FitchRatings

Public Finance
Tax-Supported
U.S.A

Mesquite Independent School District, Texas

Ratings

Long Term Issuer Default Rating	AA+

New Issues[a]

$89,670,000 Unlimited Tax School Building Bonds, Series 2020A	AAA
$6,370,000 Unlimited Tax Refunding Bonds, Series 2020B	AAA
$5,540,000 Unlimited Tax Refunding Bonds, Series 2020C	AAA

Rating Outlook

Stable

[a]The 'AAA' long-term rating on the bonds reflects the guaranty provided by the Texas Permanent School Fund, which carries a Fitch insurer financial strength rating of 'AAA'. The bonds' underlying long-term rating, reflecting the credit quality beforre the consideration of the guaranty, is 'AA+'.

Applicable Criteria

U.S. Public Finance Tax-Supported Rating Criteria (March 2020)

Related Research

Fitch Rates Mesquite ISD, TX's Series 2020A-C ULT Bonds, 'AAA'PSF/'AA+' (June 2020)

Mesquite Independent School District (TX) - ESG Navigator (May 2019)

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New Issue Summary

Sale Date: On or around June 8, 2020

Series: $89,670,000 Unlimited Tax School Building Bonds, Series 2020A; $6,370,000 Unlimited Tax Refunding Bonds, Series 2020B; and, $5,540,000 Unlimited Tax Refunding Bonds, Series 2020C

Purpose: Designing, constructing, renovating, improving and equipping school facilities; and, refunding pre-existing debt for interest cost savings.

Security: The bonds are payable from an unlimited property tax levy and are further backed by the PSF bond guaranty program. For more information on the Texas Permanent School Fund see 'Fitch Affirms Texas PSF Rating at 'AAA'; Outlook Stable', dated July 21, 2017.

The 'AA+' IDR and ULT ratings reflect Fitch's expectations that the district will maintain a high level of financial flexibility throughout the current economic contraction and future business cycles due to its solid expenditure flexibility and strong reserves. Long-term liabilities and fixed costs are expected to remain within Fitch's moderate range.

Economic Resource Base: This mature, suburban district is located 35 miles east of downtown Dallas and serves an estimated population of more than 185,000. The district, which ties into the Dallas-Fort Worth (DFW) metro area, encompasses portions of Mesquite, Balch Springs, Seagoville, and Garland. While the district is largely built-out, the area is experiencing residential tax base expansion. Over the past three years, taxable assessed value (TAV) has increased by 35% to $8.6 billion in fiscal 2019. While the district's wealth and income levels lag those of the larger DFW metro area, the district's inclusion in this broad and robust employment market, coupled with continued regional economic expansion is favorable for the district. Student enrollment has generally risen over the past decade. However, in fiscal 2019 enrollment dropped by about 2% and in fiscal 2020 management expects enrollment to drop again, albeit at less than 1%. Based on the most recent demographic information, provided by district representatives, the decline in enrollment is largely due to lower birth rates.

Key Rating Drivers

Revenue Framework: 'a': Revenue growth has historically been strong. Fitch expects future revenue growth to be more moderate but still solid based on the district's forecast for modest enrollment pressures and the state's per pupil education funding formula. The district's statutorily limited independent legal revenue-raising ability is common of Texas school districts.

Expenditure Framework: 'aa': District spending is stable and generally expected to track revenue growth. The district maintains strong expenditure flexibility in salaries (there are no contractual obligations with employees) and pay-go capital spending. The low fixed-cost burden for debt service and retiree benefits reflects state support for long-term liabilities.

Long-Term Liability Burden: 'aa': The long-term liability burden is moderate. The series 2020 issuance is the final installment of the voter authorized $325 million bond program from a May 2018 bond election. Fitch expects that the liability burden will remain moderate even following this new debt issuance.

Operating Performance: 'aaa': The district's strong history of operating surpluses, its maintenance of robust reserve levels and solid expenditure flexibility leave it well positioned to address the current pandemic-induced slowdown and any future cyclical downturns.

Rating Sensitivities

Factors that could, individually or collectively, lead to a positive rating action/upgrade:

- Although not expected in the medium term, a sustained decline in the long-term liability burden below 10% of residents' personal income.

Factors that could, individually or collectively, lead to a negative rating action/downgrade:

- A material decline in K-12 education funding due to state revenue pressures associated with the coronavirus pandemic, which could pressure operations.
- Although not anticipated in the near-term, a severe and prolonged decline in enrollment - a principal driver for state funding.

