

Pearland Independent School District, Texas

The upgrade of the Issuer Default Rating (IDR) to 'AA+' (from AA) reflects the implementation of Fitch Ratings' new "U.S. Public Finance Local Government Rating Criteria." The 'AA+' rating incorporates the Pearland Independent School District's (Pearland ISD, or the district) financial resilience assessment of 'aaa', based on a low midrange level of budgetary flexibility. It is also based on Fitch's expectation that the district will maintain unrestricted general fund reserves of at least 20% of spending, compared to almost 34% currently.

Additionally, the rating incorporates the district's strong economic and demographic level metrics and weak long-term liability composite (30th percentile of the Fitch-rated portfolio). The liability metrics incorporate the current issuance.

The 'AAA' enhanced rating on the unlimited tax (ULT) bonds reflects the credit enhancement provided by the Texas Permanent School Fund (PSF) bond guarantee program (BGP). A change in Fitch's assessment of the Texas PSF BGP would automatically result in a change to the enhanced rating of Pearland ISD's ULT bonds, but would not affect the underlying rating.

Rating Sensitivities

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

- A decline in available general fund reserve levels below 20% of spending, which would lower Fitch's assessment of financial resilience to below 'aaa'.
- Material increases to direct debt that push long-term liabilities into the extreme lower percentiles of the Fitch-rated portfolio.
- Weakened underlying economic and demographic performance, including slowing population gains and/or higher unemployment relative to the U.S. rate.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

- An approximate 20% decline in long-term liabilities, assuming current levels of personal income and governmental resources and spending.
- Strengthening of underlying economic and demographic performance, specifically a decrease in the unemployment rate as a percentage of the national rate.

Security

The bonds are payable from an unlimited ad valorem tax levied against all taxable property within the district, and are further backed by the Texas PSF BGP, rated 'AAA' by Fitch.

Local school district bonds approved under the PSF BGP are guaranteed by the assets of the PSF. By law, if a Texas school district is unable to pay its debt service, it must notify the Commissioner of Education at least five days prior to the payment date. Funds would then be transferred from the appropriate PSF account of the state treasury to the paying agent in an amount sufficient to cover any potential shortfall.

For more information on the Texas PSF, see "Fitch Affirms Texas Permanent School Fund at 'AAA'; Outlook Stable," dated December 2022 at www.fitchratings.com.

Ratings

Long-Term IDR^a AA+
^aUpgraded from 'AA' on July 11, 2024

Outlooks

Long-Term IDR Stable

New Issues

\$52,895,000 Unlimited Tax School Building Bonds, Series 2024^a AAA

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

Sale Date

July 23, 2024 via negotiation

Outstanding Debt

Unlimited Tax Refunding Bonds^a AA+
Unlimited Tax School Building Bonds^a AA+

^aUpgraded from 'AA' on July 11, 2024

Applicable Criteria

U.S. Public Finance Local Government Rating Criteria (April 2024)

Related Research

[Fitch Upgrades Pearland ISD, ULT Bonds to 'AA+' Underlying from 'AA' on Criteria Change \(July 2024\)](#)

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Rating Headroom & Positioning

Pearland Independent School District Model Implied Rating: 'AA+' (Numerical Value: 9.67)

- Metric Profile: 'AA+' (Numerical Value: 9.67)
- Net Additional Analytical Factor Notching: 0.0

Pearland ISD's Model Implied Rating (MIR) is 'AA+'. The associated numerical value of 9.67 is at the upper end of the 9.0 to 10.0 range for its current 'AA+' rating.

The Local Government Rating Model generates MIRs that communicate the issuer's credit quality relative to Fitch's local government rating portfolio (the MIRs will be the IDR, except in certain circumstances explained in the applicable criteria). The MIR is expressed via a numerical value calibrated to Fitch's long-term rating scale that ranges from 10.0 or higher (AAA), 9.0 (AA+), 8.0 (AA) and so forth, down to 1.0 (BBB- and below).

MIRs reflect the combination of issuer-specific metrics and assessments to generate a metric profile (MP), and a structured framework to account for additional analytical factors (AAFs) not captured in the MP that can either mitigate or exacerbate credit risks. AAFs are reflected in notching from the MP and are capped at +/-3 notches.

