FITCH RATES COPPELL ISD, TX ULTS 'AAA' TX PSF; 'AA+' UNDERLYING; OUTLOOK STABLE

Fitch Ratings-Austin-10 April 2019: Fitch Ratings has assigned a 'AAA' rating based on the Texas Permanent School Fund (PSF) and a 'AA+' underlying rating to the following Coppell Independent School District, TX's (the district) unlimited tax bonds (ULTs):

--$78.5 million ULT school building bonds, series 2019.

The 'AAA' long-term rating on the bonds is based on a guaranty provided by the Texas Permanent School Fund (PSF), whose bond guaranty program is rated 'AAA' by Fitch. (For more information on the Texas PSF see 'Fitch Affirms Texas PSF Rating at 'AAA'; Outlook Stable,' dated July 21, 2017.) A change in Fitch's assessment of the Texas Permanent School Fund bond guarantee program would automatically result in a change in the rating of Coppell Independent School District's ULT school building bonds, series 2019.

In addition, Fitch has assigned a 'AA+' rating to the following bonds:

--$21.2 million ULT refunding bonds, series 2019A.

In addition, Fitch has affirmed the following ratings:

--District Issuer Default Rating (IDR) at 'AA+';
--$299 million (post-refunding) in outstanding ULTs at 'AA+'.

The Rating Outlook is Stable.

The ULT school building bonds and ULT refunding bonds are scheduled for negotiated sales the week of April 15 and April 22, respectively. Proceeds of the series 2019 and 2019A bonds will be used for construction, acquisition, and equipment of school buildings in the district and to refund outstanding obligations for debt service savings, respectively.

SECURITY

The bonds are payable from an unlimited property tax levy and are further backed by the PSF bond guaranty program, rated 'AAA' by Fitch.

ANALYTICAL CONCLUSION

The 'AA+' IDR incorporates the district's high level of operating flexibility and anticipated financial resilience through the economic cycle due to a combination of its solid budgetary controls and established reserves. Fitch expects long-term revenue gains to remain strong given robust local economic expansion and demographic trends. Long-term liabilities and fixed costs may increase as a result of future debt issuances but are expected to remain within Fitch's moderate range.

Economic Resource Base
The district serves the city of Coppell (located 18 miles northwest of downtown Dallas) and small portions of the cities of Dallas and Irving in northwest Dallas County. The district's 2017 population is estimated at 49,370 and median household income is twice as high as the US average. The district's current average daily attendance (ADA) reflects a 10-year compound average annual growth of 2.5%, outpaced by robust growth in taxable assessed valuation (TAV) averaging 5%

during the same period. Fitch anticipates ongoing growth in the district's enrollment associated with residential development planned and underway. The district's location in the Dallas-Fort Worth (DFW) metropolitan area provides its residents with easy access to a large and diverse labor market.

KEY RATING DRIVERS

Revenue Framework: 'a'
Fitch expects the district to realize strong revenue growth going forward, consistent with trends of the past 10 years, fueled by favorable development trends. The district's independent ability to raise revenues is limited by state law.

Expenditure Framework: 'aa'
The natural pace of spending is expected to align with revenue growth. Solid expenditure flexibility incorporates management's control over headcount and salaries within the annual budget cycle and moderate carrying costs.

Long-Term Liability Burden: 'aa'
Fitch expects the district's long-term liability burden to remain moderate based on future debt issuance plans and potential moderate growth in overlapping debt.

Operating Performance: 'aaa'
Fitch expects the district's finances to remain strong through an economic downturn based on sizable reserves and sound expenditure flexibility. Disciplined budget management practices support the district's history of consistently favorable operating performance.

RATING SENSITIVITIES

Financial Flexibility: The IDR and ULT rating are sensitive to the district's maintenance of strong financial flexibility and expectations for strong revenue growth.

CREDIT PROFILE

The city serves as a retail base to nearby Lake Grapevine and continues to expand its commercial/industrial presence. Benefitting from proximity to the DFW airport, I-35 and other major highways, the district continues to attract distributors, big-box warehousing, and corporate headquarter operations. The tax base is diverse with top ten taxpayers accounting for less than 5% of fiscal 2019 TAV.

A 1,700 acre high-end mixed-use development, Cypress Waters, is projected to be the main source of long-term enrollment growth as the remainder of the district is approaching maturity. Completed housing units within the project total approximately 10% of the 10,000 housing units that are planned over a 20-year period. Corporate headquarters within Cypress Waters include 7-11 and Nokia (North American headquarters).