Current Developments

Sector-Wide Coronavirus Implications

The recent outbreak of coronavirus and related government containment measures worldwide create an uncertain global environment for U.S. state and local governments and related entities in the near term. While the district's most recently available fiscal and economic data may not fully reflect impairment, material changes in revenues and expenditures are occurring across the country and likely to worsen in the coming weeks and months as economic activity suffers and public health spending increases. Fitch's ratings are forward-looking in nature, and Fitch will monitor developments in state and local governments as a result of the virus outbreak as it relates to severity and duration, and incorporate revised expectations for future performance and assessment of key risks.

In its baseline scenario, Fitch assumes sharp economic contractions to hit major economies in 1H20 at a speed and depth that is unprecedented since World War II. Sequential recovery is projected to begin from 3Q2020 onward as the health crisis subsides after a short but severe global recession. GDP is projected to remain below its 4Q19 level until mid-2022. Additional details, including key assumptions and implications of the baseline scenario and a downside scenario, are described in the report entitled, "Fitch Ratings Coronavirus Scenarios: Baseline and Downside Cases - Update" (https://www.fitchratings.com/site/re/10120570), published April 29, 2020 on www.fitchratings.com.

From March 16 through the last day of the spring semester, the district was designated as "Closed, Instructing" with the Texas Education Agency, indicating that normal operations had ceased and children no longer came to campuses but were instead provided support to receive instruction at home/off-site. This designation allowed the district to continue receiving state aid based on average daily attendance. TEA reportedly is using the average daily attendance (ADA) of the first four six-week periods to estimate the last two six-week periods, accounting for historical difference in attendance rate.

Credit Profile

The district's proximity to Dallas and its location in the broader DFW metro area provides residents with easy access to a large and diverse labor market. The DFW metro area is home to numerous corporate headquarters, and prominent economic sectors include transportation, financial services, wholesale trade, manufacturing, oil/gas, and education and government.

The tax base is primarily residential, as single-and-multifamily residences account for almost 70% of TAV. Strong recent TAV growth is being driven by residential appreciation and expansion in the industrial sector. Despite the coronavirus-driven economic downturn, development initiatives continue throughout the district. Management expects industrial development to add another $150 million to $200 million to the tax base over the next couple of years. Residential development continues and is driven by the regional economy, which has been in growth mode for most of the past decade. The district's fiscal 2020 certified TAV of $9.27 billion reflects an 8% increase over the prior year. Based on preliminary figures provided

Rating History (IDR)

Rating	Action	Outlook/ Watch	Date
AA+	Affirmed	Stable	6/03/20
AA+	Revised	Stable	4/30/10
AA	Assigned		4/24/00

by the Dallas County Appraisal District, the district's fiscal 2021 TAV could reflect an additional increase of more than 10%.

Despite the sharp negative impact to the regional economy, the long-term economic prospects for both the district and the metropolitan region remain positive.

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 student characteristics) produces a district's Tier 1 allotment. The vast majority of districts are funded using a target revenue approach, whereby the combination of local and state funding for operations meets a predetermined per pupil amount (which varies from district to district).

The district received 72% of fiscal 2019 operating revenues from state aid, followed by property taxes at 24%.

For the state's fiscal 2020-2021 biennium, the state increased Texas Education Agency (TEA) funding by roughly 20% through the provisions of House Bill 3 (HB3), which was approved by the 2019 Texas legislature and signed into law by the governor. The increased funding is driven primarily by an increase in the per student basic allotment to $6,160 from $5,140. HB3 requires districts to apply 30% of annual increased funding to full-time employee compensation increases (75% of which would go to teachers, counselors, nurses and librarians). In addition to the funding increase, HB3 calls for the compression of local operating tax rates and requires districts to limit annual operating tax revenue increases to 2.5% (by requiring a reduction in the maintenance and operations [M&O] rate if TAV increases by more than 2.5%). The tax rate compression is designed to be offset by the increase in state revenues.

The coronavirus pandemic is materially affecting state revenues and is expected to continue applying downward pressure in the coming months. While state officials have made no projections to date, a reduction in K-12 funding is likely to be considered as leaders address the growing revenue shortfall.

The district's fiscal 2020 overall property tax rate at $1.45 per $100 of TAV includes a compressed $0.97 M&O rate and a separate debt service tax rate of $0.48. This debt service tax rate preserves modest margin under the statutory new money issuance limit of $0.50, but is projected to adequately support the series 2020 debt issuance.