Current Developments

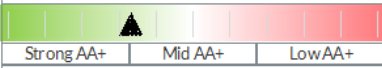
The district ended fiscal 2023 (June 30, 2023) with a surplus of \$1.8 million (roughly 0.92% of expenditures), which increased unrestricted reserves to \$66.8 million, or 33.8% of spending. In 2023, the district had an average daily attendance (ADA) of 19,834, which was a 0.03% increase from the prior year. The district has seen a modest decline in ADA, with a five-year CAGR of negative 0.88%. However, the district does expect enrolment to stabilize or slightly rise due to increasing residential development and its proximity to the Houston area.

The fiscal 2024 budget includes a planned deficit of \$13.6 million, although the district is currently projecting a surplus of \$2.5 million after finding savings in payroll expenditures and expecting higher than anticipated revenues. Additionally, the district has estimated a surplus of \$3.6 million for fiscal 2025. After the sale, the district will have approximately \$50 million in authorized but unissued debt that it plans to issue within the next few years.

Profile

Pearland ISD is a K-12 school district located in Brazoria County. It serves most of the city of Pearland, along with the city of Brookside Village and unincorporated areas in the county. The district's current ADA is 19,779 students, and it has a total of 23 campuses. Additionally, the district's TAV was approximately \$10 billion in 2023, an 8% increase from 2022.

Key Drivers

| | | | | |
|---|---------------------------------|---------------------------------|---|------|
| Issuer: Pearland Independent School District (TX) | Financial Profile | 0.0 | Issuer Position Within AA+ Model Implied Rating  Rating position post application of analytical overlay | |
| Type: School District General Obligations | Demographic & Economic Strength | 0.0 | | |
| Current: AA, RO:Sta (2024/04/04) | Long-Term Liability Burden | 0.0 | | |
| Fiscal Year | 2023 | AAF Notching Total ^d | | 0.0 |
| Metric Profile | 9.67 | MIR - Metric | | 9.67 |
| Metric Profile Mapping | AA+ | MIR - Mapping | | AA+ |

| Metric | Analyst Input | | Metric | | Composite | | |
|---|---------------|--------------|------------|--------|--------------------|------------|--------|
| | 2023 | 2023 | Percentile | Weight | Percentile / Value | Assessment | Weight |
| Financial Profile | | | | | | | |
| Financial Resilience Components | | | | | | | |
| Available Reserves (FB/Expenditures: 5-Year Low) (%) | 31.3 | | | | | | |
| Revenue Control Assessment | Low | Low | | | | | |
| Expenditure Control Assessment | High | High | | | | aaa | 35% |
| Budgetary Flexibility | Low Midrange | Low Midrange | | | | | |
| Financial Resilience | aaa | aaa | | 100% | | | |
| Lowest Cumulative 3 Year Revenue Performance (+/-) since 2008 (%) | 0.6 | | | | | | |
| Revenue Volatility(1) | | | 80% | 100% | | Strong | 0% |
| Demographic and Economic Strength | | | | | | | |
| Trend | | | | | | | |
| Population Trend (%) (2) | 2.2 | | 87% | 100% | 87% | Strongest | 8% |
| Unemployment Rate as Percentage of National Rate (%) (5) | 116.7 | | 30% | 33% | | | |
| Population w/ Bachelor's Degree and Higher (%) (2) | 42.8 | | 79% | 33% | 65% | Strong | 26% |
| MHI as a % of the Portfolio Median (2) | 148.7 | | 87% | 33% | | | |
| Concentration & Size | | | | | | | |
| Population Size (2) (3) | 107,843 | | 100% | 50% | | | |
| Economic Concentration (%) (2) (3) | 41.2 | 50.8 | 100% | 50% | 100% | Strongest | 9% |
| Long-Term Liability Burden | | | | | | | |
| Liabilities/Personal Income (%) | 6.9 | 7.2 | 35% | 35% | | | |
| Liabilities/Governmental Revenues (%) (6) | 174.3 | 182.8 | 48% | 25% | 30% | Weak | 21% |
| Carrying Costs/Governmental Expenditures (%) | 18.2 | 20.9 | 16% | 40% | | | |

