MOODY'S INVESTORS SERVICE

New Issue: Moody's assigns Aa3 underlying, Aaa enhanced to Montgomery ISD, TX's $16.8M Series 2015A

Global Credit Research - 01 Dec 2015

MONTGOMERY INDEPENDENT SCHOOL DISTRICT, TX
Public K-12 School Districts
TX

Moody's Rating

ISSUE		RATING
Unlimited Tax School Refunding Bonds, Series 2015A		Aa3
Sale Amount	$16,830,000	
Expected Sale Date	12/08/15	
Rating Description	General Obligation	
Unlimited Tax School Refunding Bonds, Series 2015A		Aaa
Sale Amount	$16,830,000	
Expected Sale Date	12/08/15	
Rating Description	General Obligation	

Moody's Outlook NOO

NEW YORK, December 01, 2015 --Moody's Investor's Service has assigned a Aa3 underlying rating to $16.83 million Unlimited Tax School Refunding Bonds, Series 2015A. Concurrently, we have assigned a Aaa enhanced rating to the series based on a guarantee by the Texas Permanent School Fund. Moody's also maintains a Aa3 underlying rating on the district's $299.37 million in outstanding parity debt.

SUMMARY RATING RATIONALE - UNDERLYING

The rating reflects the district's sizeable and growing tax base, above average socioeconomic profile, and growing enrollment. The rating also takes into consideration the district's high debt burden and financial reserves that are below state medians.

SUMMARY RATING RATIONALE - ENHANCED

The Aaa enhanced rating is based on the rating of the Texas Permanent School Fund and the structure and legal protections of the transaction which provide for timely payment by the PSF if necessary. Moody's currently rates the Permanent School Fund Aaa. For additional information on the PSF program, please see Moody's Rating Update Report on the Texas Permanent School Fund dated June 23, 2015.

OUTLOOK

Outlooks are generally not assigned to local government credits with this amount of debt outstanding.

WHAT COULD MAKE THE RATING GO UP

-Sustained and significant tax base growth

-Moderation of debt burden

-Trend of surplus operations resulting in significantly improved reserves

WHAT COULD MAKE THE RATING GO DOWN

-Further draws on current reserves

-Significant contraction of taxable value

-Additional borrowing without corresponding tax base growth

STRENGTHS

-Sizeable, growing tax base

-Increasing enrollment

-Above average wealth indicators

CHALLENGES

-High debt burden

-Below average reserve levels

RECENT DEVELOPMENTS

Recent developments are incorporated in the Detailed Rating Rationale.

DETAILED RATING RATIONALE

REVENUE GENERATING BASE: SIZEABLE DISTRICT NORTH OF HOUSTON WILL CONTINUE ON GROWTH TRAJECTORY IN THE NEAR TERM

We believe the district's sizeable tax base will experience substantial growth in the near term due to continued residential development within the district. Located in northwest Montgomery County (Aa1 stable), approximately 40 miles north of the City of Houston (Aa2 negative) near Lake Conroe, the district has experienced growth in recent years due to residential construction. Overall, taxable values have experienced rapid, double-digit growth throughout the majority of the last decade. While growth slowed down during the most recent recession and averaged 6.2% annually over the last five years, the tax base grew 8.6% to $5 billion in fiscal 2016. The largest ten taxpayers accounted for a modest 2.5% of fiscal 2016 taxable values. The recent growth stems from increased building activity, which officials attribute partially to the expanding Exxon Mobil Corporation (Aaa stable) and Anadarko Petroleum Corporation (Baa2 stable) headquarters located 20 minutes away in The Woodlands (A1). A recent demographic study shows that housing starts and closings in the first quarter of 2014 exceeded first quarter figures for each of the prior five calendar years. Despite sustained growth over the last fifteen years, officials report that a significant portion of the district remains undeveloped. As of fall 2014, the ten fastest growing subdivisions in the district had over 1,300 vacant developed lots and over 2,300 future single-family lots available for future development. The district reports some commercial activity, including recently added industrial park and a shopping center, anchored by a national chain grocery store, coming online in 2018. In addition, Bluejack National, a 755-acre golf community, is scheduled to open late this year. The majority of the development is located within district boundaries and will include an 18-hole championship golf course, close to 400 homes ranging in price from $300,000s to $1.5 million, as well as parks and several entertainment venues. Officials expect growth to continue at similar pace over the medium term.

Per the American Community Survey, the district's population reached 36,487 in 2013. The district's socioeconomic profile is strong, with the 2013 median family income equivalent to 134.6% of the national median. The district's enrollment has grown 5.2% to 7,936 students in fiscal 2015. Enrollment growth averaged 2.8 % annually over the past five years. District demographer projects a 5% enrollment increase in fiscal 2016 and a more moderate annual growth beginning with fiscal 2017. It is estimated that the district's student population will reach nearly 10,100 by fiscal 2025.

FINANCIAL OPERATIONS AND POSITION: BELOW AVERAGE RESERVES WITH SURPLUS EXPECTED IN FISCAL 2015

We believe the district's relatively limited reserve levels will improve in the near term. Historically, the district has maintained more narrow reserve levels in comparison to similarly rated peers in Texas, which continues to be a credit weakness.