Expenditure Framework

The district's main expenditure category is instruction, which accounted for about 62% of operating expenses in fiscal 2019. Fitch expects instructional and other operating costs, driven primarily by teacher wages and benefits, to generally grow in line with revenues. Historically, the district has funded some annual capital outlay from the general fund. While the district will likely continue to finance some capital needs through the general fund, Fitch does not expect this practice to negatively impact the expenditure framework assessment.

The district's fixed cost burden is low, with carrying costs for debt, pensions and other post-employment benefits (OPEB) accounting for approximately 8% of fiscal 2019 governmental expenditure (after factoring in the roughly 37% in annual debt service state aid). While Fitch expects the fixed-cost burden to increase with the series 2020 bond issuance, it will likely remain low-to-moderate given the strong state debt service support. The district retains flexibility in staffing levels, given the absence of labor contracts, although that flexibility is tempered by state student-teacher ratio guidelines.

The district participates in the Texas Teachers Retirement System (TRS), a cost-sharing multiple employer pension system. Senate Bill 12 (SB12), which was approved by the 2019 Texas legislature and signed into law by the governor, will direct the allocation of $1.1 billion in state funding to contribute to TRS over the next several years. Roughly $600 million from this allocation will be used to finance a one-time payment of $2,000 to retired teachers; the remainder will be used to gradually increase state contributions to TRS. Over the next six years, educators, school districts, and the state will incrementally ramp up their respective contributions.

Districts and employees will begin to increase their contributions in fiscal 2021; by fiscal 2024, teachers will pay 8.25% of salary (up from 7.7% currently), with districts increasing their contributions (currently 1.5% of payroll) by 0.1% annually until reaching 2.0% in fiscal 2025. Between fiscal years 2020 and 2024, the state will steadily increase its contribution of total employee payroll to 8.25% from the current 7.5%. These changes, combined with a reduction in the discount rate to 7.25% from 8.0%, will allow for a pension amortization period of less than 31 years, consistent with the current 32 years.

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 the increases mandated by SB12 without compromising spending flexibility.

Long-Term Liability Burden

The district's overall debt and net pension liability (NPL) represents about 15% of personal income, with the district's direct debt representing the bulk of the total liability. The district received a strong 72% voter support for its May 2018 bond program. The district's series 2020A issuance is the final tranche from the most recent bond program. Officials report no additional debt plans over the next several years. Fitch anticipates that the long-term liability burden will remain consistent with the current assessment category.

Pension and OPEB liabilities (largely retiree healthcare benefits) are limited because of the district's participation in the state pension program administered by the TRS. TRS is a cost-sharing, multiple-employer plan for which the state provides the bulk of the employer's annual pension contribution. Under GASB 67 and 68 reporting, TRS assets covered about 74% of liabilities as of fiscal 2019, a ratio that falls to a Fitch-estimated 66% using a more conservative 6% return assumption. The state assumes the majority of TRS employer contributions and NPL on behalf of school districts, except for small amounts that state statute requires districts to assume. 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%. This move increases the plan's current $35.5 billion NPL by $10 billion. As noted above, contributions by the state, districts and employees will be increasing over the next six years to help address the increased NPL. 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 6% assumption when considering the burden.

Operating Performance

Given the district's solid fund balance position and ability to adjust expenditures, Fitch believes the district has the capacity to reasonably absorb any potential financial pressure resulting from the ongoing coronavirus and resulting economic contraction outbreak without impairing its strong financial resilience.

The district's adopted budget for fiscal 2020 includes an operating surplus of $1.6 million. With less than three months remaining in fiscal 2020, management expects to close the fiscal year with an operating surplus of no less than $3 million (due in part to cost savings associated with campus closures). Moreover, management indicates that the district currently plans to open campus buildings at the start of the fall 2020 semester. Though the fiscal 2021 budget has not been adopted management reports the district plans to budget conservatively and preserve reserve levels. Fitch expects the district will continue managing its resources prudently to maintain a strong financial cushion.