(1) Model directly uses revenue volatility. Percentiles are for information only; metric percentile represents the issuer; composite percentile represents the average of the issuer's class. The Revenue Volatility metric represents the issuer's revenue volatility relative to the median revenue volatility of the total issuer portfolio.
 Revenue Volatility is treated asymmetrically, where weight is marginal for issuers that exhibit low to moderate revenue volatility. For issuers with higher revenue volatility, this factor will moderately lower the metric profile, implying a somewhat reduced weighting for all other variables in these instances.
 (2) Population, Concentration, MHI and Educational Attainment data is lagged by one year e.g. 2021 data is used and displayed for fiscal year 2022.
 (3) Percentiles represent the class. Economic concentration is defined as the sum of the absolute deviation of the issuer from the national average proportion across major economic sectors.
 (4) Additional Analytical Factors (AAF) have a potential notching range of +2/-2 for each of the three categories and an overall IDR notching range of +3/-3.
 (5) County level data used for sub-county entities when the latest year's data is unavailable. If county data is unavailable, MSA data is used. MSA level data is used for cities that span multiple counties.
 (6) As a proxy for per capita personal income for sub-county levels of local government, Fitch calculates the ratio of money income to per capita income for the county in which the rated entity is located and applies that ratio to the entity's money income. The estimated per capita personal income figure is multiplied by population to estimate total personal income.
 Source: Fitch Ratings

Financial Profile

Financial Resilience - 'aaa'

Pearland ISD's financial resilience is driven by the combination of its 'Low' revenue control assessment and 'High' expenditure control assessment, culminating in a 'Low Midrange' budgetary flexibility assessment.

- Revenue control assessment: Low
- Expenditure control assessment: High
- Budgetary flexibility assessment: Low midrange
- Minimum fund balance for current financial resilience assessment: >=20.0%
- Current year fund balance to expenditure ratio: 33.8% (2023)
- Five-year low fund balance to expenditure ratio: 31.3% (2023)

Revenue Volatility - 'Strong'

Pearland ISD's weakest historical three-year revenue performance is neutral to the MIR.

The revenue volatility metric is an estimate of potential revenue volatility, based on the issuer's historical experience relative to the median for the Fitch-rated local government portfolio. The metric helps to differentiate issuers by the scale of revenue loss that would have to be addressed through revenue raising, cost controls or utilization of reserves through economic cycles.

- Lowest three-year revenue performance (based on revenues dating back to 2005): 0.6% increase for the three-year period ended fiscal 2022
- Median issuer decline: -4.5% (2023)

State-Specific Revenue/Expenditure Context & Budgetary Control

Texas school districts lack any material independent revenue-raising ability. Any tax rate increases for maintenance and operations (M&O) must be approved by voters through a tax ratification election. However, ample flexibility in headcount, wages and benefits is afforded by the lack of a collective bargaining framework and the reliance on individual annual contracts with instructional staff. Although Texas school districts are subject to class-size restriction, districts can request class-size waivers from the Texas Education Agency (TEA). Fitch's assessment of low revenue control and high expenditure flexibility results in a budgetary flexibility assessment of low midrange. The district does not have a formal fund balance policy but aims to maintain 90 days of operating expenditures.

Demographic and Economic Strength

Population Trend - 'Strongest'

Based on the median of 10-year annual percentage change in population, Pearland ISD's population trend is assessed as 'Strongest'.

Population trend: 2.2% 2022 median of 10-year annual percentage change in population (87th percentile)

Unemployment, Educational Attainment and MHI Level - 'Strong'

The overall strength of Pearland ISD's demographic and economic level indicators (unemployment rate, educational attainment and median household income [MHI]) in 2023 are assessed as 'Strong' on a composite basis, performing at the 65th percentile of Fitch's local government rating portfolio. This is due to high education attainment levels and very high median, issuer-indexed, adjusted MHI offsetting an elevated unemployment rate.

- Unemployment rate as a percentage of national rate: 116.7% 2023 (30th percentile), relative to the national rate of 3.6%
- Percentage of population with a bachelor's degree or higher: 42.8% (2022) (79th percentile)
- MHI as a percentage of the portfolio median: 148.7% (2022) (87th percentile)

Economic Concentration and Population Size - 'Strongest'

Pearland ISD's population in 2022 was of sufficient size and the economy was sufficiently diversified to qualify for Fitch's highest overall size/diversification category.