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 is multiplied by average daily attendance (and adjusted for specific circumstances) and produces a district's Tier 1 allotment. The district

is considered property wealthy and relies almost entirely on local property taxes to support operations.

General fund revenues grew by a compound annual average of 3.4% for the 10-year period ending fiscal 2018. Fitch expects the pace of Coppell ISD's revenue growth will continue to exceed the pace of U.S. GDP based on development plans underway that will maintain the district's recent enrollment and TAV growth trends.

Coppell ISD's M&O tax rate of $1.17 per $100 of TAV is at the statutory cap, resulting in no ability to raise revenues through its tax rate. The district levies a separate, unlimited debt service tax rate of $0.29 per $100 TAV, well below the statutory cap of $0.50 per $100 TAV for new debt issuance. This limitation as a factor in the revenue framework assessment is somewhat offset by the recognition of K-12 education as fundamentally a state responsibility and the expectation of continued state support for education funding.

Fitch does not consider the calculated rate-adjusted revenue metric for Texas school districts as this metric is relatively meaningless for these local government entities. Local school districts do not have the independent legal ability to annually adjust their operating tax rate to changing TAV trends. Total general fund revenue volatility is primarily attributable to: natural enrollment, TAV growth/decline in conjunction with annually adjusted state funding based on the school funding formula and appropriated funding levels.

Expenditure Framework

Instructional costs account for the largest expenditure category, equal to 48% of spending in fiscal 2018. Additionally, as a property rich district under Chapter 41 of the Texas Education Code, a portion of Coppell ISD's operation and maintenance (O&M) levy is recaptured by the state for distribution to less wealthy school districts. These payments totaled $39.8 million in fiscal 2018, representing 28% of spending.

Fitch expects the district's spending to grow in line with or marginally above revenues, as both revenues and Chapter 41 payments are driven by growth in TAV.

The district maintains solid control over spending despite Chapter 41 requirements, including labor and related costs, through its annual budget process. The district's moderate carrying costs, 13% of spending in fiscal 2018, reflect the state's payment of state-wide school district pension contributions. Inclusive of a rising debt service schedule that peaks at over $37 million (in fiscal 2024), carrying costs are projected to remain in the moderate category.

The district participates in the Texas Teachers Retirement System (TRS), a cost-sharing multiple employer pension system. The TRS legislative funding request for the 2020-2021 biennium includes an increase in the state contribution rate to 8.62% of payroll 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 will likely 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 contributions.

Long-Term Liability Burden

The district's long-term liability burden, comprised of overall debt and direct unfunded pension liabilities (adjusted for Fitch's standard 6% rate of return assumption) is moderate at approximately 15% of personal income. The liability burden is comprised primarily of direct debt (63% of liability burden), followed by overlapping debt (30%). The current offering will exhaust the district's $249 million 2016 bond program. Fitch expects the district's liability burden to remain moderate considering the district's plan to seek additional voter authorization in three to four years along with commensurate growth in its wealthy resource base. Future bond projects will focus primarily on renovations and technology as instructional capacity is projected to suffice for the next eight to ten years with the current bond projects.

Under GASB 67 and 68 reporting, TRS assets covered 82% of liabilities as of fiscal 2018, a ratio that falls to a Fitch-estimated 65% using a more conservative 6% 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 fiscal 2015.

The district's pension contributions are determined by state statute rather than actuarially, and they have historically fallen short of the actuarial level. Recent state reforms have lowered benefits and increased statutory contributions to improve plan sustainability over time.

To that end, the TRS board at its July 2018 meeting voted to lower the investment return assumption for the TRS pension plan to 7.25% from 8.00%. This move increases the plan's current $35.5 billion net pension liability by $10 billion. This change in investment return assumption and overall increase in net pension liability do not affect Fitch's analysis of the long-term liability burden, as Fitch currently utilizes a lower 6% assumption when considering the burden.

Operating Performance
Fitch expects the district to retain a high level of financial flexibility during an economic downturn given its sound expenditure flexibility and healthy reserves. Financial performance and reserve levels are very strong despite the large recapture payments associated with the state funding formula. The district posted a modest $0.7 million (0.5% of spending) net surplus in fiscal 2018, completing the year with $60.8 million of unrestricted reserves (43% of spending). Fitch anticipates the district's reserves to remain well above its minimum two-month policy floor.

Conservative budgeting and diligent cost management have contributed to a history of favorable operating performance. The district's reserves remain stable during economic cycles and management does not defer spending needs. The fiscal 2019 budget was adopted as balanced although management projects a net surplus based on year-to-date performance.

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In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

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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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