The district's final budget for fiscal 2014 projected a $2 million General Fund deficit, but actual revenues exceeded budget by 5.5% and the year ended with a smaller, $793,000 draw due to a one-time capital expenditure of $1.3 million. The ending fiscal 2014 General Fund balance of $10.3 million, or 18.7% of revenues, is below the state median and the 25% balance required by board policy. Fiscal 2014 total General Fund operations were primarily funded by local property taxes (78%) and state revenues (21.8%).

The district adopted a balanced budget for fiscal 2015 budget. Preliminary results indicate a modest $138,000 deficit due to one-time capital outlay of $1.2 million. Fiscal 2016 budget is balanced. The district is currently levying a maintenance and operations (M&O) tax of $10.40 per $1,000 AV. Per state statutes, the district could levy up to $11.70 per $1,000 AV with voter authorization, but officials have expressed no desire for the additional taxing authority.

Liquidity

At the end of fiscal 2014, General Fund cash of $11 million represented 20% of revenues. We do not anticipate any significant draws or decreases in cash in the near-term and expect cash levels to remain in line with General Fund performance in fiscal 2015.

DEBT AND OTHER LIABILITIES: HIGH DEBT BURDEN WITH SLOW PAYOUT

The district's direct debt burden is elevated at 6.1% of fiscal 2016 taxable values. We expect the debt burden to moderate over the medium term given projected tax base growth. Following the sale, the district will have $56.7 million in authorized but unissued bonds. Officials expect to sell the remaining bonds within the next two years. The district currently levies and interest and sinking (I&S) levy of $3.00 per $1,000 in taxable values. A tax rate model projects that the rate will increase by $0.50 to $3.50 per $1,000 in fiscal 2018 after the remaining authorized bonds are sold. However, we note that the model is aggressive, assuming a 7% annual tax base growth between fiscal 2017 and 2021.

Debt Structure

All of the district's debt is fixed rate and amortizes over the long term. Principal amortization is slow, with 28.3% of principal retired in ten years.

Debt-Related Derivatives

The district is not party to any interest rate swaps or other derivative agreements.

Pensions and OPEB

Budgetary pressure due to the district's participation in the Texas Teachers Retirement System (TRS) pension plan is expected to remain minimal in the near term. The State of Texas (Aaa/stable) annually pays the majority of the required employer pension contributions on behalf of the district. Moody's adjusted net pension liability (ANPL) for the district, under our methodology for adjusting reported pension data, is $18.1 million. This liability is equal to 0.27 times annual operating revenues in fiscal 2014, including the General and Debt Service Funds. The three-year average of the district's ANPL to Operating Revenues is 0.24 times.

Moody's ANPL reflects certain adjustments we make to improve comparability of reported pension liabilities. The adjustments are not intended to replace the district's reported contribution information, or the reported liability information of the state-wide cost-sharing plans, but to improve comparability with other rated entities.

MANAGEMENT AND GOVERNANCE

The district is governed by a seven-member board of trustees who serve staggered three-year terms. The board performs policy-making and supervisory functions and delegates administrative responsibilities to the superintendent of schools, who is the chief administrative officer of the district.

Texas school districts have an institutional framework score of "A", or moderate. Revenues are comprised of local taxes and state aid and determined by the state funding formula. While school districts maintain some revenue raising flexibility with tax rates under the state mandated cap, districts are dependent on enrollment growth to drive additional revenue. Expenditures are highly predictable and districts have a high degree of flexibility to make cuts given the lack of unions within the state. In the near to medium term, there is uncertainty regarding the funding of school districts given the most recent ruling that the current school finance system is unconstitutional.

KEY STATISTICS

-FY 2016 full valuation: $5 billion

-FY 2016 full value per capita: $137,129

-2013 ACS Median Family Income: 134.6% of US

-Operating Fund balance as a % of operating revenues: 20.47%

-5 year dollar change in fund balance as a % of operating revenues: 10.39%

-Cash balance as a % of operating revenues: 21.58%

-5 year dollar change in cash balance as a % of Revenues: 10.45%

-Institutional Framework: A

-Operating history: 5 year average of operating revenues/operating expenditures: 1.02x

-Net direct debt/full value: 6.07%

-Net direct debt/operating revenues: 4.54x

-3 year average of Moody's adjusted pension liability/full value: 0.32%

-3 year average of Moody's adjusted net pension liability/operating revenues: 0.24x

OBLIGOR PROFILE

The district is located in northwest Montgomery County (Aa1 stable), approximately 40 miles north of the City of Houston (Aa2 negative), near Lake Conroe.

LEGAL SECURITY

The bonds are secured by an annual ad valorem tax, levied against all taxable property in the district without legal limitation as to rate or amount.

USE OF PROCEEDS

Proceeds will refund a portion of the district's outstanding debt for net present value savings of approximately $2.6 million (11.8%) and no extension of maturity.

PRINCIPAL METHODOLOGY

The principal methodology used in the underlying rating was US Local Government General Obligation Debt published in January 2014. The principal methodology used in the enhanced rating was Rating Transactions Based on the Credit Substitution Approach: Letter of Credit-backed, Insured and Guaranteed Debts published in March 2015. Please see the Credit Policy page on www.moodys.com for a copy of these methodologies.

REGULATORY DISCLOSURES

For ratings issued on a program, series or category/class of debt, this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the rating action on the support provider and in relation to each particular rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related rating outlook or rating review.

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