The composite metric acts asymmetrically, with most issuers (above the 15th percentile for each metric) sufficiently diversified to minimize risks associated with a small population and economic concentration. Downward effects of the metric on the MP are most pronounced for the least economically diverse issuers (in the 5th percentile for the metric or lower). The economic concentration percentage shown below is defined as the sum of the absolute deviation of the percentage of personal income by major economic sectors relative to the U.S. distribution.

- Population size: 107,843 (2022) (above the 15th percentile)
- Economic concentration: 50.8% analyst input (above the 15th percentile) (vs. 41.2% 2023 actual)

Analyst Inputs to the Model

The deviation of 50.8% was used for economic concentration, as the data for education and health services is missing.

Long-Term Liability Burden

Long-Term Liability Burden - 'Weak'

Pearland ISD's carrying costs to governmental expenditures and liabilities to personal income remain weak, while liabilities to governmental revenue remain midrange. The long-term liability composite metric in 2023 is at the 30th percentile, indicating a somewhat elevated liability burden relative to the Fitch local government rating portfolio.

- Liabilities to personal income: 7.2% analyst input (35th percentile) (vs. 6.9% 2023 actual)

- Liabilities to governmental revenue: 182.8% analyst input (48th percentile) (vs. 174.3% 2023 actual)
- Carrying costs to governmental expenditures: 20.9% analyst input (16th percentile) (vs. 18.2% 2023 actual)

Pension Adjustments

On an aggregate basis for all pension plans as of the most recent measurement date, the reported asset to liability ratio was 75.7%, or an estimated 66.7%, using Fitch's standard 6% rate of return adjustment. The Fitch-adjusted NPL was equal to \$102.1 million, or about 1.5% of personal income.

Additional Insight

As previously stated, the district will have approximately \$50 million in authorized, but unissued, debt that it plans to issue within the next few years.

Analyst Inputs to the Model

Direct net debt was updated with the new issuance of \$52.895 million. Total direct net debt of \$384.695 million was reported in the POS from the district, and is reflected in these metrics. Additionally, carrying costs and governmental expenditures were updated with debt service of \$8.8 million, based on the debt service schedule provided in the POS from the district.

ESG Considerations

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means 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. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit <https://www.fitchratings.com/topics/esg/products#esg-relevancescores>.

| Financial Summary | | | | | |
|--|----------------|----------------|----------------|----------------|----------------|
| (\$000, Audited Fiscal Years Ended June 30) | 2019 | 2020 | 2021 | 2022 | 2023 |
| General Fund Revenues | | | | | |
| Property Tax | 80,628 | 77,374 | 77,425 | 82,990 | 92,813 |
| Sales Tax | - | - | - | - | - |
| Income Tax | - | - | - | - | - |
| Other Tax | 514 | 500 | - | - | - |
| Total Taxes - Undifferentiated | - | - | - | - | - |
| Intergovernmental | 103,727 | 103,473 | 104,071 | 104,246 | 104,883 |
| Other Revenue | 2,752 | 2,244 | 1,216 | 1,539 | 5,145 |
| Total | 187,621 | 183,592 | 182,713 | 188,775 | 202,842 |
| General Fund Expenditures | | | | | |
| General Government | - | - | - | - | - |
| Public Safety | - | - | - | - | - |
| Educational | 109,774 | 112,273 | 113,153 | 112,030 | 113,857 |
| Debt Service | - | - | - | 613 | 961 |
| Capital Outlay | - | 531 | - | - | - |
| Other Expenditures | 62,419 | 63,499 | 69,928 | 74,739 | 77,583 |
| Total | 172,193 | 176,303 | 183,082 | 187,382 | 192,401 |
| Transfers In and Other Sources | 1,138 | 502 | 5,975 | 68 | 371 |
| Transfers Out and Other Sources | 10,000 | 4,500 | 1,000 | 1,400 | 5,500 |
| Net Transfers & Other | -8,862 | -3,615 | 5,089 | -1,332 | -8,629 |
| Adjustment for Bond Proceeds and Extraordinary One-Time Uses | - | - | - | - | - |
| Net Op. Surplus/(Deficit) After Transfers | 6,566 | 3,673 | 4,720 | 62 | 1,812 |
| Net Op. Surplus/(Deficit)/(Total Expenditures + Transfers Out and Other Uses) (%) | 3.6 | 2.03 | 2.56 | 0.03 | 0.92 |
| Total Fund Balance | 58,635 | 62,308 | 67,029 | 68,344 | 70,156 |
| Unrestricted Fund Balance | 57,051 | 60,735 | 64,603 | 65,602 | 66,839 |
| Other Available Fund Balances | - | - | - | - | - |
| Total Available Unrestricted Reserves (GF + Other) | 57,051 | 60,735 | 64,603 | 65,602 | 66,839 |
| Available Reserves as % of Spending (Adj. for Bond Proceeds and Other One-Time Uses) | 31.31 | 33.59 | 35.09 | 34.75 | 33.77 |