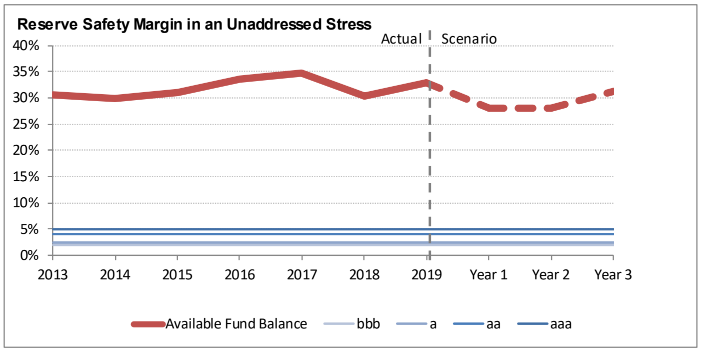
ESG Considerations

ESG issues are credit neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

The highest level of ESG credit relevance, if present, is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or to the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

Mesquite Independent School District (TX)

Scenario Analysis



Analyst Interpretation of Scenario Results:

The district has ended the past several fiscal years with an unrestricted general fund balance that accounts for no less than 30% of operating expenditures. In fiscal 2018, officials authorized a sizable general fund drawdown to finance one-time capital needs. Despite the drawdown, at the close of fiscal 2018, the district's available fund balance totaled $111 million, or 30% of general fund expenditures. Fiscal 2019 audited results reflect a surplus in excess of $7 million, boosting unrestricted operating reserves to just shy of $118 million, which equates to 33% of operating expenditures.

Scenario Parameters:			Year 1	Year 2	Year 3
GDP Assumption (% Change)			(5.6%)	4.3%	2.5%
Expenditure Assumption (% Change)			0.0%	2.0%	2.0%
Revenue Output (% Change)	*Min Y1 Stress:* **-5%**	*Case Used:* **Baseline**	(6.6%)	7.6%	5.4%
Inherent Budget Flexibility				Midrange	

Revenues, Expenditures, and Fund Balance	Actuals							Scenario Output		
	2013	2014	2015	2016	2017	2018	2019	Year 1	Year 2	Year 3
Total Revenues	282,211	306,502	324,218	341,726	349,863	358,139	362,361	338,318	364,081	383,698
% Change in Revenues	-	8.6%	5.8%	5.4%	2.4%	2.4%	1.2%	(6.6%)	7.6%	5.4%
Total Expenditures	277,871	304,470	316,861	329,535	341,581	365,936	358,025	358,025	365,185	372,489
% Change in Expenditures	-	9.6%	4.1%	4.0%	3.7%	7.1%	(2.2%)	0.0%	2.0%	2.0%
Transfers In and Other Sources	452	4,612	459	469	425	564	3,522	3,289	3,539	3,730
Transfers Out and Other Uses	440	506	537	342	767	814	743	743	758	773
Net Transfers	12	4,106	(78)	127	(341)	(251)	2,780	2,546	2,782	2,957
Bond Proceeds and Other One-Time Uses	-	-	-	-	-	-	-	-	-	-
Net Operating Surplus(+)/Deficit(-) After Transfers	4,352	6,138	7,279	12,318	7,941	(8,048)	7,116	(17,161)	1,677	14,166
Net Operating Surplus(+)/Deficit(-) (% of Expend. and Transfers Out)	1.6%	2.0%	2.3%	3.7%	2.3%	(2.2%)	2.0%	(4.8%)	0.5%	3.8%
Unrestricted/Unreserved Fund Balance (General Fund)	85,250	91,327	98,694	111,050	119,021	111,065	117,974	100,813	102,491	116,657
Other Available Funds (GF + Non-GF)	-	-	-	-	-	-	-	-	-	-
Combined Available Funds Balance (GF + Other Available Funds)	85,250	91,327	98,694	111,050	119,021	111,065	117,974	100,813	102,491	116,657
Combined Available Fund Bal. (% of Expend. and Transfers Out)	30.6%	29.9%	31.1%	33.7%	34.8%	30.3%	32.9%	28.1%	28.0%	31.3%

Reserve Safety Margins	Inherent Budget Flexibility				
Moderate	Minimal	Limited	Midrange	High	Superior
Reserve Safety Margin (aaa)	16.0%	8.0%	5.0%	3.0%	2.0%
Reserve Safety Margin (aa)	12.0%	6.0%	4.0%	2.5%	2.0%
Reserve Safety Margin (a)	8.0%	4.0%	2.5%	2.0%	2.0%
Reserve Safety Margin (bbb)	3.0%	2.0%	2.0%	2.0%	2.0%

Notes: Scenario analysis represents an unaddressed stress on issuer finances. Fitch's scenario analysis assumes the GDP and expenditure growth sequence shown in the 'Scenario Parameters' section. 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

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