but remain moderate and in line with the 'aa' assessment, based on proportional growth in the district's operations as well as low retiree costs.

The Teachers Retirement System (TRS) legislative funding request for the 2020–2021 biennium includes an increase in the state contribution rate to 8.62% (from 6.8%), at a cost of $1.68 billion for the biennium; this increase assumes no increase in member or district contribution rates. This increase would result in a pension amortization period of 31–35 years, consistent with the current 32 years.

The state likely will consider sharing the burden of increased contributions with plan members and local districts. Fitch has consistently considered the risk that the state could increase district contributions to TRS in its assessment of each entity's expenditure framework and believes most districts can accommodate a moderate increase without compromising flexibility. Nevertheless, Fitch will monitor consideration of this issue during the 2019 Texas legislative session and the potential impact to local districts' expenditure flexibility that would result from increasing pension contributions.

Long-Term Liability Burden

Including this issuance, the long-term liability burden is estimated at a low 7% of 2017 personal income, with the majority (about $2 billion, or almost 60%) due to overlapping debt. Fitch
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expects the burden to remain consistent with an 'aaa' assessment, as growth in the long-term liability burden should be offset by continued economic and resource base expansion (similar to historical performance).

The new money portion of this issuance includes the initial tranche from the $1.05 billion bond authorization approved by voters in November 2017 for the district's key capital needs. District plans anticipate annual issuances of the remaining bond authorization through fiscal 2023. Solid TAV gains have generally enabled the district to implement its capital plan with limited tax rate impact, and full issuance of the latest $1 billion bond authorization is not projected to require a tax rate increase.

The district participates in TRS, a cost-sharing multiple-employer pension system. The district also provides OPEB through the state-run, post-employment benefit healthcare plan. Under GASB 67 and 68 reporting, the district reported its share of the TRS net pension liability (NPL) at approximately $88 million in fiscal 2018, with TRS' assets covering 62% of total pension liabilities at the plan's 8% investment rate, a ratio that falls to a Fitch-estimated 85% using a more conservative 6% investment return assumption. The NPL adjusted for a 6% interest rate assumption remains small at approximately $213 million or less than 1% of personal income.

As mentioned above, at its July 2018 meeting, the TRS board voted to lower the investment return assumption for the TRS pension plan to 7.25% from 8%. This move increases the plan's current $35.5 billion NPL by $10 billion. The state currently contributes 6.8% of salaries, members contribute 7.7% and school districts that do not contribute to social security contribute 1.5% of certain salaries. This change in investment return assumption and overall increase in the NPL does not affect Fitch's analysis of the long-term liability burden, as Fitch currently utilizes a lower 8% assumption when considering the burden.

Operating Performance
Fitch judges the district's financial resilience to be consistent with an 'aaa' assessment. For details, see Scenario Analysis, page 6.

The district typically builds its reserve position in periods of economic recovery when surpluses are achieved or one-time revenues are received. District policy directs a minimal unassigned reserve balance of 20% of spending (excluding the Chapter 41 payment) to be maintained.

Most recently, continued growth in the district's Chapter 41 payment to the state (due to strong gains in the local property tax base) in conjunction with a continued pace of 1%-2% annual enrollment loss has pressured operational performance and fiscal balance. The district recorded a modest net operating deficit of about $17 million, or about 1.3% of spending, at fiscal 2018 year-end while maintaining unrestricted reserves of about $284 million, or 22% of spending, well above the 'aaa' financial resilience reserve safety margin threshold. For fiscal 2019, the year's operating deficit is currently projected at about $20 million, or 1.5% of spending, at year-end, which is anticipated to preserve an ample reserve cushion of about 17% of spending.

The district's financial forecast anticipates the structural imbalance to grow over the near-term in fiscal years 2020 ($73 million, or about 5% of budgeted spending) and 2021 ($94 million, or about 4%), with the projected continuation of tax base and enrollment trends. In preliminary budget discussions for fiscal 2020, district management is working to develop a clear path toward regaining long-term balance, inclusive of closing certain low-enrollment school facilities over the next few years.
Fitch believes the district will be challenged to realize the full amount of cost savings ($14 million) currently identified with various campus consolidations/school closures given a recent history of largely successful public push-back against such moves. A list of more immediate cost-saving measures that chip away at the aforementioned deficits include salary savings at year-end, future staffing and program reductions and some higher secondary staff-to-student ratios.

Public school funding proposals in both the Texas House of Representatives and Senate for the 2020-2021 biennium include sizable increases, which, if realized, would boost near-term revenue growth expectations for Texas school districts. For additional details, please see Fitch's press release, "Fitch Ratings: TX K-12 Funding Proposals Would Boost Rev Expectations," dated Feb. 5, 2019.