Source: Fitch Ratings, Fitch Solutions, Pearland Independent School District (TX)

Long-Term Liability Burden

| (\$000, Audited Fiscal Year Ended June 30) | 2023 |
|---|----------------|
| Direct Debt | 362,127 |
| Less: Self-Supporting Debt | - |
| Net Direct Debt | 362,127 |
| Fitch Adjusted NPL | 102,079 |
| Net Direct Debt + Fitch-Adjusted Net Pension Liabilities (NPLs) | 464,206 |
| Population | 105,503 |
| Per Capita Personal Income | 63,812 |
| Estimated Personal Income (\$000) | 6,732,355 |
| Net Debt + Fitch-Adjusted NPLs/Personal Income (%) | 6.9 |
| Total Governmental Revenues | 266,353 |
| Net Direct Debt + Fitch-Adjusted NPLs as % of Governmental Revenue | 174.28 |
| Debt Service (Net of State Support) | 41,042 |
| Actuarially Determined Pension Contributions | 5,298 |
| Actual OPEB Contributions | 1,151 |
| Total Governmental Expenditures | 260,988 |
| Carrying Costs/Governmental Expenditures (%) | 18.2 |

Note: Figures above do not reflect any analyst input adjustments.
Sources: Fitch Ratings, Fitch Solutions, Pearland Independent School District (TX)

Summary

| Description | Final Value |
|--|-------------|
| Budgetary Flexibility Assessments | |
| Revenue Control Assessment | Low |
| Expenditure Control Assessment | High |
| Collective Bargaining and Resolution Framework | High |
| Workforce Outcomes | High |
| Cost Drivers | Midrange |
| Metrics Assessments | |
| Financial Profile - Financial Resilience | aaa |
| Financial Profile - Revenue Volatility | Strong |
| Demographic & Economic Strength - Trend | Strongest |
| Demographic & Economic Strength - Level | Strong |
| Demographic & Economic Strength - Concentration & Size | Strongest |
| Long-Term Liability Burden | Weak |
| Metric Profile Mapping | AA+ |
| Metric Profile | 9.67 |
| Additional Analytical Factors | |
| Total Notching - Capped | 0 |
| Financial Profile | |
| Fiscal Oversight | 0 |
| Revenue Capacity | 0 |
| Contingent Risks | 0 |
| Nonrecurring Support or Spending Deferrals | 0 |
| Political Risks | 0 |
| Management Practices | 0 |
| Demographic & Economic Strength | |
| Economic & Institutional Strength | 0 |
| Revenue Concentration Risks | 0 |
| School District Resources | 0 |
| Long-Term Liability Burden | |
| Pension Funding Assumptions | 0 |
| Pension Contributions | 0 |
| OPEB | 0 |
| Debt Structure | 0 |
| Capital Demands & Affordability | 0 |
| Model Implied Rating - Mapping | AA+ |
| Model Implied Rating - Metric | 9.67 |
| Outliers & Developing Situations Considerations | No |
| Notching Rationale - 1 | |
| Notching Rationale - 2 | |
| Issuer Default Rating / Issuer Default Credit Opinion | AA+ |
| Source: Fitch Ratings | |

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