If realized, this prospective new legislative funding (which is assumed by management to total an additional $35 million annually for the district over the next biennium) and cost-saving measures would result in a smaller net operating deficit of $12 million in fiscal 2020 with a return to a modest surplus in fiscal 2021. Fitch believes housing affordability issues and charter school competition will remain steady operating pressures, but expects any further, material enrollment declines or external cost pressures would be met with the necessary operational right-sizing by management to maintain a reserve safety margin consistent with an 'aaa' financial resilience assessment.
Austin Independent School District (TX)

Scenario Analysis

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Austin Independent School District (TX)

Scenario Analysis

Reserve Safety Margin in an Unaddressed Stress

Actual vs. Scenario

Financial Resilience Subfactor Assessment:

Available Fund Balance

35.0%

30.0%

25.0%

20.0%

15.0%

10.0%

5.0%

0.0%

2012 2013 2014 2015 2016 2017 2018

Year 1 Year 2 Year 3

GDP Assumption (% Change)

Expenditure Assumption (% Change)

Revenue Output (% Change)

Inherent Budget Flexibility

Revenues, Expenditures, and Fund Balance

<table>
<thead>
<tr>
<th>Scenario Output</th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
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<tbody>
<tr>
<td>Total Revenues</td>
<td>1,272,889</td>
<td>1,296,743</td>
<td>1,366,663</td>
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<tr>
<td>% Change in Revenues</td>
<td>(1.6%)</td>
<td>1.9%</td>
<td>5.4%</td>
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<tr>
<td>Total Expenditures</td>
<td>905,653</td>
<td>1,022,807</td>
<td>1,189,364</td>
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<tr>
<td>% Change in Expenditures</td>
<td>10.8%</td>
<td>17.4%</td>
<td>8.4%</td>
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<tr>
<td>Transfers Out and Other Uses</td>
<td>21,152</td>
<td>26,644</td>
<td>32,670</td>
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<tr>
<td>% Change in Transfers Out</td>
<td>22.1%</td>
<td>25.4%</td>
<td>28.7%</td>
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<tr>
<td>Bond Proceeds and Other One-Time Uses</td>
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<td>-</td>
<td>-</td>
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Net Operating Surplus/(Deficit) / After Transfers

22,670 (12,105) (16,370) (21,338) 74,544 (2,100) 17,140

Net Operating Surplus/(Deficit) / (Grossed-up) Transfers Out

4.2% (1.5%) (2.5%) (0.4%) 7.9% 0.8% (1.3%) (4.8%) (1.0%) (1.8%)

Net Operating Surplus/(Deficit) / (Grossed-up) Transfers Out

Unrestricted/Unreserved Fund Balance (General Fund)

243,959 231,152 210,927 290,398 290,896 301,360 284,232

Other Available Funds (GF + Non-GF)

243,959 231,152 210,927 290,398 290,896 301,360 284,232

Combined Available Funds Balance (GF + Other Available Funds)

93.4% 80.8% 78.2% 67.1% 65.0% 62.0% 59.0%

Inherent Budget Flexibility

Reserve Safety Margin (nsa)

26.3% 13.2% 8.2% 4.9% 3.3%

Reserve Safety Margin (oa)

10.7% 9.9% 6.0% 4.1% 2.5%

Reserve Safety Margin (b)

12.2% 6.6% 6.4% 2.5% 2.0%

Reserve Safety Margin (lab)

4.5% 5.5% 2.5% 0.0% 2.0%

Notes: Scenario analysis represents an unaddressed stress on issuer finances. Fitch’s downturn scenario assumes a -1.0% GDP decline in the first year, followed by 0.5% and 2.0% GDP growth in Years 2 and 3, respectively. Expenditures are assumed to grow at a 2.0% rate of inflation. Inherent budget flexibility is the analyst’s assessment of the issuer’s ability to deal with fiscal stress through tax and spending policy choices, and determines the multiples used to calculate the reserve safety margin. For further details, please see Fitch’s U.S. Tax-Supported Rating Criteria.

Analyst Interpretation of Scenario Results:

Fitch judges the district’s financial resilience to be consistent with an ‘aaa’ assessment. Fitch expects the district would use its solid expenditure flexibility and a portion of its ample reserve cushion to preserve the highest level of financial flexibility through a moderate economic decline scenario. Modest historical revenue volatility as depicted by the Fitch Analytical Sensitivity Tool (FAST) also contributes to the district’s high financial resilience. The FAST scenario indicates a modest 1.6% general fund revenue decline for the district in a 1% decline U.S. GDP scenario.

Scenario Parameters:

GDP Assumption (% Change)

Expenditure Assumption (% Change)

Revenue Output (% Change)

Inherent Budget Flexibility

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